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Schroder ISF* Hong Kong Equity

Fund Manager: Toby Hudson | Fund update: Q4 2024

Performance overview

- Hong Kong equities fell over the quarter. Donald Trump's presidential election victory in November acted as a headwind. Share prices weakened in the face of investor concerns about the impact of Trump's intended tariffs, particularly on China.
- The Federal Reserve cut interest rates by 25 basis points at its December meeting but indicated that ongoing persistent inflation may mean there are fewer cuts in 2025 than previously anticipated. The US dollar and bond yields rallied, creating further pressure on Chinese markets.
- Most sectors fell, with the exception of telecommunications – the strongest performer over the quarter – and utilities. Healthcare led the fall, while basic materials and financials also delivered negative returns.
- The fund produced a negative return but outperformed the benchmark over the period.

Drivers of fund performance

- Positive stock selection was the key driver of the fund's strong relative returns.
- At the sector level, selection was strongest, by far, in financials. Allocation also supported returns, with the underweight to financials proving to be beneficial.
- At the market level, selection in Hong Kong was the key positive factor.
- The best-performing positions were the underweight in **AIA Group**, and the holdings in **Crystal International** and **Standard Chartered**.
- The weakest returns came from the position in **Alibaba**, and the zero weightings in HongKong Land and Power Assets Holdings.

Portfolio activity

- We purchased **CATL** as we believe the electric-vehicle battery maker will benefit from car subsidies in China. A proposed Hong Kong listing is also positive for CATL's global footprint expansion. We added to education company **New Oriental Education** for its resilient business amid the uncertain growth outlook in China.
- We sold **Sinopec** as the softer global macroeconomic outlook is negative for the oil price. We took profits in **Atour Lifestyle** and **Prada**.

Past performance is not a guide to future performance and may not be repeated. 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	Fund	Target	Comparator
2024	5.7	-0.1	14.8
2023	-15.1	-12.7	-12.8
2022	-12.5	-7.0	-15.1
2021	-11.6	-4.1	-11.6
2020	21.2	7.5	11.4
2019	16.1	11.8	12.9
2018	-14.3	-10.2	-12.8
2017	50.5	36.3	40.7
2016	0.4	4.1	0.6
2015	-5.1	-4.3	-5.0

Source: Schroders, net of fees, NAV to NAV, with net income reinvested. USD A Acc share class, as at 31 December 2024. The fund's performance should be assessed against its target benchmark being to exceed the FTSE Hong Kong (Net TR) index and compared against the Morningstar Hong Kong Equity Category. The fund's investment universe is expected to overlap to a limited extent with the components of the target benchmark. The comparator benchmark is only included for performance comparison purposes and does not have any bearing on how the investment manager invests the fund's assets.

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

Outlook/positioning

- In 2024, the annual returns of the Hong Kong equity market, as measured by the Hang Seng Index, turned positive after declining for three consecutive years. The rise was propelled by two significant rebounds – at the end of April and at the end of September – on the back of positive policy support in mainland China. Additionally, the anticipation of interest-rate cuts has also been supportive of the overall sentiment towards the Hong Kong market throughout the year.
- Looking ahead, the return of Trump as US president is likely to bring about greater uncertainty to the Hong Kong market, given tariff threats, higher inflation risks and upward pressure on the dollar and interest rates. A slower reduction in interest rates will hinder the recovery of Hong Kong's property market. A strong-for-longer Hong Kong dollar, as a result of high interest rates, will undermine the attractiveness of Hong Kong as a travel destination, adversely affecting the overall consumer market. If a 'Goldilocks' US economic scenario – growth 'not too hot or too cold', providing leeway for further rate cuts – continues in 2025, that would be more favourable for Hong Kong.
- In mainland China, we continue to look for more effective fiscal policy support from the authorities to enhance macroeconomic improvements. Specifically, domestic consumption and investment demand must pick up, and the property market will need to stabilise for the economy to bottom out. Longer-term, effective structural reform and economic restructuring are needed for the China market to shake off its prolonged weakness.
- In summary, we believe the sustainability of the recovery in the Hong Kong equity market will depend on the effectiveness of policy support and the magnitude of macroeconomic improvement in China. Externally, a friendlier US-China relationship and continued rate cuts will also be very helpful to sustain positive sentiment in the market. Portfolio construction remains focused on keeping a healthy level of diversification across growth and value ideas. We hold quality stocks that show value at the current level, and those longer-term growth ideas that are less cyclically exposed.

Risk considerations

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.

Currency risk: The fund may lose value as a result of movements in foreign exchange rates.

Concentration risk: The fund may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down.

Derivatives risk – efficient portfolio management: 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.

Emerging markets & frontier risk: Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.

Higher volatility risk: The price of this fund may be volatile as it may take higher risks in search of higher rewards.

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.

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 macroeconomic environment, investment objectives may become more difficult to achieve.

Stock connect risk: The fund may be investing in China "A" shares via the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.

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