

Schroder ISF* EURO High Yield

Fund Manager: Hugo Squire | Fund update: August 2025

Market overview

- Spreads in the euro credit markets widened during August. The first half of the month was characterised by low trading volumes as the US postponed new tariffs on China for a further 90 days.
- Subsequently, there was an uptick in primary market activity while risk sentiment was adversely impacted by renewed political turmoil in France. Prime Minister Bayrou called a vote of confidence for 8 September after his plans to tackle the country's widening deficit faced strong opposition in parliament, triggering fears that the government would collapse.
- Significantly, book coverage ratios for new issues in the euro markets fell well below the usual levels of 4-5 times oversubscribed as buyers became increasingly cautious on valuations and spreads widened accordingly overall, with most institutional investors remaining on the sidelines. The best performing sectors in the euro high yield market, in terms of spread compression, were energy and retail. The sectors which exhibited marked spread widening included basic industries and financial services.
- Eurozone economic indicators continued to highlight a trend of improvement with the purchasing managers index (PMI) for August highlighting a pick-up in business activity across the manufacturing and services sectors. The survey was the strongest since May last year, registering its eighth consecutive monthly gain.
- This strengthened the prevailing view that the European Central Bank (ECB) would leave interest rates unchanged at its September meeting, as investors scaling back expectations for any further rate cuts with the ECB's programme of monetary easing increasingly likely to have run its course.
- European government bond yields rose steadily through August, with benchmark 10-year French government bond yields sharply higher on growing political instability. The rise in longer-dated yields across Europe reflected mounting concerns about the sustainability of fiscal deficits.

Drivers of fund performance

- The fund posted a positive total return and outperformed the ICE BofA Euro High Yield Constrained index in August.
- Security selection in the real estate sector made the most significant positive contribution to relative performance over the month. Specifically, a special situation in a formerly distressed owner of German office and logistics assets where progress on refinancing has been positive for bondholders.
- In the leisure sector, we saw encouraging performance from a luxury cruise operator where the owners have provided further equity support for the business.
- Our holding in a German cable operator providing internet services to the residential market also performed well.
- The most notable detractor was our position in a German packaging company, where the prospects of a near-term refinancing have become more challenging with additional funding now required. We hold senior secured bonds and remain confident progress can be made. The company focuses on packaging for the consumer staples and healthcare sectors which are less sensitive to the economic cycle.

Portfolio activity

- During August we added a new holding in a French lab testing group where there is the prospect of a restructuring over the coming months to ease liquidity constraints. We purchased senior secured bonds which have significant upside potential given a favourable outcome for the company's creditors.
- In the transport sector, we established a holding in a provider of helicopters to offshore oil and gas platforms, a niche business issuing debt at a high coupon on an attractive credit spread.
- In the healthcare sector, we participated in a new short-dated issue from a French care home network, which carries a high coupon and is backed by the company's property portfolio.

- We reduced exposure to additional tier one (AT1) paper issued by banks, which is more sensitive to market movements, and increased exposure cash and cash equivalents to reduce the risk profile of the portfolio in the event of any significant widening in credit spreads.
- Investment grade exposure is focused primarily on higher yielding BBB-rated securities, as a buffer against market volatility.
- In the investment grade segment, we added a holding in a specialist US insurer group owned by a leading private equity investor. Although the group's investment portfolio is focused on less liquid alternative assets, the bonds are secured and in the safest segment of the capital structure while offering an attractive credit spread.
- 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.
- With new issuance expected to pick up in September, any widening of credit spreads should present investment opportunities to reinvest into credit markets.

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.

Outlook/Positioning

- In Europe, the economic environment continues to improve as tariff uncertainty declines, while the ECB has indicated that they are not expecting to cut interest rates further.
- 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.
- Looking ahead, the combination of higher fiscal spending and more accommodative monetary conditions should continue to underpin a recovery in eurozone economic activity.
- Inflation is expected to remain in line with the ECB's medium-term target of 2% as lower energy costs, subdued services sector inflation and the weaker US dollar result in a relatively benign backdrop.
- We also expect corporate fundamentals to remain stable and the default rate to stay low.

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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