

Schroder ISF* EURO Credit Conviction

Fund Manager: Patrick Vogel | Fund update: October 2025

Market overview

- European credit spreads tightened modestly during October, underpinned by a strong technical backdrop with continuing fund inflows into the euro-denominated investment grade market.
- The third quarter earnings season in Europe has depicted a mixed picture. Results for the banking sector were better-than-expected, highlighting a further expansion of net interest margins. In contrast, several cyclical sectors exhibited weakness. Notably chemicals, where the impact of overcapacity and higher energy costs continues to erode margins, and the autos sector which faces headwinds from US tariffs and weaker demand in China.
- In contrast to European markets, spreads on US investment grade widened as the collapse of two US firms – First Brands and Tricolor – fuelled concerns about residual risk in the private credit market. High volumes of new issuance from major US technology companies to fund AI-related investment also weighed on sentiment.
- October's European Central Bank (ECB) meeting was uneventful, with interest rates held at 2% as expected. French politics remained in the spotlight, with Prime Minister Lecornu's resignation then subsequent reappointment. He later survived two votes of no-confidence following concessions on pension reforms. S&P downgraded France's sovereign rating to A+ (previously AA-) citing ongoing political instability.
- Third quarter economic growth for the eurozone was slightly better-than-expected while inflation remains broadly in line with the ECB's 2% target. The Eurozone Composite Purchasing Managers Index (PMI) for October recorded its strongest expansion in 17 months, with a sharp acceleration in services sector activity, although manufacturing output registered only a slight increase.

Drivers of fund performance

- The Fund posted a positive total return, marginally underperforming the reference benchmark during October after fees.
- Security selection in the services, automotives, financial services and subordinated financials was additive.

- Exposure to high yield credit detracted as spreads widened.
- Off-benchmark exposure to Romania made a positive contribution, as several corporate issues attracting strong demand, boosting sentiment with the country's sovereign debt continuing to outperform European peers.
- Within the real estate sector, a new holding in an Eastern European commercial developer weakened on short selling in the secondary market.

Portfolio activity

- With credit spreads at tight levels, we have retained a cautious approach. The Fund's spread duration has been reduced and is now in line with the reference benchmark, limiting the portfolio's sensitivity to any widening of credit spreads.
- During October, we further reduced exposure to higher beta BBB-rated securities.
- As a tactical measure, we increased exposure to sovereign debt, parking funds in German bunds and awaiting investment opportunities to redeploy cash into credit markets.
- Similarly, we established a holding in a well-capitalised Turkish bank which is majority owned by a leading European financial services company.
- As the structural outlook for fiscal consolidation in France remains challenging, we sold holdings in government debt and in a leading French bank, switching into covered bonds due to their liquid and defensive characteristics.
- In the real estate sector, we participated in a re-financing from a leading Eastern European commercial real estate investor and developer which strengthens the company's balance sheet with the issuance of senior secured bonds. The issue has the added attraction of a high coupon.
- We participated in a euro-denominated issue from a major US technology group. The issue is backed by a high credit rating, with the business generating healthy operating margins and substantial free cash flow. The bonds came to the market on an attractive yield.

Outlook/Positioning

- We remain moderately positive on the economic outlook for the eurozone. Manufacturing growth is improving from low levels, however we do not see a broad recovery yet and the order to inventory ratio in many sectors is still negative. However, 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, while inflation measures suggest an underlying trend that is hovering around or slightly above its 2% target.
- Notwithstanding geopolitical developments, we also expect corporate fundamentals to remain stable and the default rate to stay relatively low.
- In terms of the technical picture, we see little change on the horizon with structural demand from institutional investors for euro-denominated credit likely to remain a supportive feature, with the investment grade market offering a yield pick-up over deposit rates.

Calendar year performance (%)

	A Acc	I Acc	Target**
2024	6.9	8.3	5.2
2023	10.6	12.0	9.0
2022	-16.7	-15.7	-14.8
2021	-1.1	0.2	-0.6
2020	4.8	6.1	3.0
2019	9.8	11.1	7.7

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. 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.

- However, we are mindful that credit spreads at index level measured over government bonds are expensive relative to historic levels, with the US investment grade credit market now trading on a higher spread than euro-denominated credit. Accordingly, we have a strong emphasis on credit quality.
- Cognisant of market valuations, we have positioned the portfolio more defensively, while still picking up good carry, in view of the risk of a widening of credit spreads particularly if we reach a turning point on inflows into the euro investment grade market.

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.

2018	-3.6	-2.4	-2.0
2017	6.2	7.5	3.4
2016	6.8	78.1	5.4
2015	1.5	2.8	-0.9

Source: Schroders as at 31/12/2024 net of fees (where applicable), NAV to NAV (bid to bid), EUR. **iBoxx EUR Corp BBB. The fund's performance should be assessed against its target of exceeding the iBoxx EUR Corporates BBB (TR) index. The fund's investment universe is expected to overlap to a limited extent with the components of the target benchmark.

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 and less developed markets: The fund may invest in emerging and less developed markets. Investing in emerging and less developed markets is subject to greater risks than investing in securities of

developed countries such as ownership and custody risks, political and economic risks, market and settlement risks, liquidity and volatility risk, legal and regulatory risks, execution and counterparty risk, and currency risk, which may adversely affect the net asset value per share of the fund and investors may as a result suffer losses.

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.

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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.

Sustainability risk: The fund has environmental and/or social characteristics. This means it may have limited exposure to some companies, industries or sectors and may forego certain investment opportunities, or dispose of certain holdings, that do not align with its sustainability criteria. Therefore, the fund may underperform other funds that do not apply similar criteria. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

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