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Schroder ISF* Asian Convertible Bond

Fund Managers: Dr. Peter Reinmuth & Chris Richards, CFA | Fund update: December 2024

Performance overview

- Global stock markets finished the year on the downside and gave up some of the strong annual gains. General market developments made it increasingly difficult to justify stocks reaching new all-time highs, implying that the market had been overbought and a pullback might have been anticipated.
- Longer-term interest rates in the US are up to 4.6% which also is a good indicator of some market stress. The fear and greed indicator has quickly moved to fear and the market looks short-term oversold. It is a sign of the times that greed and fear seem to take turns even after rather small market swings.
- December was a challenging month for the Dow Jones, which recorded its poorest performance since 2018 and its largest monthly percentage decline since September 2022. The S&P 500 shed -2.4% while the tech heavy Nasdaq index ended the year on a slight plus of 0.6%.
- European markets fared a bit better. The Euro Stoxx finished the year on a plus of 1.9%, mainly driven by positive performance in Germany (Dax 1.4%) and France (CAC 2.1%).
- Asian stock markets also presented a mixed bag. The overall MSCI Asia ex Japan finished on a gain of 0.2%.
- The Hang Seng was up 3.3%. China's CSI 300 gained 0.6%. Singapore stated some gains of 1.3%. Taiwan was up 3.6%. In Japan, the Nikkei was up a strong 4.5%.
- Convertibles benefited very efficiently from the positive stock returns in Asia. The FTSE Asia ex Japan convertible index finished the month of December on a gain of 1.5%. Our asset class outperformed stocks as measured by the MSCI Asia ex Japan equity index.

Drivers of fund performance

- The fund slightly underperformed its benchmark.
- On a sectoral level, our overweight in information technology generated relative performance. Our exposure to real estate, though rather small in size, detracted.
- Turning to single-names, we find **Hon Hai**, and **Xiami** as well as **China Yuhua Education** amongst the detractors. On the other side of the spectrum, **Vinpearl** and once more **China Hongqiao** added to relative performance

Portfolio activity

- The strategy seeks to maintain good upside exposure to Asian stocks, balanced by 'bondfloor' protection. As a result, we maintain an equity exposure positioning above benchmark.
- We took small profits throughout the month in names such as **Lenovo**, **Singapore Air, JD** and **Zhen Ding**, using this cash to add to the attractive USD 1.5 billion **Anta Sports** new issue
- The investment year 2024 witnessed a highly active primary market for convertible bonds, a trend that persisted into December. In that month alone, we observed the launch of USD 12 billion in new securities. This increased the total global IPO volume for 2024 to USD 128 billion. The Asian region was notably influential in this resurgence of interest in convertible financing. In 2024, Asian companies issued USD 17 billion in convertible bonds, accounting for approximately 13% of global issuance.
- Despite the strong annual performance, valuations remain subdued in Asian convertibles.

Outlook

- China remains the trigger for the overall stock market returns in Asia. In our convertible investment universe, China also is the main country of risk. Hence, China – and here the political influence – is vital for longer-term returns of the asset class.
- The recent stream of disappointing economic data appears to have surpassed the government's threshold for accepting slower growth, leading to a series of new policy announcements prior to the Golden Week holiday.
- The direction of macroeconomic news has not changed since then. We now expect growth in the region of just 4% for next year – clearly below official government targets. Perhaps a modest bounce could also occur in 2026.
- We stated in our earlier updates that "we believe that more needs to come in order to put the Chinese

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

economy on a solid growth path again. Analysts warn that without significant support for households, these efforts may fall short of substantially improving the economic landscape."

- Further dovish comments from authorities, including President Xi Jinping's New Year address, suggest an increasing probability that our "China stimulus" scenario could sustain growth at 5% this year. However, the nature of the policy support will be crucial. Adjustments to the People's Bank of China's framework imply potential interest rate cuts, but we are sceptical about their impact. The outcomes from December's Central Economic Work Conference identified boosting domestic demand as the government's top priority, although supply-side subsidies may not be as effective as direct stimulus measures. The scale and speed of government bond issuance will be key factors to watch
- In a nutshell, after the stimulus package is before the stimulus package.
- Markets remain on tenterhooks with China's government preparing for yet another announcement. At the same time, Chinese state media has cautioned against the uncritical pursuit of rapid growth and indicated a greater emphasis on stimulating consumption in a series of articles that are preparing the ground for an important economic meeting scheduled for next week.
- Chinese equities have experienced significant outperformance following the flurry of policy announcements, partly due to direct interventions in an undervalued and unappreciated market. We believe that a renewed package could have similar effects.
- Official activity indicators, alongside our own growth measures, suggest that the economy gained momentum after the government's policy pivot in late September. The increase in December PMIs points to further improvement towards year-end, driven by service sector activity, although manufacturing measures have slightly retreated.
- Real M1 has started to rise, reflecting improved financial conditions. However, the long lags between changes in real M1 and economic activity indicate that underlying growth is likely to remain weak until Q3 2025, with a recovery anticipated into 2026. Consequently, our baseline forecast suggests below-consensus growth of about 4% this year.
- Headline inflation fell to just 0.2% year-on-year in November, raising the possibility of outright deflation.
- It remains to be seen what President Trump's policy priorities will be after he takes office on 20 January. So far, little evidence indicates that exporters are aggressively preparing for potential tariffs.
- In the long run, only a more significant policy shift in China can generate a positive economic effect. The government's intervention and the strict transition towards a less market-based economy have not only deterred investors, but also instilled fears among entrepreneurs about earning substantial profits due to potential government repercussions. Sectors driven by research and innovation, such as healthcare and pharmaceuticals, face the dilemma of needing to compete while adhering to the government's objective of affordable national health, which tends towards a more socialistic framework. A shift back to policies more reminiscent of Deng Xiaoping's era rather than those of Xi Jinping would certainly be beneficial.
- Overall, we remain of the view that China appears oversold and undervalued. The economic and, more importantly, political news has been reflected in stock market returns to such an extent that some investors see China as non-investable. We view China as an opportunity.
- Having a long-term option in uncertain times is the primary advantage of our asset class. We must exercise patience and maintain the flexibility to wait for economic changes, while benefiting from coupon payments and awaiting market movements.
- We continue to hold to our long-term conviction that convertible bonds offer excellent access to exploit equity upside participation in Asian stocks, with a safety net attached.

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.

Calendar year performance (%)

Year	Fund (A Acc)	Fund (I Acc)	BM
2024	8.8%	10.5%	12.3%
2023	7.8%	9.5%	10.7%
2022	-13.3%	-12.0%	-9.0%
2021	0.5%	2.1%	-0.1%
2020	18.1%	19.9%	17.4%
2019	9..1%	10.8%	9.8%
2018	-5.65%	-4.16%	-2.30%
2017	9.29%	10.98%	7.93%
2016	0.63%	2.24%	3.12%
2015	6.22%	7.96%	6.76%

Source: Schroders, NAV to NAV (bid to bid), net of fees (where applicable), USD, as at 30/12/2024. The fund's performance should be assessed against its target benchmark being to exceed the FTSE Asia ex Japan Hedged Convertible Bond Index (USD). 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.

Risk considerations

- **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.
- **Emerging markets & frontier risk**: Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.
- **Interest rate risk**: The fund may lose value as a direct result of interest rate changes.
- **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.
- **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.
- **Credit risk**: A decline in the financial health of an issuer could cause the value of its bonds to fall or become worthless.
- **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.
- **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.
- **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.
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