

## Schroder ISF\* European Small & Mid Cap Value

### Portfolio Analysis

#### Economic environment

In the first three months of the new year global macroeconomic trends were basically unchanged from the last quarter in 2012. Growth held up quite well in China and most other emerging markets, while the US continued to show a moderate albeit subpar pace of economic activity. Growth in Japan again proved to be anemic while European growth remained slightly negative. Eurozone numbers were even more negative as flattish economies in the North were no longer able to offset weakness in the South.

Monetary policies around the globe remained utterly expansive, keeping interest rates at their extremely low levels. The fragility of financial markets in the eurozone was once more exposed during the Cyprus banking crisis. Yet, fiscal policies were barely altered and decisive efforts to contain deficits remained elusive. Fortunately, inflationary pressures proved benign in most areas as commodity prices moved more or less sideways and wage pressures remained moderate.

#### Market environment

Stock markets in Europe, on average, moved ahead some 5%. The performance in the Swiss and UK markets was well above this average whereas the Italian and Spanish markets underperformed substantially. Corporate profits throughout Europe were under pressure and only few companies were able to favorably surprise with their numbers. Instead, equity markets were very much driven by liquidity creating an environment of financial repression where investors desperately searched for returns.

#### Performance review

Total returns in €(%)	3 months	1 Year	Since inception <sup>1</sup>
Schroder ISF European Small & Mid Cap Value A Acc	2.1	9.5	9.2
MSCI Europe Small & Mid Cap TR Net	7.1	16.3	20.2
Quartile position	Q4	Q4	Q4

Source: Schroders; all fund performance data on a NAV to NAV basis, net income reinvested. Quartile data source: Morningstar

<sup>1</sup> Fund inception date 30 November 2010

In the first quarter, Schroder ISF European Small & Mid Cap Value (A shares) rose 2.1%, while the benchmark returned 7.1%. Since inception, the fund has underperformed the benchmark by 11.0%, returning 9.2%.

The significant underperformance of the fund has to be seen in the context of the liquidity driven stock market environment. As investors focused their purchasing on futures of stock market indices and ETFs our unconstrained fund with an active share of around 90% fell by the wayside. This is corroborated by the fact that only the stock of the Italian oil service company **Saipem** experienced significant weakness which cost about 0.6% of performance. All other holdings more or less held up but did not increase as much as the benchmark. As far as valuation is concerned, the fund's average P/E multiple on 2013 earnings stands at 12.9x which compares with 18.1x for the benchmark, displaying our strict value approach. The performance history of the fund often shows an underperformance in times of strongly rising equity markets which, recently, have been further aggravated by the liquidity-driven nature of the equity market surge.

The largest positive performance contributions by individual companies came from the Swedish tissue manufacturer **SCA** and Norwegian bank **DnB**. The largest negative performance contributors were the aforementioned Italian oil-service company **Saipem** and French tyre company **Michelin**.

#### Fund activity & positioning

Overall, we maintain a well-diversified portfolio with 82 positions as at 29 March 2013. Our three largest holdings are **Svenska Cellulosa** (3.3%), **Nutreco** (3.1%) and **Rosenbauer** (2.9%). Svenska Cellulosa is a leading global producer and marketer of paper tissue products. In addition, the company is the largest owner of forest land in Sweden. Nutreco, a Dutch producer of feed for pigs, poultry, salmon and trout, has an attractive dividend yield of ca 3% and it trades at only 13.1x 2013 earnings. Rosenbauer is an Austrian fire truck manufacturer. Rosenbauer has a full order book and trades at 11.0x 2013 earnings.

During the quarter, we initiated a position in **LEG Immobilien**, a German residential real estate company located in North Rhine Westphalia. We also increased our holdings in **OMV**, **Rosenbauer**, **EVN** and **Yara**. We reduced our holdings in **Wacker Chemie**, **Saipem** and **DnB**. Elsewhere we took profits in **Svenska Cellulosa**.

At a country level, our largest weights are in Germany, Austria, and Switzerland, followed by the Netherlands. With an overall weight of 4.8%, we have only a minor exposure to the southern European peripheral countries and the UK. The most represented sectors in the fund are materials, industrials and financials. As at 29 March 2013, liquidity stood at 6.9%.

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

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### Key stock positions

Top 10 holdings	Sector	Country	Absolute weight (%)
Svenska Cellulosa	Consumer staples	Sweden	3.3
Nutreco	Consumer staples	Netherlands	3.1
Rosenbauer	Industrials	Austria	2.9
Mayr-Melnhof Karton	Materials	Austria	2.7
Michelin	Consumer discretionary	France	2.6
Semperit	Industrials	Austria	2.6
Helvetia	Financials	Switzerland	2.5
Sixt	Industrials	Germany	2.4
Vienna Insurance	Financials	Austria	2.3
Banque Cantonale Vaudoise	Financials	Switzerland	2.3

Source: Schroders as at 29 March 2013

### Outlook

In our view, the desperate efforts to stimulate growth in the developed world will continue for some time to come. Therefore, the extremely-expansive monetary policies are likely to be pursued. The reduction of fiscal deficits will have no priority and badly-needed reforms will be postponed. The recent political manoeuvres on a fiscal compromise and the deficit ceiling in the US prove the point.

We continue to expect the world economy to grow 3 % in the current year. There will, however, be a big difference in the growth performance between developed and developing economies. Despite very expansive monetary policies, sustained economic recoveries in developed countries will be difficult to achieve as long as the overly-stretched debt situation in these countries does not improve. Notwithstanding a dramatic and, potentially dangerous, shift in economic policies, growth in Japan will turn out to be modest at best. European growth might turn out slightly negative whereas the eurozone might even experience a decline of 1.5 % in economic activity. In the developing regions growth in Asia will continue at a very healthy pace whereas in the other emerging regions' growth will at least hold up at last year's level. Inflation in most areas of the developed world ought to remain contained, at around current levels, for the moment at least. European stocks at this juncture are exposed to crosscurrents between pressured corporate profits and liquidity-driven buying. Valuations have recently become rather elevated, particularly in the UK and Switzerland.

For the time being, it might well be that equity prices continue to move up as liquidity supply is still ample and economies outside Europe continue to show growth. However, the environment for financial markets is increasingly fraught with danger. Already, small unforeseen negative incidents might lead to sharp setbacks at any moment. We stick to our value-driven investment philosophy, focusing on equities of companies with strong balance sheets and relatively high and sustainable dividend yields. While we cannot exclude lagging the market in the case of an ongoing liquidity-driven bull market, our approach will deliver either further modest appreciation or conservation of capital longer term.

### Portfolio characteristics

<b>Fund managers</b>	Caspar Benz & Daniel Lenz	<b>Number of stocks in fund</b>	82
<b>Managed fund since</b>	30 November 2010	<b>Current yield</b>	3.6%
<b>Fund launch date</b>	30 November 2010	<b>Bloomberg</b>	SESMVAA LX
<b>Fund benchmark</b>	MSCI Europe Small & Mid Cap TR Net	<b>Reuters</b>	LU0559386015.LUF
<b>Fund size</b>	€114.9m	<b>ISIN</b>	LU0559386015
<b>Annual management fee</b>	n/a	<b>Swiss Valoren</b>	11866647
<b>Estimated TER</b>	n/a	<b>Fund base currency</b>	EUR

Source: Schroders, as at 29 March 2013

**Risk Considerations:** The capital is not guaranteed. Investments denominated in a currency other than that of the share-class may not be hedged. The market movements between those currencies will impact the share-class. Investments in small companies can be difficult to sell quickly which may affect the value of the fund and, in extreme market conditions, its ability to meet redemption requests upon demand. The Fund will not hedge its market risk in a down cycle. The value of the fund will move similarly to the markets.

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