

Schroder ISF* Strategic Credit

Fund Manager: Peter Harvey | Fund update: May 2025

Market overview

- Credit markets continued to recover from the early April sell-off, as a de-escalation of China-US trade tensions eased US recession fears. US labour market data for April was encouraging, while purchasing managers surveys highlighted a continued expansion in activity despite the uncertainty surrounding US trade tariffs
- US high yield (HY) was the biggest beneficiary of the improvement in risk sentiment. An easing of US recession concerns combined with a more conciliatory outlook on tariffs supported strong investment flows into the asset class. The robust monthly performance was broad-based across sectors as spreads contracted sharply, leaving them at tighter levels than pre 'Liberation Day'. Euro-denominated HY also had a positive month but underperformed the US. Real estate, healthcare and basic industries were among the leading sectors over the month.
- May was another challenging month for government bond markets, particularly for longer-dated issues as the focus quickly switched to concerns around fiscal deficits and their sustainability. Most notably in the US, where the Reconciliation Bill passing through Congress was viewed as worsening the budget deficit, driving longer-term Treasury bond yields higher.
- In contrast to other sovereign markets, European government bonds performed relatively well with only modest yield rises in core markets – such as Germany. Peripheral markets outperformed, with yields on 10-year Italian bonds falling slightly over the month.
- Ahead of the European Central Bank (ECB) monetary policy meeting in early June, markets were expecting a further 25 basis point interest rate cut. Although eurozone inflation remained slightly above its 2% target in April, the impact of lower oil prices has yet to feed through into consumer prices.

Drivers of fund performance

- The fund generated a positive total return during May.
- Positioning in the healthcare, banking and financial services sectors was additive.
- In the healthcare sector, holdings in pan-European pharmaceutical group Cheplapharm and UK-based Advanz Pharma recovered from security-specific concerns that had overshadowed both issues.
- Among financials, holdings in banking group Lloyds and UK-based debt purchaser Arrow Global were leading contributors over the month.
- In the real estate sector, holdings in European groups CPI and Foncia made a positive contribution as lower interest rates have led to a more favourable backdrop for refinancing activity throughout the sector.
- Positioning in the telecoms sector detracted. The holding in UK retail broadband operator TalkTalk lost ground on concerns over competitive pressures and high debt levels.

Portfolio activity

- During May, we added risk modestly increasing spread duration and exposure to HY bonds.
- We increased exposure to real estate sector, which is less affected by global trade tensions. We added holdings in Accor (pan-European hotels and a new 5-year issue) and Medical Properties Trust (transatlantic hospitals). Both securities are first lien on physical property.
- We continue to find several opportunities at the lower end of the investment grade (IG) credit spectrum. We participated in a new issue from sports gaming company Flutter Entertainment on an attractive credit spread over swap rates.
- In healthcare sector, we added a new issue from generic pharmaceutical company Teva. We consider the credit has the potential to be re-rated to IG, as deleveraging is strengthening the balance sheet and improving the credit outlook.

- In the retail sector, we added to our holding in UK pub operator Punch Taverns. Recent interim results highlighted strong like-for-like revenue growth and the impact of capital investment in its estate, particularly from pubs converted from tenanted to management partnership status.
- Disposals over the month included investment vehicle Nidda Healthcare, following a recent financing, and IG holdings in UK banking group TSB and Nordea Bank, as well as Trivium Packaging.

Outlook/Positioning

- While immediate recession fears have abated, last month did little to quell the ongoing uncertainty around tariffs. We believe the market will continue to focus on trade-related news, as well as the consequences for fiscal deficits and the risk of additional bond supply.
- The resilience we have observed so far in global growth is partly attributable to a front-loading of demand prior to tariff hikes. However, we expect the US economy to slow over the coming months, with hard data moderating, but importantly not drastically. Despite the dialling back, tariffs have not been completely removed. While the US Court of International Trade's ruling to block most of President Trump's tariffs will complicate the path ahead, there are still several provisions the administration can invoke.
- The uncertainty being created from the fluid trade agenda translates into a difficult business environment to make investment and hiring decisions. The outlook is largely contingent on the response from the US corporate sector to the significant sentiment shock. However, there will be some buffer here as profit margins remain close to record highs.
- We have downgraded the probability of a 'hard landing' recessionary scenario, revising up our base case of a 'soft landing', where economic growth slows and inflationary pressures ease.
- Credit markets have already responded sharply to the change in outlook. In the very short-term, we are

focusing less on HY markets, where spreads have tightened substantially, in favour of the lower end of the IG market (by credit rating), which we still consider offers a decent total return from here. That is partly because global government bond yields are at the upper end of their recent range. Accordingly, the all-in corporate bond yield is attractive.

- Currently, we are looking to maintain spread duration at modestly higher levels, incorporating this emphasis when identifying investment opportunities in the IG market.

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.

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