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Schroder ISF* Sustainable EURO Credit

Fund Manager: Saida Eggerstedt | Fund update: June 2024

Market review

- June was generally a positive month for global bond markets, as government bond yields fell and concerns about inflation lessened slightly. While positive, the performance of corporates lagged government bonds, with spreads widening on weaker sentiment due to French political uncertainties. High yield corporate bonds underperformed the investment grade segment over the period in total return terms.
- The European Central Bank (ECB) announced a 25bp cut in the deposit rate - the first of such cuts since 2019. However, the major market-moving event was around political developments in France. The formation of a left-wing alliance generated greater uncertainty, not only about the outcome of the parliamentary elections, but also about France's already unstable fiscal position. The European Commission also announced that France would be entering its Excessive Deficit Procedure, which imposes certain requirements for bringing spending back in line with the EU's 3% GDP deficit ratio.
- In the US, Treasury yields fell across the curve amid fresh anticipation that the US Federal Reserve would still cut rates this year, following a series of generally weaker economic data.
- UK elections have been less contentious, with opinion polls showing that the Labour party is likely to secure a majority on the 4 July. May's inflation release showed an encouraging fall in the year-on-year headline figure to 2%. However, beneath the surface some of the details were less favourable, including services inflation, a key metric monitored by the Bank of England (BoE), which came in at a higher-than-expected 5.7%.

Drivers of fund performance

- The fund delivered positive returns over the month (net of fees) but underperformed the reference index. The fund continues to deliver on Sustainability performance metrics including a high SustainEx™ overall impact score and MSCI ESG rating.
- The main detractors included security selection in European automotives and healthcare, as well as underweight sector allocations to consumer non-cyclicals, energy (zero exposure) and basic industry. In contrast, security selection in European senior banking, capital goods, real estate and consumer cyclicals was positive for active returns.

Portfolio activity

- Throughout the month, we increased our exposure to automotive, basic industry, AT1 banking and consumer goods. Conversely, we reduced our exposure to senior banking, tier 2 insurance, healthcare, services, real estate, and telecoms, among others.
- Our investment strategy focuses on a broad range of sustainable themes and bonds, including waste recycling and biodiversity, sustainable infrastructure, the circular economy, and responsible consumption. We also prioritize opportunities in decarbonizing technology and health and education. In alignment with our commitment to sustainability, we exclude investments in fossil fuels, weapons, alcohol, tobacco, and companies that violate the UN Global Compact.
- Over the month, we added exposure to a global real estate company, specialising in logistics, through green bonds. The proceeds will be used towards green buildings, energy efficiency solutions, such as battery storage systems, and renewable energy projects. The company is a leader in onsite rooftop solar capacity.
- Elsewhere we initiated a new position in a British media company that has top quartile employee treatment, with a strong culture of employee care.
- We continue to invest in our preferred responsible finance names, including green, social, and sustainability-linked bonds issued by UK and European companies.
- Our fund's carbon emissions intensity, as measured by tonnes CO_2e per $mn sales (scope 1 and 2 emissions), is less than half that of the reference index. Additionally, our overall SustainEx™ impact score remains significantly higher, as we strive to identify improvers, limit laggards, conduct ESG research, utilize tools, and focus on positive sustainability themes.

Outlook

- Looking at the outlook for European credit markets, the macroeconomic backdrop is supportive with Eurozone growth on an improving trajectory while the corporate sector is in better financial shape.
- Although we were cautious on the near-term prospects given both the speed and the extent of spread compression, the volatility surrounding the recent French elections have caused spreads to extend, leaving us alert about potential opportunities.
- We have seen peak tightness of financial conditions, and the European Central Bank is expected to loosen its monetary policy, however less than expected at the beginning of the year.

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

Going forward a combination of positive carry and idiosyncratic opportunities should underpin total returns from the European investment grade market.

Calendar year performance (%)

Past performance is not a reliable indicator of future results. The value of investments and the income from them may fall as well as rise and investors may not get the amount originally invested.

Some performance differences between the fund and the benchmark may arise because the fund performance is calculated at a different valuation point from the benchmark.

Please see the respective fund factsheets for the performance of other share classes.

	C Acc	A Acc	I Acc	Target**
2023	8.3	7.8	8.9	8.0
2022	-12.4	-12.7	-11.8	-13.9
2021	0.7	0.3	1.3	-1.0
2020	5.6	5.2	6.2	2.6
2019	-	-	-	-
2018	-	-	-	-
2017	-	-	-	-
2016	-	-	-	-
2015	-	-	-	-
2014	-	-	-	-

Source: Schroders, as at 31/12/23. All performance net of fees (where applicable), NAV to NAV (bid to bid), EUR. ** ICE BofAML Euro Corporate TR.

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.

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.

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.

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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