June 2013
(All data expressed as at 31 May 2013)

For professional investors or advisors only

Schroders
Fund Update

Schroder International Selection Fund^
Emerging Markets Debt Absolute Return

Fund overview:

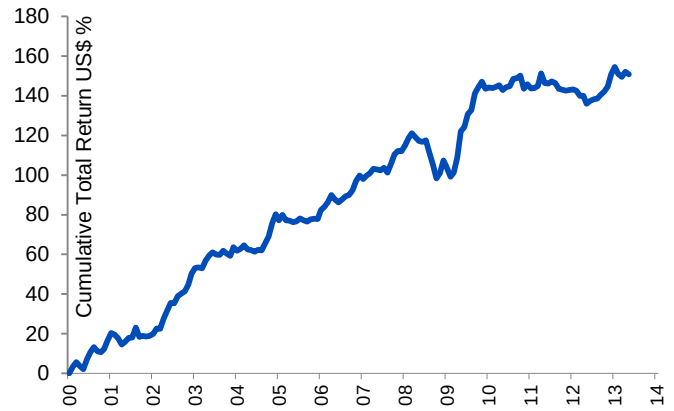
The Schroder ISF Emerging Markets Debt Absolute Return team manages global emerging market debt funds using a variety of instruments and techniques in an effort to enhance overall risk-adjusted returns. The funds' aim is to achieve high, long-term absolute returns while keeping volatility to a minimum. Specifically, the team aims to make positive absolute returns in any 12 month period. Schroders benefits from the consolidated experience and proven track-record of the Schroders Emerging Markets Debt team, led by Geoff Blanning since 1998, with a total of four professionals based in London. The team manages "absolute return" EMD funds of over ***US$4,284** million as at 31 May 2013 on behalf of private clients, institutional and retail investors worldwide.
*Source: Schroders

Schroder ISF EMD AR Performance to May 2013

% *	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2000		3.30	2.40	-1.90	-1.52	4.66	3.55	2.35	-1.89	-0.39	1.36	3.97	16.75
2001	3.18	-0.77	-1.59	-2.59	1.24	1.67	0.12	4.30	-3.78	0.31	-0.24	0.31	1.90
2002	0.78	2.25	-0.15	4.34	3.14	2.90	-0.07	2.54	0.94	0.86	2.37	3.80	26.31
2003	1.86	0.24	-0.30	2.50	1.66	0.99	-0.64	-0.12	1.34	-0.98	-0.64	2.75	8.93
2004	-1.14	0.63	1.03	-1.19	-0.23	-0.52	0.64	-0.23	2.19	2.14	3.91	2.60	10.13
2005	-1.76	1.58	-1.50	-0.11	-0.42	0.26	0.79	-0.52	-0.37	0.63	0.21	-0.10	-1.34
2006	2.51	0.92	1.32	1.90	-1.18	-0.84	0.85	0.84	0.34	1.23	2.47	1.42	12.36
2007	-0.93	0.85	0.65	1.07	-0.09	-0.28	0.60	-1.14	2.18	2.36	0.80	-0.04	6.11
2008	1.36	1.73	1.07	-0.84	-0.85	-0.26	0.39	-2.91	-2.78	-3.45	1.41	3.15	-2.20
2009	-1.89	-2.15	1.03	3.80	6.34	0.97	2.95	0.85	3.60	1.35	1.07	-1.43	17.39
2010	0.27	-0.11	0.27	0.30	-0.99	0.65	0.15	1.56	0.11	0.52	-2.64	0.92	0.96
2011	-0.87	0.08	0.46	2.55	-1.89	-0.11	0.42	-0.30	-1.17	-0.19	-0.23	0.12	-1.21
2012	0.15	-0.27	-1.08	0.04	-1.71	0.59	0.39	0.12	0.78	0.70	1.08	2.59	3.38
2013	**1.37**	**-1.39**	**-0.59**	**1.05**	**-0.48**								**-0.07**

* Performance is presented on USD A NAV NET basis

Performance Overview*



Since Jan 2000*	Fund	EMBI+	ELMI+**
Annual Rate of Return %	7.14	10.90	6.80
Annual Volatility %	5.84	10.00	7.58
Sharpe Ratio	0.88	0.91	0.65
Sortino Ratio	1.58	1.10	0.71
Correlation	1	0.55	0.60
Positive Quarters %	69.23	73.08	71.15
Maximum Drawdown %	-10.29	-19.71	-19.93
Best Month %	6.34	8.52	5.03
Worst Month %	-3.78	-13.79	-8.73
Max 12M Rolling Return %	27.66	40.19	20.29
Min 12M Rolling Return %	-8.98	-18.15	-13.87

* Since inception of USD A NAV NET basis
** ELMI to 31.01.02 (Index discontinued)

Please note the Fund is an absolute return fund therefore, the EMD indices are for illustrative purposes only.
^Schroder ISF Emerging Markets Debt Absolute Return is referred to as Schroder ISF EMD AR throughout this document.

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Review

- Schroder ISF EMD Absolute Return took some profits in May on Convertible bonds (reduced from a high of 10% of NAV to 5.3% at month end) and on restructured Greek bonds (cut to 3.8% of NAV).
- Currencies, which had been a major focus of our investment strategy over the course of the last few months, have recently stopped appreciating. This weakness accelerated in May and has become more broad-based, which prompted further reduction in the fund's currency holdings.
- The fund's minimal duration exposure, along with its focus on a few bond markets which continued to perform extremely well in May (Greece and Vietnam) and its selection of a number of currencies which have proved to be resilient (e.g. the Chinese Renminbi, the Vietnamese Dong, the Taiwanese Dollar and a selection of European currencies) have helped it to weather the on-going sell-off in EM debt markets. Indeed, the fund's drawdown from its recent peak is very small.
- EM Debt markets have started to come under severe pressures, as evidenced by the EMBI+ which lost 4.3% in May. These markets are perfectly set for yet another episode of a disorderly liquidation. Our analysis has been highlighting the risk of this re-pricing for a while and the recent developments suggest that this risk is now materialising. Below we present an update on our Quantitative, Fundamental, Chart and Sentiment Analyses.
- Our Fundamental Analysis has often highlighted that major market turnarounds are usually triggered by shifts in monetary conditions and/or by policy mistakes. Unfortunately, EM bond markets are currently suffering from the combination of these two triggers. Liquidity conditions have tilted towards "tightening or tapering" mode in the US and we also believe that policy mistakes have been made by the majority of EM policy makers, who having kept unnecessarily ultra lax monetary policies, have resultantly encouraged the formation of what we consider to be a bond bubble.
- Indeed, recent renewed easing implemented by central banks in countries such as Hungary, Poland, Turkey, South Korea, India and Thailand appears to have sucked in more investors, into generally overvalued and overcrowded bond markets. One specific example is the Hungarian bond market, which appears to have recently witnessed a blow-off top, which is now being followed by a sharp reversal. This is occurring in very poor liquidity conditions and why a sell-off could become disorderly in most EM markets. In another case, our Chart Analysis for South African local government bonds has highlighted deteriorating chart patterns. These have not yet turned unequivocally bearish but yields need to only increase by another 50bps from current levels to open the possibility for a more impulsive spike.
- The on-going scare in these bond markets may not at present be justified by an inflation problem. In fact, inflation data has recently been relatively benign. However, if the current sell-off in currencies escalates further, inflationary pressures will re-emerge and a tightening in EM monetary policies would then become necessary. South Africa appears to be the first candidate for this potential vicious cycle as the Rand appears to be in free fall (the Rand has lost nearly 20% so far this year, extending the big losses already accumulated in 2011 and 2012).
- Brazil, where inflation has been sticky, has already initiated a tightening cycle. The Selic target rate has been increased in May by 50bps and is now at a relatively high level of 8%. However, it is worrying that this has done little so far to trigger a rebound in the recently weak Real.
- Our Sentiment Analysis highlights that demand for bonds is broadly fading after a long period of euphoria towards the asset class. It should be noted that a number of countries have experienced in May very weak domestic bond auctions. This includes Poland, South Africa, Romania, Turkey and even Singapore.
- One of the key vulnerability indicators used in our Quantitative Analysis is "Hot Money", which attempts to quantify the reliance of countries on short-term capital flows. Our previous notes have consistently highlighted the poor scoring attributed to this indicator for most EM countries. These "Hot Money" inflows have obviously been mostly directed to bond markets. Countries which publish frequent data covering foreign holdings of domestic debt (Hungary, Poland, Turkey, Indonesia, Thailand, Malaysia, Brazil and Mexico) show that on average more than 32% of these bond markets are owned by foreigners. This is a record high (note that this percentage was only around 13% in early 2009).
- Overall, the outlook for most EM bond markets remains extremely challenging in the period immediately ahead. Currencies and Convertible bonds are also likely to suffer from what could be a period of withdrawal of capital from Emerging Markets. We believe that the fund's long-standing conservative positioning and its recent reduction in exposure should continue to protect the fund's performance against the poor dynamics highlighted above. This should equally put the fund in an extremely good position to seize some attractive buying opportunities in due course.

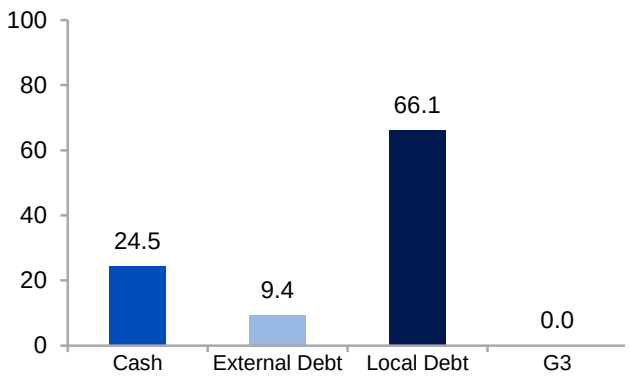
Asset Allocation as at 31 May 2013

Holdings as at 31 May 2013

	Exposure	Duration
Greece	3.8	8.5
Hong Kong	0.5	4.4
Hungary	0.6	2.6
India	0.8	2.8
Korea	1.2	1.5
Mexico	0.7	0.0
Russia	0.3	2.0
Taiwan	0.6	4.6
UAE	0.4	2.4
Vietnam	0.6	3.5
External Debt	**9.4**	
China	10.3	1.0
Czech Republic†	4.2	0.1
Hong Kong	0.5	1.2
Hungary	2.0	0.1
India	1.2	0.9
Indonesia†	1.5	0.5
Korea†	4.7	1.7
Malaysia†	4.3	0.1
Mexico^	7.8	1.0
Philippines	0.9	0.2
Poland^	4.5	0.9
Russia	3.0	0.1
Serbia	1.9	0.7
Singapore†	6.0	0.4
Taiwan	2.0	0.2
Thailand^	7.0	4.5
Vietnam	4.5	3.7
Local Debt	**66.1**	
G3		
Cash	24.5	
Cash	**24.5**	

†Hedged
^Partially Hedged
Source: Schroders

Sector Allocation as at 31 May 2013 %



Fund Summary	%
Yield to Maturity	1.46
USD Exposure	61
Duration (years)	1.28
Average Credit Rating	A
Corporate Exposure	5.3

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An investment in the Company entails risks, which are fully described in the prospectus.

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A security issuer may not be able to meet its obligations to make timely payments of interest and principal. This will affect the credit rating of those securities.
The currency derivative instruments employed are subject to the risk of default by the counterparty. The unrealised gain on the transaction as well as some of the desired market exposure may therefore be lost.
Emerging markets will generally be subject to greater political, legal, counterparty and operational risk
The Fund's operations depend on third parties and it may suffer disruption or loss in the event of their failure.
The fund may use financial derivative instruments as part of the investment process. There is no guarantee that they will deliver the expected results.

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