Schroders

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Schroder ISF* EURO High Yield

Fund Manager: Hugo Squire | Fund update: March 2025

Performance overview

- Credit spreads in European high yield markets, as measured over government bonds, widened in March. With the exception of the services and leisure sectors, where there was further tightening, spreads widened across the market The autos sector, in particular, was impacted by the imminent prospect of US trade tariffs on European exports.
- March saw a significant change in the global macroeconomic landscape. US exceptionalism continued to be challenged as heightened policy uncertainty led to a sharp fall in sentiment and raised concerns of recession. Meanwhile, Germany's fiscal regime change drove a much-improved reflationary outlook across the eurozone.
- Germany's parliament approved plans by incoming Chancellor Friedrich Merz to loosen borrowing limits, exempting spending on defence and security from Germany's strict debt rules. It also enabled the creation of a €500 billion infrastructure fund designed to run for the next 12 years.
- German bunds bore the brunt of the ensuing sell-off across the eurozone, with yields recording their biggest daily jump since Germany's reunification in 1990 on the initial announcement (yields move inversely to price). The yield curve steepened, with longer dated bonds rising in anticipation of higher borrowing costs in the future, while shorter maturities were supported by current expectations of easier monetary policy conditions. The European Central Bank (ECB) cut its main interest rate by 25 basis points as expected.

Drivers of fund performance

- The fund posted a negative total return but outperformed the ICE BofA Euro High Yield Constrained index in March.
- A key contributor was the holding in European satellite operator Eutelsat, which is viewed as a beneficiary of proposals for increased defence expenditure, drawing on the strategic importance for Europe to be less reliant on US satellite operator Starlink.
- In the healthcare sector, the holding in Advanz Pharma was additive as the early completion of a re-financing was positive for the bonds.
- Detractors over the month were focused on holdings where earnings updates fell short of market expectations. Security selection in financial services and automotives detracted.

Portfolio activity

- We continued to look for investment opportunities in the primary market. During March, we participated in a new issue of secured bonds from cruise ship owner SP Cruises, priced on an attractive yield.
- We also added holdings in the oil and gas sector from Norwegian groups DNO, a secured issue, and VAR Energi.
- On valuation criteria, we hold a significant underweight allocation to BB-rated issues. During March, we sold holdings in Vodafone and Telefonica, as well as French rolling stock manufacturer Alstom.
- We feel comfortable with our barbell strategy and a reduced risk profile, maintaining investment grade BBB exposure and overweight to B and CCC rated issues.
- We favour B-rated and CCC-rated issues, adding new holdings in senior secured bonds from US multi-media company Urban One and QuickTop, a subsidiary of Nordic industrial group Nimlas.
- The narrowing differential in credit spreads between BB and BBB-rated securities shifts the risk/return profile in favour of the latter, while also acting as a buffer against market volatility.
- Accordingly, we have maintained a significant allocation to investment grade corporate bonds, adding BBB-rated holdings in insurer Aviva and Austrian bank Raiffesen.

Outlook/Positioning

- For some time now, the eurozone has struggled with declining competitiveness, high energy prices, a downbeat global manufacturing backdrop and, in the case of Germany, a lack of ambition to fiscally stimulate its economy.
- However, a combination of increased self-reliance for security reasons and a change in leadership appears

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to have heralded a change in Germany's fiscal backdrop. The infrastructure and defence-led package announced by chancellor Merz represents a significant change in the level of proactivity among German policymakers. We believe this could stimulate further spending in other eurozone countries or facilitate joint debt or loan issuance at the EU level.

– However, since month-end and in a matter of days, the announcement on US trade tariffs all but eradicated the fiscally-stimulated optimism priced into eurozone government bond markets following the shift in Germany's fiscal stance. If Europe does not retaliate aggressively with further tariffs, the growth hit would most likely come with a limited inflationary impact.
– European high yield bonds outperformed US credit and European credit spreads trade below those of the US high yield market. Hence, we will selectively look for opportunities in the US high yield market. Within the European high yield markets there remains a continuing disparity in valuations.
– When volatility increases credit opportunities rise, particularly where markets are mispricing a substantial change in outlook, and we are starting to see some of those appear. However, we remain very mindful of credit risk particularly in the light of the economic uncertainty. Going forward, a combination of positive carry and idiosyncratic opportunities should underpin total returns from the European high yield market. For now, uncertainty persists, which makes an agile approach to portfolio construction crucially important.

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 (%)

	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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