Fund performance

For the month of October the fund posted a return of -2.50%. This compared to the FTSE Gold Mines Index benchmark return of -3.67%.

Year-to-date the fund has returned 8.14%. This compared to the FTSE Gold Mines Index benchmark return of 4.58%.

Since inception (29 June 2016) to end September 2017 the fund has returned -10.47%. This compares to the FTSE Gold Mines Index benchmark return of -16.55%.

Source for performance: Bloomberg I Accumulation shares USD gross. Performance is on a NAV to NAV basis.

Gold and broader market commentary

Short-term headwinds should have been reasonably intense for gold prices. Rising US real yields, a rising dollar, rising equity markets, increased expectations of US tax “reform” and broader Central Bank policy normalisation have all weighed on it. In addition, investor positioning in gold has been gradually reducing (down 33% from its previous highs).……..this is all very bearish?

Not necessarily, for all these headwinds, gold prices were down only 0.65% in US$ terms over the month. Gold prices are proving extremely resilient.

The broad gold equity indices underperformed the fall in gold prices, though our fund's holdings fared better, declining a more moderate 2.5% through the month.

For investors looking to hedge their diverse portfolios with some precious exposure, it is the longer-term that matters. Here the outlook for gold (and silver) prices remains very strong.

As we often repeat, several key drivers are converging:

- a. The need for global real interest rates to remain negative amid record debt levels.
- b. Broad equity valuations are extremely high and complacency stalks financial markets.
- c. The dollar is potentially entering a bear market.
- d. Global geo-political uncertainty is profound, and increasing.

This month we focus on the third of those points, the possibility of a USD bear market.

Reasons for a dollar bear market

For context, the dollar bull markets of the early 1980s and the late 1990s each lasted around six years on average. The most recent bull market which, commenced in 2011, has also lasted just over six years (chart 1).

Chart 1 – The long-term US dollar trend


¹Schroder International Selection Fund is referred to as Schroder ISF throughout this document.
Forecasting the exact path of any currency, including the dollar, is beyond any analytical power. However, what we can validly attempt is point out several factors that we think make dollar weakness a high probability outcome over the next few years.

Three stand out:

1. A likely increase in the US twin deficit;
2. Potential increased political dysfunction in the US;
3. The fact that the US is more deeply indebted than commonly perceived.

**Firstly, a likely increase in the US twin deficit.** Historically, periods when the US twin deficit (the current account deficit plus the fiscal deficit as a percentage of GDP) has been expanding have corresponded reasonably well with periods of dollar weakness (chart 2). It is quite possible that a combination of Republican proposed tax cuts and difficulty in further cuts to government spending. A US recession, when it inevitably arrives at some point, would likely see the twin budget blow out back towards historical highs of over 12% of GDP.

![Chart 2 - The trade weighted US dollar plotted against the US twin deficit](image)


**Secondly, potential increased political dysfunction in the US;** be it via presidential impeachment or simple legislative paralysis and disruption an increased perception of political instability, near or long-term, could lead to a dilution in the role of the US dollar and US treasuries as safe haven assets in times of stress and/or accelerate the process of Central Bank reserve diversification away from the dollar globally.

**Thirdly, the US is more deeply indebted than commonly perceived.** US central government debt is close to 100% of current GDP (around US$19tn). This point is often dismissed since while high, the US pales in comparison to nations including Japan (243%), China (>250% if including SOE debt) and various European countries including Greece (175%) and Italy (129%).

We find this obsession with simple debt/GDP odd. Isn't what really matters how serviceable the debt burden is? On that basis debt to central government revenue and debt to total government revenue is possibly more meaningful. On this measure the US is actually more indebted than many “problem child nations”. Central government debt is close to 10x total central government income (taxation) – see chart 3 below (we have removed Japan from these charts to allow better visualisation. Japan has debt/central government revenue of more than 2300%).

![Chart 3 - National debt burdens expressed as a % of GDP, Total and Central government revenue (excluding Japan)](image)

Source: OECD and Schroders.
Equity sub sector performance and positioning

The Australian gold equities (ASX Gold Mining Index) increased by 2.8% in USD terms during October. At month end the fund had around 15.0% exposure to Australian listed gold equities. This compared to the benchmark weight of 14.9%.

The South African gold equities (JSE Gold Mining Index) decreased by 0.5% in USD terms in October. At month end the fund had 6.8% exposure to South African gold equities. This compared to the benchmark weight of 7.1%.

The North American gold equities (S&P/TSX Gold Index) decreased 4.9% in October in USD terms. At month end the fund had 60.5% exposure to North American gold and precious metals producers. This compared to the benchmark weight of 62.6%.

Performance attribution and portfolio activity

Overall fund attribution was positive in October (by around 120bps versus the benchmark).

Monthly chart pack
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Risk Considerations: The counterparty to a derivative or other contractual agreement or synthetic financial product could become unable to honour its commitments to the fund, potentially creating a partial or total loss for the fund. A failure of a deposit institution or an issuer of a money market instrument could create losses. The fund can be exposed to different currencies. Changes in foreign exchange rates could create losses. A derivative may not perform as expected, and may create losses greater than the cost of the derivative. Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty and operational risk. Equity prices fluctuate daily, based on many factors including general, economic, industry or company news. A rise in interest rates generally causes bond prices to fall. 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. Failures at service providers could lead to disruptions of fund operations or losses.

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