Schroders

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Schroder ISF* Strategic Bond

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Performance overview

- Trade negotiations dominated news flow during July, while markets were also preoccupied by renewed concerns over fiscal deficits which saw global government bond yields rise.
- The US faced conflicting pressures from tariffs and fiscal policy. President Trump signed the 'Big Beautiful Bill' into law, with the net impact from tax reductions, increased spending on defence and border security and cuts to social security judged to be negative for the country's deficit.
- Concerns over central bank independence resurfaced, although President Trump later refuted speculation that Federal Reserve (Fed) Chair Powell's position was under threat. As expected, the Fed left interest rates unchanged (4.00-4.25%) while the market interpreted Powell's press conference as relatively hawkish.
- Following weeks of negotiations between the EU and the US, a baseline tariff rate of 15% on almost all EU goods entering the US was agreed, with the EU also committing to significant spending on US military equipment and energy. Meanwhile, the European Central Bank (ECB) kept interest rates unchanged for the first time in a year, with President Lagarde striking a surprisingly hawkish tone.
- Credit markets posted further gains, outperforming government bonds. In the US, a constructive economic outlook and robust company earnings - which exceeded expectations particularly in cyclical industries - drove solid performance across sectors and ratings (both investment grade (IG) and high yield (HY)). June's payroll data and job opening report depicted a positive picture of the US labour market, while survey data extended further into expansionary territory.
- Euro denominated corporates equally produced positive total and excess returns as spreads compressed for the third consecutive month. Spread tightening was broad based across sectors, with insurance and real estate investment trusts (REITS) among the outperformers.

Drivers of fund performance

- The fund delivered a positive return and outperformed the reference benchmark during July (Bloomberg Multiverse ex Treasury A+ to B- USD Hedged).
- The fund captured the compression of credit spreads, most significantly through overweight exposure to US and EUR HY bonds.
- A defensive position in IG credit detracted, although this was partially offset by an overweight to US agency mortgage-backed securities (MBS), where we retained a focus on high coupon issues.
- An underweight US duration stance was positive as Treasury yields rose amid a constructive economic outlook and hawkish guidance on monetary policy from the Fed.
- Curve positioning, in the form of steepeners, produced positive results in the eurozone but detracted in the US.

Portfolio activity

- The main change to asset allocation was the reduction of our US HY position.. Given the strong performance of HY bonds and a significant tightening in credit spreads over recent months, valuations look expensive and vulnerable to some reversal in the event of any softening in economic indicators.
- In line with our macroeconomic views, we remained modestly defensive in terms of overall duration. In terms of cross market positioning, we reduced our short position in Germany versus the UK.
- Within rates, our highest conviction is in curve positioning. We rotated some of our directional German short exposure into an existing steepening strategy. This reflects our view that the disinflationary narrative in the eurozone should continue to underpin relative outperformance of the shorter end of the curve.
- We opened a tactical short position in US inflation, which as well as looking expensive helps to offset some of the more cyclical credit exposure in the portfolio.
- In emerging market bonds, we introduced a small position in Philippines government bonds (currency hedged), which offers an attractive yield. Disinflation

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

and ongoing growth concerns, related to US trade tariffs, should allow the central bank to further ease monetary policy.

Outlook/positioning

- From a macroeconomic perspective, we continue to see a ‘soft landing’, where economic growth slows and inflationary pressures ease, as the likeliest outcome.
- Nevertheless, July’s US payrolls release which incorporated a significant -258,000 backward revision was one of the contributing factors to us factoring in a modestly raised risk of a ‘hard landing’. A weakening of the labour market would also give the US Federal Reserve the green light to cut interest rates further.
- We’re also yet to see the full impact from tariffs on inflation, and we’re watching carefully to assess whether they will represent a one-off price shock or if there will be a greater and longer felt pass-through into prices.
- At least there’s now greater clarity on trade, with agreements with some of the US’ key trading partners, including Japan and the European Union.
- Meanwhile, we expect the Bank of England to continue its cautious approach in easing monetary policy conditions. On the fiscal side, the Chancellor continues to warn that tax rises are needed to plug the gap in public finances and we anticipate some volatility in UK assets as we approach the Autumn Budget.
- In credit markets, we have become more cautious on valuation grounds, as spreads are now trading at quite tight levels historically, making them less appealing at current prices.
- Accordingly, we have adopted a more defensive stance favouring securitised bonds, particularly high coupon agency MBS given their low volatility.

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.

Important information

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