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Schroder ISF* Global Credit Income

Fund Managers: Julien Houdain & Martin Coucke | Fund update: March 2025

Market overview

- March saw a significant change in the global macroeconomic landscape. US exceptionalism continued to be challenged as heightened policy uncertainty led to a sharp fall in sentiment and raised concerns of recession. Meanwhile, Germany's fiscal regime change drove a much-improved reflationary outlook across the eurozone.
- In investment grade credit markets, euro corporates outperformed on a spread basis, with the difference in yield between corporate and government bonds dipping below that of the US for the first time since January 2022. Euro corporates later unwound some of their spread tightening, as focus shifted from planned increases in fiscal spending to looming trade policy risks. European credit spreads ended the month slightly wider, but still trading at tighter levels compared to the US. Spreads ended the month wider in both US and European high yield, with the latter outperforming. Given the increasingly risk-off tone, high yield spreads in both markets ended the month at their widest level year-to-date.
- Germany's parliament approved plans by incoming Chancellor Friedrich Merz to loosen borrowing limits, exempting spending on defence and security from Germany's strict debt rules. It also enabled the creation of a €500 billion infrastructure fund designed to run for the next 12 years.
- German bunds bore the brunt of the ensuing sell-off across the eurozone, with yields recording their biggest daily jump since Germany's reunification in 1990 on the initial announcement. The yield curve steepened, with longer dated bonds rising in anticipation of higher borrowing costs in the future, while shorter maturities were supported by current expectations of easier monetary policy conditions. The European Central Bank (ECB) cut its main interest rate by 25 basis points as expected.
- In the UK, the Spring Statement was the key event in the UK, with the market watching closely for any signs of budget slippage that could lead to a breach of the government's fiscal rules. In the event, the Office of Budget Responsibility (OBR) kept the government's fiscal headroom unchanged at £9.9 billion. Encouraging inflation data also helped gilts recover some of their earlier losses.

Drivers of fund performance

- The Fund posted a positive total return and outperformed its reference index during March.
- The primary driver of outperformance was the Fund's underweight spread duration, as credit spreads widened.
- An underweight in US investment grade bonds was additive as the US market exhibited underperformance.
- Tactical curve steepening trades, focused on Europe, also had a positive impact on returns.
- Although our allocations to European investment grade and high yield bonds were impacted by the spread widening in March, security selection within the European investment grade market was additive.

Portfolio activity

- We increased our holdings within the US investment grade market, which had underperformed in March, taking advantage of cheaper valuations. These additions were made on an idiosyncratic basis, rather than as a shift in our overall asset allocation.
- We added a new issue from an auto manufacturer, as we believe the prospect of US trade tariffs is largely reflected in valuations and the available yield is attractive from an income perspective.
- Among financials, we added an issue from a Canadian bank on a higher yield than sector peers as we consider underlying credit fundamentals should ultimately be reflected in the price of the bonds. We also purchased a dollar-denominated AT1 (Additional Tier 1) issue from a German bank with substantial real estate exposure.
- The Fund maintains a positive outlook on agency MBS (Mortgage-Backed Securities), which have continued to outperform US investment grade.
- We reduced exposure to the European logistics sub-sector, where valuations have rebounded strongly from distressed levels, outperforming the European investment grade market.
- On a tactical basis, we sold protection on the US high yield market, in response to the significant spread

*Schroder International Selection Fund is referred to as Schroder ISF throughout this document.

widening. Due to the more liquid nature of the market, we considered this a better option for capitalising on the widening spreads rather than investing directly in individual high yield securities.

Outlook/Positioning

– The last few weeks have seen a dramatic shift in narrative across the global economy. With Germany finally awakening to the idea of a sizeable fiscal stimulus and US economic growth slowing down, bringing recession fears with it, bond markets have moved aggressively to reflect this backdrop.
– A combination of increased self-reliance for security reasons and a change in leadership appears to have heralded a change in Germany's fiscal backdrop. The infrastructure and defence-led package announced by chancellor Merz represents a significant change in the level of proactivity among German policymakers. We believe this could stimulate further spending in other eurozone countries or facilitate joint debt or loan issuance at the EU level.
– The US economy is slowing, but from a high starting point, as consumers and businesses brought forward purchases ahead of potential tariffs. Recent weaknesses can also be attributed to a decline in business investment stemming from high levels of uncertainty. Recession fears have started to mount. While we believe these are partly justified in the short term, we are not expecting them to persist over the medium term. On inflation, bond markets appear relatively unconcerned about the risks of tariff-induced price rises. The downbeat growth outlook is likely to assuage concerns about the inflationary impact of tariffs in the near term, although it could preoccupy investors at some point.
– The dramatic market moves in bond markets over recent weeks, and the strong outperformance of European corporates over the US with credit spreads at tight levels historically, leads us to maintain a strong emphasis on quality and a cautious approach to adding more exposure to cyclical sectors.
– We are focusing on shorter-dated corporate bonds providing an attractive yield with limited spread duration risk, as opposed to adopting a sector-oriented approach.
– We continue to identify opportunities in securitised assets such as US agency MBS, which provide an attractive income in comparison with the broader US investment grade market, with less idiosyncratic credit risk.
– Lastly, we also favour retaining a degree of liquidity. With valuations in most credit sectors at the tighter end of history and policy uncertainty quite high, it is very likely that periods of market volatility will provide the right entry points for establishing new holdings.

Past performance does not predict future returns. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.

Calendar year performance (%)*

Year	A DisMF	I DisMF	BM1	BM2	BM3	BM4
2024	5.7	7.6	4.2	1.1	9.2	5.7
2023	9.5	11.0	9.7	9.6	14.0	10.5
2022	-12.7	-11.5	-14.1	-14.1	-12.7	-16.5
2021	0.9	2.3	-0.2	-2.9	1.0	-1.5
2020	6.6	8.0	7.9	10.4	7.0	5.9
2019	11.3	12.9	13.2	11.5	12.6	14.4
2018	-1.6	-0.3	-1.4	-3.6	-4.1	-4.6
2017	7.8	9.3	6.7	9.1	10.4	9.3
2016	-	-	-	-	-	-
2015	-	-	-	-	-	-

Source: Schroders, NAV to NAV (bid to bid), net of fees (where applicable), USD, as at 31/12/2024. Comparator benchmarks: 1. Bloomberg (Bbg) Multiverse ex Treasury A+ to B- USD Hedged, 2. Bbg Global Aggregate Corp TR, 3. Bbg Global **High Yield TR USD), 4. JP Morgan EMBI Global TR. Comparator** benchmarks included for performance comparison purposes and do not have any bearing on how the manager invests the fund's assets.

Risk considerations

– **ABS and MBS risk**: The fund may invest in mortgage or asset-backed securities. The underlying borrowers of these securities may not be able to pay back the full amount that they owe, which may result in losses to the fund.
– **Capital risk / distribution policy**: As the fund intends to pay dividends regardless of its performance, a dividend may represent a return of part of the amount you invested.
– **Contingent convertible bonds**: The fund may invest in contingent convertible bonds. A reduction in the financial strength of the issuer of such bonds may result in losses to the fund.
– **Counterparty risk**: The fund may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the fund may be lost in part or in whole.

- **Credit risk**: A decline in the financial health of an issuer could cause the value of its bonds to fall or become worthless.
- **Currency risk**: The fund may lose value as a result of movements in foreign exchange rates.
- **Currency risk / hedged shareclass**: The hedging of the share class may not be fully effective and residual currency exposure may remain. The cost associated with hedging may impact performance and potential gains may be more limited than for unhedged share classes.
- **Derivatives risk**: Derivatives may be used to manage the portfolio efficiently. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the fund.
- **Emerging markets & frontier risk**: Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.
- **High yield bond risk**: High yield bonds (normally lower rated or unrated) generally carry greater market, credit and liquidity risk.
- **IBOR risk**: The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the fund.
- **Interest rate risk**: The fund may lose value as a direct result of interest rate changes.
- **Liquidity risk**: In difficult market conditions, the fund may not be able to sell a security for full value or at all. This could affect performance and could cause the fund to defer or suspend redemptions of its shares.
- **Market risk**: The value of investments can go up and down and an investor may not get back the amount initially invested.
- **Operational risk**: Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund.
- **Performance risk**: Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve.
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