Schroders

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Schroder ISF* US Small & Mid Cap Equity

Fund Manager: Robert Kaynor, CFA | Fund update: November 2024

Performance overview

- US equity markets were especially strong in November, and US small and mid-cap equities gave an impressive performance, beating large caps by a wide margin.
- The fund underperformed the benchmark during the month.

Drivers of fund performance

- Stock selection and sector allocation both lagged in November.
- The top detractors were industrials and communication services. Industrials lagged, primarily due to stock selection, particularly in the commercial services and aerospace and defence industries. The key laggard in the sector was global consulting and engineering firm **Tetra Tech**. It traded down as investors weighed up its earnings guidance and the potential impact of the presidential election result. There have been substantial market concerns surrounding future US federal government spending levels. Communication services underperformed due to weak stock selection in the interactive media & services group. **Match Group**, which provides online dating products and services, lagged after reporting weaker-than-forecast trends, along with Tinder, in the second half of 2024.
- The top contributor from a sector perspective was healthcare. The portfolio's single holding in biotechnology, **Natera**, as well as the underweight to healthcare, added value. Natera was one of the top contributors after it reported earnings results that came in ahead of expectations. Additionally, stock selection within the healthcare providers and healthcare equipment segments also contributed positively to performance.
- In terms of the alpha sources[1], the "mispriced growth" group outperformed, while the "steady eddies" and "turnarounds" lagged.
- Major detractors included **Match Group**, **Tetra Tech** and **Leidos Holdings**.
- Major contributors included **Lumentum Holdings, Natera** and **NeoGenomics**.

Portfolio activity

- The only change over the month was the addition of **Axalta Coating Systems**.

Calendar year performance (%)

Year	Fund	Target	Comparator 1	Comparator 2
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 2021. 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 "turnarounds" – firms that are addressing their problems, often with new management, which are likely to outperform over time.

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

Outlook/positioning

- Even though the US economy is likely to slow over the next six months, the base case is that growth will remain modestly positive, with the US avoiding a recession in the near term. Consensus forecasts predict positive, but slower growth in third-quarter earnings. The environment remains attractive for equity investment and there are indications that market performance can continue to broaden in favour of small and mid-cap companies as we approach 2025. Looking ahead, risk appetite will likely be supported as Federal Reserve interest-rate cuts accompany further disinflation, amid a stable labour market and healthy consumer spending.
- If lower rates light the fuse for better small and mid-cap performance, we expect the inflection towards superior earnings growth relative to large caps to keep it burning in the months ahead. The gap in earnings and revenue growth between large caps and small and mid-caps is set to narrow, with the latter group's earnings coming in better by the fourth-quarter reporting season. A resilient US economy, evidenced by recent better-than-expected jobs data, supports more domestically based small and mid-sized companies. In some cases, they are just starting to experience the benefits of fiscal initiatives such as the Inflation Reduction Act, as well as the spill-over of the AI capex boom.
- M&A has been strong this year, the sixth-best on record to date. Historically, it has been a positive sign when activity has increased, as it confirms that good value and strong prospects exist. Our only disappointment in this current cycle is that agreed takeover prices, both from strategic and private equity firms, are below our estimates of fair value for the companies we have owned.
- In terms of risks, high valuations and concerns about consumer confidence remain as bearish factors. The impact of China's stimulus measures on the world economy is also uncertain, and there are many geopolitical risks. A continued focus on companies with high quality financial ratios and resilient business outlooks is the best way to mitigate long-term risks, as well as diversifying portfolios between "steady eddies" and "mispriced growth" companies.
- With the Republicans assuming power next year, and despite concerns about tariffs and immigration, we remain optimistic about economic growth being driven by pro-business policies, such as tax cuts and deregulation. These measures, paired with increased consumer confidence, could lead to projected growth of 2.7% in 2025. However, inflation is anticipated to remain elevated, with core inflation seen trending towards 3%.

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.

Currency risk / hedged shareclass: 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.

Fund Disclosure: SISF US Small & Mid-Cap Equity: The fund invests primarily in equity and equity related securities of small and mid-sized US companies. - The fund invests in equity would subject to equity investment risk. - The fund invests in concentrated region/sector and subjects to higher level of risks than a fund investing in a more diversified portfolio/strategy. - The fund may invest in smaller companies which are relatively less liquid and more volatile than larger companies. - The fund may use derivatives to meet its investment objective. Derivatives exposure may involve higher counterparty, liquidity and valuation risks. In adverse situations, the fund may suffer significant losses from their derivative usage for hedging. - For share classes with a general dividend policy, expenses will be paid out of capital rather than out of gross income. The amount of distributable income therefore increases and the amount so increased may be considered to be dividend paid out of capital. Share classes with a fixed dividend policy may pay out both income and capital in distributions. Where distributions are paid out of capital, this amounts to a return or withdrawal of part of your original investment or capital gains attributable to that and may result in an immediate decrease in the net asset value of shares. You should not make any investment decision solely based on this document. Please read the relevant offering document carefully for further fund details including risk factors.

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.

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.

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.

Smaller companies risk: Smaller companies generally carry greater liquidity risk than larger companies, and they may also fluctuate in value to a greater extent.

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 chosen by the investment manager. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

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Subscriptions for shares of the Company can only be made on the basis of its latest Key Information Document and prospectus, together with the latest audited annual report (and subsequent unaudited semi-annual report, if published), copies of which can be obtained, free of charge, from Schroder Investment Management (Europe) S.A.

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