

Schroder ISF* Strategic Bond

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

Performance overview

- March saw a significant change in the global macroeconomic landscape. US exceptionalism continued to be challenged as heightened policy uncertainty led to a sharp fall in sentiment and raised concerns of recession. Meanwhile, Germany's fiscal regime change drove a much-improved reflationary outlook across the eurozone.
- Germany's parliament approved plans by incoming Chancellor Friedrich Merz to loosen borrowing limits, exempting spending on defence and security from strict debt rules. It also enabled the creation of a €500 billion infrastructure fund designed to run for the next 12 years.
- German bunds bore the brunt of the ensuing sell-off across the eurozone, with yields recording their biggest daily jump since Germany's reunification in 1990 on the initial announcement. The yield curve steepened, with longer dated bonds rising in anticipation of higher borrowing costs in the future, while shorter maturities were supported by expectations of easier monetary policy conditions. The European Central Bank (ECB) cut its main interest rate by 25 basis points as expected.
- US Treasuries outperformed all other major government bond markets. Ongoing policy uncertainty continued to cloud the outlook for the US, with market participants expecting a weaker growth outcome as a result. Meanwhile, the Federal Reserve kept interest rates unchanged for a second consecutive meeting while announcing a slowing in the pace of quantitative tightening
- In investment grade credit markets, euro corporates outperformed on a spread basis, with the difference in yield between corporate and government bonds dipping below that of the US for the first time since January 2022.
- Euro corporates later unwound some of their spread tightening, as focus shifted from planned increases in fiscal spending to looming trade policy risks. This left spreads slightly wider at the end of the month, but still trading at tighter spreads compared to the US.

Drivers of fund performance

- The total fund return was slightly positive during March.
- Within credit markets, limited exposure to US investment grade market worked well.
- Holdings in euro high yield weakened as credit spreads widened.
- In broader spread markets, holdings in US agency MBS (mortgage-backed securities), while providing more stable performance relative to other US spread markets, lost ground.
- A European curve steepening strategy worked well as the market priced in higher borrowing costs in the future.
- A cross market short position in Europe versus the US was also beneficial.

Portfolio activity

- We were strategically positioned for markets to react to an element of fiscal convergence between the eurozone and the US. This materialised sooner than we anticipated with Germany's surprise pivot on its strict debt rules. The improved eurozone outlook drove a steepening of European yield curves as investors priced in higher borrowing costs in the future. Following the market move, we locked in profits.
- Bond markets saw the move as reflationary and the eurozone sold off sharply in response. We closed the cross-market short position in the eurozone versus the US for now given the swift market reaction. Preferring to express further fiscal convergence through currencies, we introduced a long position in the euro versus both US dollars and sterling.
- We consider the European inflation-linked market has moved to overprice the reflationary outlook, particularly when energy and wage inflation is softening. Accordingly, we initiated a cross-market short Europe versus the US in inflation swaps.
- Following the widening of US credit spreads, we tactically added exposure to US high yield by selling protection on credit default swap indices (CDX).

Outlook/positioning

- As we enter the second quarter of the year, there remains a great deal of uncertainty around the global outlook. 'Liberation Day' proved to be worse than expected by the market. President Trump's executive order introduced a universal tariff along with a variety of country-specific reciprocal tariffs, with some exclusions.
- Nevertheless, there is a degree of scepticism around the permanency of some of these new tariffs. In fact, Trump mentioned that tariff rates could be negotiated down if other countries lower their trade barriers to US products. We await signs of negotiations aimed at lowering tariff levels to below those initially imposed. There will be much more volatility, and a clear risk that the situation escalates into a global trade war, with more severe consequences for risk assets.
- In a matter of days, the announcement on tariffs all but eradicated the fiscally-stimulated optimism priced into eurozone sovereigns following the shift in Germany's fiscal stance. We will continue to monitor developments closely.
- Credit spreads have risen sharply, particularly within high yield markets, in a matter of days since the end of the first quarter. The prospect of an escalating trade war triggered by US tariffs has heightened volatility and risk aversion, at least in the near-term. When volatility increases credit opportunities rise, particularly where markets are mispricing a substantial change in outlook, and we are starting to see some of those appear.
- We continue to identify opportunities in securitised assets such as US agency MBS, which provide an attractive income in comparison with the broader US investment grade market, with less idiosyncratic credit risk.

- However, we remain very mindful of credit risk particularly in view of the economic uncertainty. Going forward, a combination of positive carry and idiosyncratic opportunities should underpin total returns from credit markets. For now, uncertainty persists, which makes an agile approach to portfolio construction crucially important.

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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