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| Schroder ISF\* EURO High Yield  Fund Manager: Hugo Squire | Fund update: July 2025 |

Market overview

* Despite ongoing uncertainty as investors awaited the outcome of trade negotiations, July was another positive month for credit markets. Euro denominated corporates produced positive total returns as spreads compressed for the third consecutive month, outperforming government bonds.
* Following weeks of negotiations between the EU and the US, a baseline tariff rate of 15% on almost all EU goods entering the US was agreed, providing more clarity. The EU also committed to significant spending on US military equipment and energy.
* With investors preoccupied by renewed concerns over rising fiscal deficits, government bond yields rose in the US and across European markets. The German budget deficit for 2025 is forecast to increase substantially, funding increased defence spending and infrastructure investment, and is more front-end loaded than had been anticipated when borrowing limits were relaxed in the spring.
* The European Central Bank (ECB) kept interest rates unchanged for the first time in a year, with President Lagarde striking a surprisingly hawkish tone. Accordingly, investors scaled back expectations of further interest rate cuts. Despite uncertainty over trade tariffs, the eurozone economy unexpectedly expanded during the second quarter with signs of a recovery in consumer spending.
* Second quarter corporate earnings announcements in Europe were mixed. Results from the financial sectors and in healthcare were encouraging but cyclical industries, notably chemicals, energy and construction, are still struggling. In the consumer discretionary sectors, earnings guidance from leading auto manufacturers has been downgraded, reflecting the likely impact of US trade tariffs.
* In European corporate bond markets, performance was broad based across sectors, with life insurance and real estate investment trust (REITS) among the outperformers.

Drivers of fund performance

* The fund posted a positive total return and outperformed the ICE BofA Euro High Yield Constrained index in July.
* An overweight allocation to the real estate sector contributed, notably a special situation in an owner of German office and logistics assets where progress on refinancing was made.
* Exposure to additional tier one (AT1) banking credit made a positive contribution.
* Security selection in the automotive, telecommunications, healthcare and subordinated banking had a positive impact on active returns.
* Moreover, our off-benchmark exposure to US dollar-denominated bonds was additive.
* In addition, the fund made a windfall profit upon the completion of the restructuring of a Swedish financial services business.
* An underweight in autos and telecommunications detracted, as did not owning a distressed French supermarket chain where a significant credit positive event took place.

Portfolio activity

* During July we added holdings in a Spanish telecom group and a Polish real estate developer.
* We increased our holding in a UK financial services group following a recent restructuring.
* In the healthcare sector, we added to our position in a Spanish pharmaceutical company where the credit outlook is improving, following a refinancing, as operating revenues in its underlying business have rebounded.
* We exited the holding in a UK pub company that faces rising cost pressures due to the hike in employers’ national insurance contributions and higher wages.
* We also sold down an investment grade holding in a hygiene solutions business.
* Investment grade exposure is focused primarily on higher yielding BBB-rated securities, as a buffer against market volatility.
* Given the significant compression in credit spreads over recent months, we are at the lower end of the beta range with a modest overweight to duration (interest rate risk).
* We have also hedged the portfolio against any upsurge in market volatility and spread widening in the high yield bond markets.

Outlook/Positioning

* The deal between the EU and the US provided some relief that the threat by the Trump administration to impose 30% tariffs had been avoided, with some sectors including aircraft and component suppliers securing an exemption. Furthermore, the combination of higher fiscal spending and more accommodative monetary conditions should underpin a recovery in eurozone economic activity. Although conditions in the manufacturing sector remain challenging, the latest eurozone PMI survey for July highlighted a further expansion in private sector activity. This improvement appears to be a response to the European Commission’s recent relaxation of fiscal rules, allowing for additional spending on defence.
* Furthermore, Germany’s easing of the ‘debt brake’, alongside the recent announcement of a €500bn infrastructure and defence fund, has increased optimism within the manufacturing and industrial sectors.
* Inflation is expected to decline further based on lower energy prices, as the recent spike in the oil price quickly dissipated, and the weaker US dollar.
* We also expect corporate fundamentals to remain stable and the default rate to stay low.
* Monetary policy should continue to provide some support for bond markets, although the ECB’s programme of interest rate cuts looks to have run its course.
* However, we are mindful that credit spreads at index level measured over government bonds have compressed significantly over recent months.
* We remain focused on identifying idiosyncratic opportunities that can provide strong total returns in a variety of market environments.

*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.*

Calendar year performance (%)

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|  | **A Acc** | **I Acc** | **Target** |
| 2024 | 10.9 | 12.3 | 8.6 |
| 2023 | 11.8 | 13.1 | 12.0 |
| 2022 | -13.9 | -12.9 | -11.5 |
| 2021 | 4.5 | 5.8 | 3.3 |
| 2020 | 4.2 | 5.6 | 2.7 |
| 2019 | 9.8 | 11.1 | 11.2 |
| 2018 | -5.5 | -4.4 | -3.6 |
| 2017 | 6.7 | 8.0 | 6.7 |
| 2016 | 10.0 | 11.4 | 9.1 |
| 2015 | 3.5 | 4.8 | 0.7 |

Source: Schroders, as at 31/12/2024. All performance net of fees (where applicable), NAV to NAV (bid to bid), EUR. Target : ICE BofA Euro High Yield Constrained Index.

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.
* **Currency risk / hedged share class:** 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. 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.
* **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.
* **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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