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Schroder ISF* US Small & Mid Cap Equity

Fund Manager: Robert Kaynor, CFA | Fund update: January 2025

Performance overview

- US equities regained positive momentum in January. Small and mid-cap stocks made a recovery from December's losses and outperformed large caps.
- The fund beat the benchmark during the month.

Drivers of fund performance

- Stock selection drove the outperformance, with sector allocation slightly negative.
- The top contributors from a sector point of view were information technology and healthcare.
- Within technology, the portfolio benefited from strong stock selection, primarily in the IT services and communications equipment groups. **Viavi Solutions** reported better-than-expected results behind a strong rebound in telco fibre tests and increasing deployments at cloud providers. Healthcare, which was the best-performing area of the market in January, was led by stock selection within pharmaceuticals and biotechnology. **Natera**, which provides genetic testing services, announced positive results from two important clinical colorectal cancer studies that are a major step forward in developing evidence to make MRD the standard of care.
- The top detractors for the month were consumer discretionary and financials.
- Consumer discretionary lagged due to stock selection within hotels, restaurants and leisure as well as household durables. **Sonos**, which provides multi-room wireless audio products, announced that its CEO would be stepping down effective immediately. This came after an app redesign in May was poorly received by customers and the stock traded down. Financials lagged in the portfolio, primarily due to an underweight to capital markets, which performed well within the benchmark for the month
- In terms of the alpha sources[1], mispriced growth and turnarounds outperformed, while steady eddies slightly lagged.
- Major contributors included **WNS, Intra-Cellular Therapies and Twilio.**
- Major detractors included **Haemonetics**, **NeoGenomics** and **PVH Corp.**

Portfolio activity

- We added **IDACORP.**
- We exited **Intra-Cellular** and **PotlatchDeltic.**

Calendar year performance (%)

Year	Fund	Target	Comparator 1	Comparator 2
2024	10.4	11.1	10.3	13.0
2023	12.2	11.3	18.4	15.0
2022	-13.3	-18.5	-20.4	-13.0
2021	21.6	17.8	19.4	24.4
2020	6.8	20.4	22.4	13.0
2019	28.9	28.6	29.9	26.7
2018	-12.4	-11.5	-10.8	-12.9
2017	15.2	17.2	16.1	15.9
2016	17.6	16.4	13.6	19.4
2015	0.7	-3.2	-2.6	-2.7
2014	11.6	7.8	8.3	10.8
2013	35.0	38.4	37.7	34.6
2012	9.1	14.7	12.0	15.0

Source: Schroders, net of fees, NAV to NAV, with net income reinvested. USD C Acc share class as at 31 December 2024. The fund's performance should be assessed against its target benchmark being to exceed the Russell 2500 Lagged (Net TR) index and compared against the Morningstar US MidCap Equity Category and the S&P Mid Cap 400 Lagged (Net TR) Index. The fund's investment universe is expected to overlap materially with the components of the target benchmark and the S&P Mid Cap 400 Lagged (Net TR) Index. The comparator benchmarks are only included for performance comparison purposes and does not determine how the investment manager invests the fund's assets. The investment manager invests on a discretionary basis and there are no restrictions on the extent to which the Fund's portfolio and performance may deviate from the target benchmark or the S&P Mid Cap 400 Lagged (Net TR) Index. The benchmark(s) does/do not take into account the environmental and social characteristics or sustainable objective (as relevant) of the fund. Please see appendix III of the fund's prospectus for further details.

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

- [1] We target three types of opportunities: "mispriced growth stocks" – stocks where we think the market continues to undervalue a company's growth prospects; "steady eddies" – strong companies with recurring revenues and/or cashflows; and

*Schroder International Selection Fund is referred to as Schroder ISF throughout "turnarounds" – firms that are addressing their problems, often with new management, which are likely to outperform over time.

Outlook/positioning

- The US emerged from the pandemic with greater strength than most other economies around the globe. That rebound was fuelled, in part, by the fiscal stimulus the Biden administration promoted with two major pieces of legislation – the CHIPS (Creating Helpful Incentives to Produce Semiconductors) and Science Act and the Inflation Reduction Act (IRA). In addition, the US consumer has demonstrated, once again, a propensity to drive the economy. With a strong labour market and policies from the Trump administration that will probably support domestic growth, indications suggest investing in the US economy could remain beneficial.
- Small businesses generate just under half of employment opportunities in the US. Small business owners could feel that the incoming administration will lift a big weight from their shoulders. This could be by cutting taxes, slashing regulation, or shutting out foreign competitors. There is then a reason why they may be more inclined to hire workers, increase employees' pay and invest more capital. All of this would be good news for growth.
- After two strong years of performance, US equities may be considered expensive, with growth potential already priced in by the market. The reality is that the US equity market's performance has been highly concentrated in a few mega and large-cap US stocks, leaving the rest of the market including small and mid-cap companies still with attractive valuations. Given how expensive some large caps are today, small- and mid-cap stocks provide a less costly way to gain exposure to the US economy. Small and mid-cap companies are much more likely to have customer bases that are either exclusively or predominantly in the United States.
- It is true that small and mid-cap valuations have been at a discount to large caps for several years. So, what is changing as we head into 2025? Beyond the ongoing strength of the US economy and the pricing considerations, several key trends could also work together to create a highly favourable environment for small and mid-cap stocks.
- 1. Wall Street is forecasting a bigger rebound in small and mid-cap earnings into 2025. The developments that made 2023 such a difficult year for small caps, namely rate hikes and the ripple effects of the collapse of Silicon Valley Bank, may now be well in the rearview mirror. A consensus of Wall Street analysts believes that looking into 2025, earnings for small caps will exceed large caps for the first time since 2022. This is a key catalyst for a broadening of the market.
- 2. The recovery in M&A activity and IPOs is likely to continue in 2025. The pickup in M&A activity and IPOs benefits small-cap stocks in multiple ways. Attractive small caps often become acquisition targets, and high-quality companies garnering headlines as they go public increases interest in the small-cap space. Overall, the pick-up in animal spirits demonstrated by greater M&A activity and IPOs delivers the optimism that increases risk appetites and the confidence investors may need to pursue the potentially stronger growth small caps can deliver.
- 3. While the Mega-cap tech stocks have been dominating the AI headlines, many small-cap companies will help propel the AI revolution. Artificial intelligence (AI) needs much more than the sophisticated chips provided by companies like Nvidia. Small-cap companies are often key, and even leading, players in those industries that will both shape and benefit from the growth that the AI revolution generates.
- 4. Reshoring enables more small- and mid-cap companies to step in as reliable suppliers. COVID-19 and the lockdowns at Chinese manufacturers and other suppliers led many companies to reconsider their supply chains. The move to onshoring benefits many small US companies that are replacing global competitors as the suppliers to large US firms.
- In 2024, attention centred on inflation, central bank responses and global elections. As we transition into 2025, although business cycle dynamics remain crucial to the outlook, there will be a heightened focus on policy changes in the US across trade, immigration, fiscal, and regulatory policies. These changes should significantly influence outcomes in the US and elsewhere for 2025 and beyond.
- The upcoming year presents a promising landscape for small and mid-cap equity investors, driven by the convergence of robust earnings growth, favourable flows, and supportive economic conditions.

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.

Concentration risk: The fund may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down.

Currency risk: The fund may lose value as a result of movements in foreign exchange rates.

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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.

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