

Schroder ISF* Sustainable EURO Credit

Fund Manager: Saida Eggerstedt | Fund update: December 2024

Market review

- December was a slow month for Fixed Income, reversing most of the gains achieved in November. Despite the tightening in credit spreads in Europe and the UK, total returns have been negative, as government bond yields widened across the board.
- The US underperformed Europe, as spreads remained flat or even rose in US high yield and US treasury yields climbed, based on inflationary pressures and concerns about the incoming economic policies of the Trump administration.
- Europe's economy is struggling to gain any momentum. The Eurozone PMI rose, driven by the services industry, which managed to offset some of the ongoing weakness in manufacturing; however, this contraction does not appear to have an end in sight, given the potential for a trade war with the US. The Eurozone PMI remains below the 50 mark (currently 49.5), suggesting the economy is contracting.
- The Bank of England kept interest rates unchanged in December, the decision was heavily influenced by sticky inflation, which saw a rise for the second consecutive month to 2.6%. 10-year yields rose 33bps over the month.
- In the US, 10-year treasuries rose over the month, ending the year 70bps higher than December 2023. The 25bps cut by The Fed was accompanied with a hawkish tone as Powell admitted the central bank are at the point where it would be appropriate to slow the pace of cuts. Markets began pricing in the decreasing likelihood of another cut in January, as well as the anticipation of inflationary policies threatening to increase the US fiscal deficit.

Drivers of fund performance

- The fund delivered negative returns over the month but outperformed (net of fees) relative to the reference index. Over the year the fund has also significantly outperformed the European Credit Index. Meanwhile, the fund continues to deliver on Sustainability performance metrics including a high SustainEx™ overall impact score and MSCI ESG rating.
- Security selection contributed to positive active returns over the month, particularly in EUR-denominated healthcare, utilities, real estate and banking sectors. The fund's underweight duration stance versus the benchmark was also positive.
- Conversely, off-benchmark exposure to sovereigns and USD-denominated utilities and services detracted slightly.

Portfolio activity

- Throughout the month, we increased our exposure to healthcare, real estate and AT1 banking. In contrast, we marginally reduced our exposure to media, consumer goods and automotives.
- 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 to our allocation to German government bonds, particularly green bond exposure. The proceeds fund projects relating to (1) transport; (2) international cooperation; (3) research, innovation and awareness raising; (4) energy and industry; (5) agriculture, forestry, natural landscapes and biodiversity.
- Also of note, included green bonds from a Finnish commercial property company. The company has ambitious targets to become carbon neutral 2030. Proceeds will be used towards green buildings, improving energy efficiency, clean transportation, renewable energy and waste management.
- We remain invested in our preferred responsible finance names, including green, social, and sustainability-linked bonds issued by UK and European companies.
- The fund's carbon emissions intensity, as measured by tonnes CO₂e 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

- The macroeconomic picture in Europe remains subdued, with weakness spreading from manufacturing to services and consumer confidence dropping amid job security concerns
- Political uncertainty in France, the prospect of US tariffs, and upcoming elections in Germany amplify these headwinds.
- Nevertheless, a softening inflation outlook could pave the way for the European Central Bank to ease

monetary policy in 2025, potentially providing support for a soft landing

- Despite the challenging environment, European corporate fundamentals remain resilient. The lacklustre economic climate has driven companies to strengthen their balance sheets, reduce leverage and maintain healthy credit metrics.
- From a valuation perspective, there are mixed signals. Following the strong performance, spreads on an index level have now dipped below historical averages, suggesting that valuations are no longer outright cheap. Nonetheless, European credit still offers attractive all-in yields, providing a meaningful cushion against market volatility and a positive real income stream.
- Even though spreads on index level don't look cheap anymore, there are still pockets of value and single A's look particularly attractive.
- Meanwhile, looming concerns around fiscal deficits in both Europe and the US have underscored the importance of distinguishing between sovereign and corporate risk, with corporate bonds offering a potentially safer haven in some instances.
- In light of these dynamics, a more defensive portfolio stance appears prudent
- 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**
2024	5.6	5.2	6.3	4.7
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	-	-	-	-

Source: Schroders, as at 31/12/24. 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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