Schroders

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Schroder ISF* Strategic Credit

Fund Manager: Peter Harvey | Fund update: August 2025

Market overview

- Global Events in the US were the main influence on credit markets during November. Initially markets weakened as the Federal Reserve (Fed) adopted a more hawkish tone on monetary policy, while high issuance volumes from major US technology companies to fund AI-related investment also weighed on sentiment.
- Subsequently, weaker US economic indicators combined with a more dovish tone from the Fed paved the way for additional interest rate cuts and triggered a rally over the second half of the month.
- In high yield markets, US dollar denominated credit outperformed euro-denominated issues over the month. In Europe, there was significant weakness in the insurance, basic industries and technology sectors, while spreads tightened in the real estate, financial services and autos sectors.
- Similarly, in investment grade markets US dollar credit outperformed euro-denominated issues although spreads widened versus US Treasuries. In European credit markets, spreads widened over the month as investors digested record new issuance volumes for November. BBB-rated and higher yielding securities lost ground, as did corporate hybrids.
- US Treasuries outperformed other major government bond markets. The yield curve steepened as yields in shorter maturities (given their greater sensitivity to changes in interest rates) fell. Initially expectations for a December rate cut were finely balanced. However, with September's delayed labour market report suggesting a weaker outlook coupled with speculation that Kevin Hasset was the leading candidate for the next Federal Reserve Chair (paving the way for additional rate cuts next year) the market tone shifted in a more dovish direction.
- Eurozone markets were driven by global events. Looking at regional economic indicators, there was further evidence of an improvement heading towards the end of the year. The Composite Purchasing Managers Index (PMI) for November highlighted the strongest expansion in private sector activity in two and a half years. This momentum was underpinned by the strength of the services sector activity, while in contrast there was a slowdown in manufacturing amid signs of renewed demand-side weakness.
- In contrast, European government bond yields rose steadily through August as the economic outlook appears to be improving. Survey data indicated a continued recovery in manufacturing and other cyclical sectors. With inflation broadly stable, the European Central Bank has indicated the current

Drivers of fund performance

- The Fund generated a positive total return during November.
- Security selection within the financial services sector made a positive contribution to returns. The holding in European payments processor Worldline rebounded, following a positive capital markets day, as a programme of asset disposals and equity funding have improved sentiment on the company's credit outlook.
- Security selection in banks was additive, notably Additional Tier One (AT1) holdings in Deutsche Bank and Lloyds Banking Group.
- Exposure to UK gilts made a positive contribution, as the Autumn Budget announcement was well-received with the government's headroom against its own self-imposed fiscal rules larger than expected, while forecasted gilt supply was lower than had been forecast.
- Detractors over the month were specialty chemical group Ineos, on further sector weakness, and technology conglomerate Softbank, on concerns over high capital expenditure in the sector to finance the build out of AI-related infrastructure.

Portfolio activity

- During November, we participated in an issue of senior secured bonds from German pharmaceutical group Gruenethal, a specialist in pain management, the proceeds from which will be partially used to pay down existing liabilities as well as for general business purposes.

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

- In the financial services sector, we acquired a holding in a sterling-denominated new issue from Wise Financing, a cross-border payments business generating strong revenue growth and positive free cash flow, which is benefiting from the shift from cash transactions to mobile and digital payments.
- We added a euro-denominated issue from German auto components group Schaeffler, while in the energy sector we acquired a holding in a new issue of medium-dated senior secured first lien bonds from Odfjell to refinance existing debt. The company focuses on drilling services in the oil and gas industry.
- In the real estate sector, we added a holding in Nordic commercial developer Citycon with an impending takeover by the now majority shareholder, which has secured funding to delist the company.
- There were no significant disposals during the month.
- With credit spreads in the high yield market now at substantially tighter levels, we continue to hold a significant proportion of the portfolio in investment grade corporate bonds, mainly BBB-rated and AA-rated securities, as well as exposure to gilts, which act as a buffer against market volatility.

Outlook/Positioning

- As we head towards the year-end, we continue to be in an environment of slowing growth, albeit not dramatically. Our base case is for a soft landing, although the risks around this remain skewed to the downside.
- For direction on interest rates, the US labour market will be key. For a Fed that has a dual mandate of maintaining 'full employment' – not to mention political pressure to ease monetary policy - the growing risks to the downside in the labour market have led investors to price in another interest rate cut in December.
- Although recent data releases have highlighted clear signs of weakness in the employment market, in terms of job creation, the immigration crackdown is likely to restrict labour supply and act as a constraint on unemployment. We see soft hiring as symptomatic of trade uncertainty and concerns about the spillover effects on growth.
- In the US, credit spreads offer a limited cushion against any deterioration in the economic fundamentals. Isolated bankruptcies in the loan market indicate growing vulnerabilities across the credit spectrum.
- We remain moderately positive on the economic outlook for the eurozone. The services sector is rebounding strongly, while the labour market remains resilient. In contrast to the rise in unemployment in the US, eurozone unemployment has equalled all-time lows in recent months. However, we have yet to see any broad recovery in the manufacturing sector and the order to inventory ratio in many sectors is still negative. Inflation measures continue to suggest an underlying trend that is hovering slightly above its 2% target.
- Notwithstanding geopolitical developments, we also expect corporate fundamentals in the eurozone to remain stable and the default rate to stay relatively low in comparison with the US.
- However, we are mindful that credit spreads in euro high yield, at index level measured over government bonds, are expensive relative to historic levels. Accordingly, we continue to place a greater emphasis on higher quality credit, with an element of exposure to cash and sovereign debt awaiting investment opportunities in the euro credit markets.
- We also remain focused on identifying idiosyncratic opportunities that can provide strong total returns in a variety of market environments, particularly among BB-rated issues which could prove to be a fertile hunting ground for active investors over the coming months.

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

Wall Place, London EC2Y 5AU. Registration No 1893220 England. Authorised and regulated by the Financial Conduct Authority.