

Schroder ISF* Strategic Bond

Fund Manager: Julien Houdain, James Ringer, Martin Coucke & Global Unconstrained Fixed Income Team | Fund update: May 2025

Performance overview

- May was another volatile month for global bond markets. While a de-escalation of China-US trade tensions eased US recession fears, the market's focus quickly switched to concerns around US fiscal sustainability. The Reconciliation Bill, which was approved by the House of Representatives and is now required to be passed by the Senate, was seen as worsening the US budget deficit, driving longer-end Treasury yields higher.
- Despite the ongoing uncertainty, credit markets continued to recover from the early April sell-off. Within investment grade (IG) corporates, US credit spreads tightened more significantly versus their Euro denominated counterparts (marking an outperformance), although both markets generated positive excess returns over government bonds. US IG spreads are once again trading at tighter levels versus the EU, at the margin a reflection of the continued headwind of euro-denominated investment grade supply.
- US high yield (HY) was the biggest beneficiary of the improvement in risk sentiment. An easing of US recession concerns combined with a more conciliatory outlook on tariffs supported strong investment flows into the asset class. The robust monthly performance was broad-based across sectors as spreads contracted sharply, leaving them at tighter levels than pre 'Liberation Day'. Euro-denominated HY also had a positive month but underperformed the US.
- Other high deficit countries were vulnerable to the sell-off in the US Treasury market. The UK gilt market did not escape, with the shift higher in yields reflecting investors' concerns about the country's fiscal outlook. The Bank of England (BoE) cut its base rate by 25bps to 4.25%, but with April's inflation data higher than expected, particularly in services - a measure closely monitored by the BoE, the market is sceptical over the depth of future rate cuts.
- European government bond markets in comparison had a much better month, with only modest yield rises in core markets – such as Germany. Peripheral markets outperformed, with yields on 10-year Italian bonds falling slightly over the month.

Drivers of fund performance

- The fund delivered a positive return and outperformed the reference benchmark during May (Bloomberg Multiverse ex Treasury A+ to B- USD Hedged), with credit strategies driving the outperformance.
- Our exposure to US and euro-denominated HY was a notable contributor to performance, amid a much-improved environment for risk assets.
- An underweight to US IG & EUR IG detracted, although bond selection was positive.
- The fund's government bond strategy detracted overall, principally due to an overweight to US duration held early in the month. A cross-market position – overweight US versus Germany – also detracted from relative performance.

Portfolio activity

- We reduced the probability assigned to a 'hard landing' and subsequently reduced headline duration (extending the underweight stance relative to the reference benchmark). While we recognise that it might be too early for the tariff-induced volatility to have impacted the real economy, so far, the US economy has been resilient.
- The reduction in duration was firstly achieved by converting an overweight to the US to a cross-market overweight versus the eurozone.
- Subsequently we also sold eurozone duration on an outright basis. Our bearish view on eurozone duration is based on the reality that the ECB has already significantly eased policy, combined with our relatively upbeat growth outlook for the region.
- We believe yield curves still have the potential to steepen structurally given the renewed focus on long-dated debt supply. Yield curve steepening strategies are focused on the US and on the UK, where there are well-known fiscal vulnerabilities.
- Minimal changes were made to the fund's asset allocation. Despite the rally in HY, the asset class continues to provide attractive carry to the portfolio, and we continued to hold an overweight to US dollar and euro denominated issues.
- We continued to rotate exposure from US Agency mortgage-backed securities (MBS) into US investment

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

grade credit as and when the shift in relative value permits.

Outlook/positioning

- While immediate recession fears have abated, last month did little to quell the ongoing uncertainty around tariffs. We believe the market will continue to focus on trade-related news, as well as the consequences for fiscal deficits and the risk of additional bond supply.
- The resilience we have observed so far in global growth is partly attributable to a front-loading of demand prior to tariff hikes. However, we expect the US economy to slow over the coming months, with hard data moderating, but importantly not drastically. Despite the dialling back, tariffs have not been completely removed. While the US Court of International Trade's ruling to block most of President Trump's tariffs will complicate the path ahead, there are still several provisions the administration can invoke.
- The uncertainty being created from the fluid trade agenda translates into a difficult business environment to make investment and hiring decisions. The outlook is largely contingent on the response from the US corporate sector to the significant sentiment shock. However, there will be some buffer here as profit margins remain close to record highs.
- We also cannot totally dismiss the idea that tariffs risk raising price pressures in coming months. So far, we have only seen a minor impact from tariffs coming through into inflation data. However, with businesses already warning of higher prices, we

expect this to be a theme that plays out through the summer.

- Meanwhile, deficit vulnerabilities are likely to continue to be a focus. The market will be watching closely for concessions as President Trump's so called, 'Big Beautiful Bill' passes through the Senate.

Past performance does not predict future returns. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.

Calendar year performance (%)*

Year	Fund (A Acc)	Fund (I Acc)
2024	5.0	6.3
2023	6.9	8.2
2022	-5.3	-4.2
2021	-0.7	0.6
2020	-1.3	-0.1
2019	7.7	9.0
2018	-3.0	-1.7
2017	1.2	2.5
2016	2.9	4.2
2015	-3.5	-2.3

Source: Schroders, Bloomberg, as at 31/12/2024. Performance net of fees (where applicable), NAV to NAV (bid to bid), USD. Fund performance should be assessed against its objective of providing a positive return over a 12-month period in all market conditions.

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.
- **Bond Connect risk:** The fund may be investing in the China Interbank Bond Market via the Bond Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.
- **Capital risk / distribution policy:** As the fund in Against this background, with the European Central Bank having now cut interest rates by a further 25bps to 2.5% in March, and we anticipate further easing to come Against this background, with the European Central Bank having now cut interest rates by a further 25bps to 2.5% in March, and we anticipate further easing to come Against this background, with the European Central Bank
- having now cut interest rates by a further 25bps to 2.5% in March, and we anticipate further easing to come tends to pay dividends regardless of its performance, a dividend may represent a return of part of the amount you invested.
- **Contingent convertible bonds:** The fund may invest in contingent convertible bonds. A reduction in the financial strength of the issuer of such bonds 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.
- **Issuer risk:** The fund is permitted to invest more than 35% of its scheme property in transferable securities and money market instruments issued or guaranteed by an EEA State / governments of the following country: United States of America.
- **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.
- **No capital guarantee risk:** Positive returns are not guaranteed and no form of capital protection applies
- **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.

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