Schroders

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Schroder ISF* Strategic Bond

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Performance overview

- Against a relatively benign economic and market backdrop, yields fell across the major government bond markets in anticipation of interest rate cuts commencing in June. The Federal Reserve (Fed), European Central Bank and the Bank of England left interest rates unchanged. The Fed's Summary of Economic Projections (SEP) showed no change to its forecast for three rate cuts this year, despite forecasting lower unemployment and higher core inflation compared to December's release. The accompanying statement also set a dovish tone.
- In Europe, the Swiss National Bank surprised market participants announcing a 0.25% interest rate cut to 1.5%. With inflation back to target, the move was aimed at easing pressure on the Swiss franc and supporting growth.
- Against the trend, the Bank of Japan (BOJ) raised interest rates (from -0.1% to 0.1%) for the first time in 17 years in an anticipated move to end negative rates. Nevertheless, the BOJ's forward guidance remains dovish, with the statement indicating an accommodative stance would most likely be maintained given the current outlook for economic activity and inflation.
- The US 10-year Treasury yield fell from 4.24% to 4.20%, and with the curve still heavily inverted, the yield on the benchmark 2-year remained unchanged at 4.62% on the month. The 10-year German bund yield fell from 2.41%. to 2.30%, while yields in the Italian and Spanish markets fell further. UK gilts outperformed on the month, with the 10-year yield declining from 4.12% to 3.93% as February's inflation data highlighted a larger than expected decline in both the core and headline consumer price index measures.
- Corporate bonds continued to outperform government bonds amid stronger economic data and robust corporate earnings. Despite heavy supply, credit spreads tightened further in March on the back of strong investor demand, with spreads in both US and European investment grade markets declining to the tightest level for two years. High yield markets also generated positive total returns, although the European market lagged with spreads widening on the month.
- Amongst currencies, the US dollar trade weighted index rose over the month, with the Japanese yen and other low yielding currencies declining. Emerging markets, particularly the Mexican peso, benefited from lower volatility as investors continued to be attracted by higher interest rates.

Drivers of fund performance

- The total fund return was positive during March as bond yields declined over the month. Credit and rates strategies were both additive.
- In credit markets, long positions in covered bonds and agency Mortgage-Backed Securities (MBS) worked well.
- Exposure to European investment grade corporate bonds made a positive impact as spreads compressed further.
- In rates, a long position in the UK versus the US and Germany made a positive contribution.
- Tactical trading of the yield curve steepening position in the US was also additive.

Portfolio activity

- The main change during March was an increase in our long US duration position. Based on our outlook for the US economy, particularly the labour market, Treasury bond valuations look attractive. In terms of cross-market positioning, we introduced long positions in the US versus Canada, where in our view the bond market is discounting too many cuts relative to the Fed, and Germany. Our concern around the risk of US labour market conditions re-tightening, which would prompt concerns of secondary round inflation effects, diminished somewhat last month. While February's US non-farm payroll report showed the labour market remaining healthy, large downward revisions to previous months have reduced the likelihood of any inflationary impact.
- We continue to favour a curve steepening strategy in the US, and during March we tactically traded this position, partially reducing and subsequently reinstating the 5 to 30 year Treasury curve steepener.

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

- While we still favoured a long position in the UK gilt market based on an improved disinflationary outlook, we reduced the size of this allocation, taking profit versus the US and reducing the position against Germany. Aiming to capitalise on a similar rationale, we introduced a short position in the UK inflation-linked gilt market.
- Our highest conviction positions remain in covered bonds and agency MBS, which offer attractive yields with relatively low credit risk.
- In corporate bond markets, we retained a preference for high quality European issues.
- In currency markets, we halved the long position in the Australian dollar versus the New Zealand dollar to take profits. The position aims to exploit the divergence between the two central banks, with the RBNZ likely to cut sooner and more aggressively than the RBA. We also closed the short position in the Swiss franc versus the euro early in the month, following a period of positive performance.

Outlook/positioning

- Consistent with our central thesis of a 'soft landing', firming goods demand has driven an upturn in the global manufacturing cycle. The US has led the way, but the Eurozone has been a more recent beneficiary of this cyclical uplift, with a more accommodative interest rate outlook offering additional support. Not only does it appear that the region's manufacturing cycle has turned, but the services sector also seems to be recovering, feeding through to the labour market. Leading indicators are signalling a clear improvement and given the weakness of growth expectations for the region, the hurdle for positive surprises is easy to beat.
- However, an improving global growth backdrop presents an upside risk to inflation and there has already been a flurry of surprises in recent data releases. Although favourable base effects mean year-over-year core inflation should continue to decline in the immediate future, continued stickiness in underlying prices could pose challenges further out, without marked improvement.
- The resilience of labour markets is also a potential headwind to the depth of the forthcoming interest rate cutting cycle. This continues to warrant close scrutiny, particularly in the US.
- With lower bond market volatility and the possibility that we are entering a more rangebound environment, we continue to favour those fixed income asset classes which offer additional yield. While some markets look expensive, there remains value in high quality sectors, particularly European investment grade corporates, and securitised assets.

Calendar year performance (%)*

Year	Fund (A Acc)	Fund (I Acc)
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
2014	2.0	3.3

Source: Schroders, Bloomberg, as at 31/12/2023. 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.

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.

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 intends 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.

Important information