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Schroder ISF* US Small & Mid Cap Equity

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

Performance overview

- The US stock market declined in October, with the S&P 500 and Nasdaq Composite indices breaking their winning streaks. Small and mid-caps also performed poorly for the third-consecutive month.
- The fund underperformed the benchmark in October.

Drivers of fund performance

- Stock selection was the main source of underperformance, while sector allocation was flat.
- The top detractors were financials, communication services and healthcare. Financials lagged due to stock selection within banks, as our stocks underperformed what was the top group within the sector in October. Selection in the media sub-sector caused communication services to underperform. **Stagwell**, the portfolio's sole holding in the group, was down over 10%. Healthcare lagged due to healthcare providers, primarily **Option Care Health**, which provides home and alternate site infusion services. Despite reporting results that were ahead of market forecasts and solid guidance, its shares were down over 20% after management stated that headwinds to its Crohn's disease treatment, Stelara, will put pressure on the company's profitability.
- The top contributors from a sector perspective were industrials and consumer discretionary.
- Within industrials, stock selection in aerospace & defense and commercial services added value. **BWX Technologies** was the best-performing stock in the sector. Positive selection within the textiles, apparel & luxury group in consumer discretionary also boosted returns.
- In terms of the alpha sources[1], all three groups underperformed for the month.
- Major contributors included **BWX Technologies**, **Masimo Corporation** and **Twilio**.
- Major detractors included **Option Care Health**, **Mohawk Industries** and **Azenta**.

Portfolio activity

- We added **Twilio**, **V.F. Corporation** and **Patrick Industries**.
- We exited **Valvoline**, **Popular** and **Domino's Pizza**.

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

*Schroder International Selection Fund is referred to as Schroder ISF throughout revenues and/or cashflows; and “turnarounds” – firms that are addressing their problems, often with new management, which are likely to outperform over time.

Outlook/positioning

- Even though the US economy is likely to slow over the next six months, consensus forecasts predict growth will remain modestly positive and the US will avoid a recession in the near term. The market expects positive, but slower earnings in the third quarter. The environment remains supportive of equities and there are indications that performance can continue to broaden out into 2025 in favour of small and mid-cap companies. Looking ahead, risk appetite will likely be supported by the US Federal Reserve's interest-rate cuts as disinflation persists, and by a stable labour market and healthy consumer spending.
- If lower interest rates light the fuse for better small and mid-cap performance, it is likely to be a shift towards superior earnings growth relative to large caps that will keep the fuse burning. 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 the 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 from the AI capex boom.
- M&A has been strong this year, the sixth-best on record to date. Historically, it has been a good sign when activity has increased, as it confirms good value and strong prospects exist. Our only disappointment in this current cycle is that agreed takeover prices, both from strategics and private equity firms, are below our estimates of fair value for companies we have owned.
- The November presidential election presents a risk to the US outlook. The race is still too close to call. Whoever wins, it seems that most of the macroeconomic impact will not be felt until after 2025. Much depends on whether the winning party also achieves control of both houses of Congress, making the passage of new legislation easier.
- In terms of risks, high valuations and concerns about consumer confidence are still bearish factors. The impact of China's stimulus measures on the world economy is uncertain and many geopolitical risks remain. We believe a continued focus on companies with high-quality financial ratios and resilient business outlooks is the best way to mitigate long-term risks, while diversifying our portfolio with “steady eddies” and “mispriced growth” companies.

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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