Schroders

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Schroder ISF* Strategic Credit

Fund Manager: Peter Harvey | 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.
- Spreads ended the month wider in both the US and European high yield markets 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. The autos sector was particularly impacted by the imminent prospect of US trade tariffs. In the US, spread widening was exhibited across the whole market, while in Europe only the services and leisure sectors saw spreads tighten.
- 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 (yields move inversely to price). 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.

Drivers of fund performance

- The fund generated a negative total return during March.
- As spreads in high yield markets widened, we took profit across our major holdings.
- Several holdings weakened where earnings updates fell short of market expectations. Notably, French real estate group Foncia and facilities management company Atalian.
- A key contributor was the holding in European satellite operator Eutelsat, which is viewed as a beneficiary of proposals for increased defence expenditure, drawing on the strategic importance for Europe to be less reliant on US satellite operator Starlink.
- In the healthcare sector, the holding in Advanz Pharma was additive as the early completion of a re-financing was positive for the bonds
- Given the broader spread widening in credit markets, our exposure to UK treasury bills, and 5-year gilts performed well which we held as a hedge to credit risk.

Portfolio activity

- We bought the 3-year paper of Schaeffler, a European automotives component company which we see as one of the stronger automotives company amongst a sector which has been challenged in recent months.
- We also purchased the 2-year floating rate note of the US insurance company Athene, a single-A rated name with an attractive yield which we see as a defensive position amidst the broader market volatility.
- We also added holdings in the oil and gas sector from Norwegian group DNO as well as Stena which was a new issue that is secured against ships they own.
- On the disposals side, our holding in North Sea oil producer Harbour Energy was repaid, in the form of a tender.
- Given the narrow differential in credit spreads between BB and BBB-rated securities we have maintained a significant allocation to investment grade corporate bonds, adding BBB-rated insurer Aviva, but conversely we were partly repaid back in the form of a tender of Harbour Energy bonds a BBB-rated name.

*Schroder International Selection Fund is referred to as Schroder ISF throughout

Outlook/Positioning

- The recent shift in narrative to one of slowing US economic growth has led to a significant market reaction, and we continue to assess whether this is simply a soft patch in data, or a more pronounced downturn.
- Against this background, with the European Central Bank having now cut interest rates by a further 25bps to 2.5% in March, and we anticipate further easing to come.
- Another key trend is the prospect that there will be some level of fiscal convergence between the eurozone and the US. Germany's fiscal package, announced on the 4th March, surprised the market by its size. Inevitably the loosening of fiscal policy in Germany will have implications for the rest of Europe. This has provided a boost to growth and sentiment across the region, while interest rates might not now fall as much as previously expected.
- There is a continuing disparity in credit valuations within high yield markets. Spreads in some parts of the market, as measured over government bonds, are at historically tight levels. However, we can still identify security specific opportunities across the rating spectrum, particularly in European markets which offer more value than in the US.
- However, we remain mindful of duration risk particularly in view of tighter spreads and generally more demanding valuations. preferring to focus on shorter-dated credit. Going forward, a combination of positive carry and idiosyncratic opportunities should underpin total returns from the high yield bond markets.

Past performance is not a reliable indicator of future results. The value of investments and the income from them may fall as well as rise and investors may not get back the amount originally invested.

Calendar year performance (%)

	C Acc	Target
2024	8.2	5.2
2023	11.3	4.6
2022	-7.7	1.3
2021	3.7	0.0
2020	3.8	0.3
2019	8.8	0.8
2018	-1.8	0.7
2017	4.3	0.4
2016	5.9	0.5
2015	3.4	0.6

Source: Schroders, as at 31/12/2024. All performance net of fees (where applicable), NAV to NAV (bid to bid), GBP returns. Target : ICE BofA Sterling 3-Month Government Bill Index.

Some performance differences between the fund and the benchmark may arise because the fund performance is calculated at a different valuation point from the benchmark.

Please see the respective fund factsheets for the performance of other share classes.

Risk considerations

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. If the financial strength of the issuer of a contingent convertible bond falls in a prescribed way, the value of the bond may fall significantly and, in the worst case, 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.

Derivatives risk – efficient portfolio management and investment purposes: Derivatives may be used to manage the portfolio efficiently. 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. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. When the value of an asset changes, the value of a derivative based on that asset may change to a much greater extent. This may result in greater losses than investing in the underlying asset.

Event risk: The fund will take significant positions on companies involved in mergers, acquisitions, reorganisations and other corporate events. These may not turn out as expected and may result in losses to the fund.

High yield bond risk: High yield bonds (normally lower rated or unrated) generally carry greater market, credit and liquidity risk.

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.

Important information