



## Fund profile

Comprehensive expertise on corporate bonds around the world: Schroder ISF Global Corporate Bond.

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Germany surprises with strong growth – is it Europe's new economic powerhouse?

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China topples Japan as the world's second-largest economy. Nathan Gibbs analyses the impact.

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## Point of view



**Ketil Petersen,**  
Managing  
Director.

### Invest in the “ageing” megatrend

“Old age is a cold fever, the frost of whims and need ahead,” says Goethe in Faust. So it's no surprise that people don't like thinking about their twilight years. But that is exactly what forward-looking investors should do, because societies – particularly in industrialised nations – are ageing. This provides companies offering products and services to senior citizens with attractive opportunities, ranging from smaller pooled funds in supermarkets to tailor-made financial products for pensioners. And that's just for starters. Healthcare providers should also reap benefits. Age-related illnesses, such as heart failure, cognitive disorders and obesity, will increase, opening up new opportunities for treatments. And let us not forget that demographic change and urbanisation will provide infrastructure companies with fresh growth stimulus. Generally, however, company valuations have yet to reflect these positive factors, so investors who buy into the “ageing” megatrend stand a good chance of reaping above-average returns in the long-term.

I wish you pleasant reading.



## Corporate bonds: proven cure for income starvation

Fear is eating into yields. With demand for safe-haven government bonds still riding high, investors have seen their earnings opportunities dwindle. Corporate bonds can help them earn more from their bond portfolios.



**Rich pickings, not meagre scraps** Corporate bonds have performed well in 2010 and still offer investors attractive opportunities.

Spitting images: In a previous edition of this newsletter we wrote “Investors looking for attractive, long-term returns from fixed income should find alternatives to government bonds.” At the time, recession and bank failures were sending scores of investors into the safe havens offered by German Bunds and US Treasuries. Yields had fallen to low levels as a result and the advice of Schroders' expert was to add high-quality corporate bonds to the portfolio mix. Those who followed this advice reaped rich rewards. In 2009, corporates enjoyed their best returns against government bonds for 77 years. The globally invested Schroder ISF<sup>1</sup> Global Corporate Bond, for example, closed the year an impressive 17.8% higher.<sup>2</sup> Now, 18 months and a southern European debt crisis later, safety is once again the watchword for many investors. At the end of August 2010, yields on ten-year Bunds plummeted below 2.5% to a new low and those on US paper were only just higher. With neither US nor eurozone central banks showing signs of diverging from their cheap money policies, yields will probably stay rock

bottom for the foreseeable future. Factoring in inflation and taxes, many investors will probably find their returns totally wiped out. So need to ask themselves whether it's worth foregoing earnings for the sake of a safe home for their money – or whether they are better off enhancing their bond

portfolios with corporates.

### Credit spreads remain attractive

The conditions are favourable. Admittedly credit spreads are no longer at the extreme levels seen in spring 2009, when the markets were pricing in an unprecedented crash scenario with high double-digit default rates. But corporates have continued to perform very well in 2010 and valuations remain attractive. Spreads have widened a touch over the year and are much wider than in 2004-2006, when there was hardly any differential between corporate and government bond yields.

Many companies have well-filled coffers and the growth outlook generally remains positive so default rates should stay within reasonable bounds. Nevertheless, it is still crucial to select issuers with care, by means of detailed analysis. Cautious investors will prefer investment grade bonds – i.e. those issued by companies with

excellent creditworthiness, indicated by a rating of AAA to BBB. The investment risks can be further reduced by a professionally thought-out allocation across different regions, sectors and maturities. Given these factors, an actively managed investment in funds can be the instrument of choice for practically any investor. ■

<sup>1</sup> Schroder ISF stands for Schroder International Selection Fund throughout the document.

<sup>2</sup> Source: Schroders. Performance based on the net asset value of unit class A, hedged in EUR, acc. Calculation net of annual management fee, but does not include initial fee or other charges, transaction costs or taxes, which would have a negative impact on the performance figure if included. Foreign currency investments are subject to currency fluctuations. Past performance is not a reliable indicator of future performance.

### About this newsletter

This edition of Expert may look familiar, but there is a lot about it that's new. To improve readability, we've made a few considered changes to the typography and page layout. We hope you will appreciate the brand new

**Schroders Expert forecast and portfolio** on page 4. The Markets pages will now contain regular economic forecasts and a sample asset allocation. Another new feature is the **Schroders Expert small talk**, where Schroders staff reveal a personal side to themselves. Enjoy reading Expert!

Editorial team

## Schroder ISF Global Corporate Bond

## Top-grade corporate bonds

**With almost 3,000 company contacts per year, 12 specialist portfolio managers and EUR 18 billion in assets under management, you'd be hard pushed in the global corporate bond market to find as successful a team as the Schroders fixed income team.**

Returning 17.5 percentage points more than government bonds, high-quality corporates had a bumper year in 2009. "We probably won't see such spectacular returns again this year", says Schroders bond specialist Jamie Stuttard, "but there are a raft of important factors, which should boost the

investment grade credit markets in 2010 and 2011". Companies in the US and elsewhere have latterly been using much of their excess

profits to strengthen their credit ratings and in many cases have massive cash reserves. Many have even reduced dividends to enhance their ratings. On the other side of the coin, risky takeovers and excessive debt have fallen from grace – banks have seen to that with their stricter guidelines and general reticence over lending. Should the economy plummet unexpectedly, corporate bonds are well-placed within a company's **capital structure** to benefit. As Stuttard says, "If you invest in equities, your holding may be diluted if there's a new issue. You'll be the first to lose money if things get serious and restructurings hit you the hardest too". In times of uncertainty, money invested in corporate bonds therefore enjoys much better protection than equity. Stuttard has been lead fund manager for Schroders ISF Global Corporate Bond since 2008 and is responsible for one of the largest and most

successful funds investing in global corporate bonds. He primarily invests in top-quality securities issued by high-grade companies around the world. This growing global market encompasses many regions, sectors and credit ratings, providing rich pickings for active managers. "Growth and diversification within markets can cause inefficiencies", says Stuttard, "and our well-staffed, experienced team can make money out of these". The Schroders team of bond experts, one of the strongest in the market, operates around the globe. It numbers more than 30 portfolio managers, 12 of whom specialise in corporate bonds, together with 20-plus credit analysts and 4 quantitative analysts. In terms of volume, the team manages fixed-

"Our well-staffed, experienced team can make money out of market inefficiencies."

income portfolios approaching EUR 35 billion and global corporate bonds to the tune of EUR 18 billion.<sup>1</sup>

#### Intensive contact with companies

Because it has a global presence, the Schroders team doesn't just conduct desk-bound analysis, but often meets issuers face-to-face. In 2009, its members' schedules included almost 3,000 company contacts, 217 of which were exclusive one-to-ones. When analysing companies, the team also works closely with in-house equity specialists, another source of valuable opinions. Last year, Schroders equity and bond experts took part in joint meetings on average every three days.

The fund's performance has been impressive. The Schroder ISF Global Corporate Bond has beaten its benchmark since inception and over three and five years, as well as making the first quartile for both three and five years on a peer comparison<sup>3</sup>. It is not surprising, therefore, that the Schroders bond team has regularly received



Fund manager **Jamie Stuttard** is Head of UK & European Fixed Income at Schroders. He joined Schroders in 2003, having previously managed investment grade corporate bonds at investment company PIMCO, which specialises in bonds. Prior to that he worked within the Dresdner Bank group as an analyst and portfolio manager. Jamie Stuttard is a history graduate from Cambridge University and has 12 years' investment experience.

#### The fund's strategy targets three sources of returns:

- 1. Macro credit strategy.** Global investment themes and credit quality are analysed in a traditional top-down process.
- 2. Global sector strategy.** Analysts develop sector rankings and form opinions on correlations between individual sectors.
- 3. Individual security strategy.** The core of Schroders' investment philosophy, this is based on intensive bottom-up analysis of individual issuers and their creditworthiness. "We believe that our credit analysis make a significant contribution to the fund's superior risk-adjusted performance", stresses Stuttard. "Most of all, they help us to avoid defaults". To enhance performance, unattractive bonds can also be sold short.

Schroder ISF Global Corporate Bond <sup>2</sup>		Reasons to invest	Investment risks
ISIN	LU0201324851 (unit class A, EUR hedged, acc.)	➔ The Schroder ISF Global Corporate Bond invests predominantly in selected global corporate bonds of good and very good quality.	➔ The Schroder ISF Global Corporate Bond invests primarily in corporate bonds, which carry higher default risks than safer government bonds.
Launch Date	20 September 1994	➔ The market for global corporate bonds is well-diversified in terms of region, sector and credit quality.	➔ The fund's performance essentially depends on the manager's ability to identify and acquire securities within the market which have attractive yields and low default risks.
Fund Managers	Jamie Stuttard	➔ Corporate bonds provide a higher yield than government bonds. Over the long term this can generate higher total returns.	➔ The fund does not offer any capital protection. The value of the units in the fund may at any time fall below the price that the investor paid for the units, resulting in losses.
Total Fund Size	USD 1,777.4 million	➔ The fund has a disciplined, active investment approach based on in-depth credit analysis.	➔ The fund may use financial derivatives as part of the investment process. This may increase the fund's price volatility by increasing the impact of market events.
Base Currency	USD	➔ The Schroders corporate bond team comprises a wealth of experts with a long track record and the support of in-house resources worldwide.	➔ If the distributing units have not earned the amount distributed, the difference is taken from capital. The distribution is not guaranteed; in some market situations the amount may be adjusted or the distribution suspended to protect the unit net asset value.
Number of Holdings	323	➔ There is a hedged unit class for euro investors.	
Benchmark	Barclays Capital Global Aggregate Credit Component EUR Hedged	➔ The fund's distributing unit class (A dis EUR hedged share class) aims to distribute 3% p.a. in quarterly instalments. <sup>4</sup>	
Maximum Initial Fee	Up to 5.00% of the total subscription amount (equivalent to 5.26315% of the net asset value per unit)		
Annual Management Fee	0.75%		
Minimum Investment Amount	EUR 1,000		

<sup>1</sup> Source: Schroders. Data as at 30 June 2010. Total fund size excluding emerging market bonds. <sup>2</sup> Source: Schroders. Data as at 31 July 2010. <sup>3</sup> Source: Schroders, Mercer. Data as at 31 July 2010. Performance based on the net asset value of unit class A, hedged in EUR, acc. Calculation net of annual management fee, but does not include initial fee, any other charges, transaction costs or taxes, which would have a negative impact on the performance figure if included. Past performance is not a reliable indicator of future performance. <sup>4</sup> The distributions are not guaranteed. In the event of the sub-fund's return being less than the intended distributions, the distributions will be made from capital of the share class.

industry awards for its quality. The Schroder ISF Global Corporate Bond currently enjoys a four-star rating from investment research firm Morningstar and AA from Standard & Poor's.<sup>5</sup>

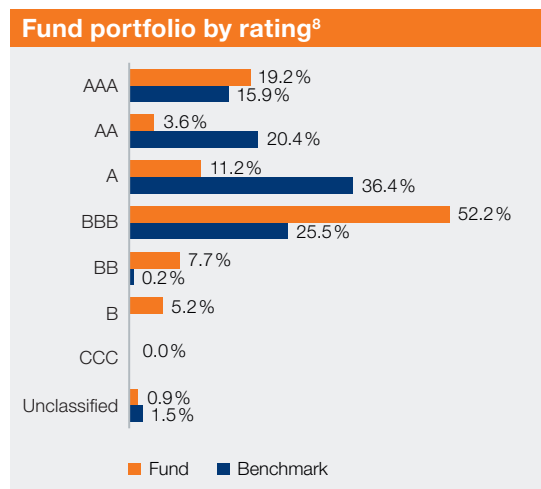
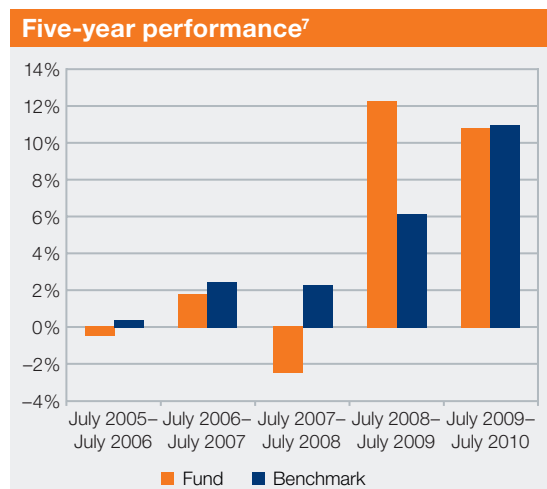
### BBB securities with upgrade potential

The fund portfolio primarily comprises high-grade corporate bonds. Up to 20% of the fund's assets can be invested in emerging markets and riskier **high-yield bonds** and another 20% in government bonds. The fund currently<sup>6</sup> invests 36.8% of its assets in the US and 19.4% in the UK; France, Germany and the Netherlands are the next largest positions. Of the issuers in the investment universe, 86.2% are investment grade, i.e. have a rating of AAA to BBB, which indicates good to very good creditworthiness. BBB-rated bonds, which offer potentially higher returns, account for 52.2%, a much higher weighting than in the benchmark. This is partly because if, as hoped, they are taken over by larger competitors, their credit ratings would instantly improve.

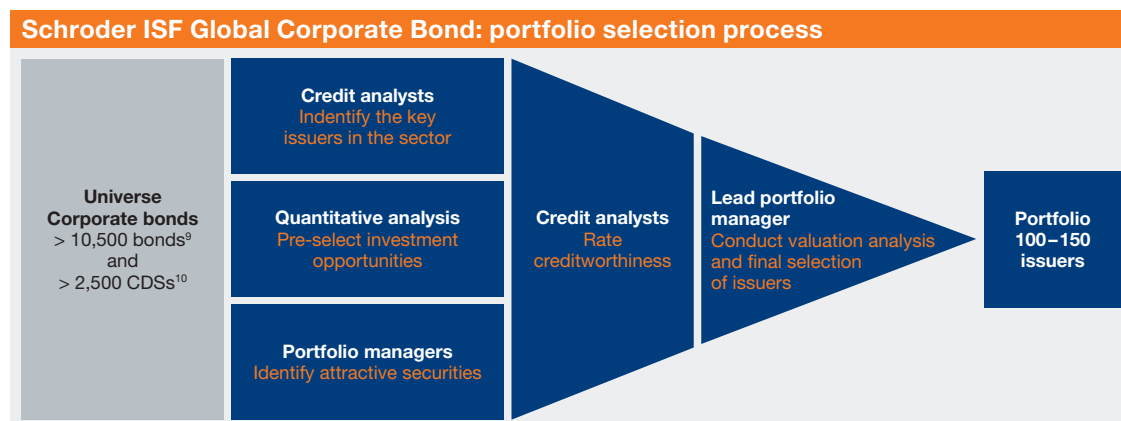
### Positive trend in 2010 as well

Jamie Stuttard is optimistic that the portfolio is well-primed for the market's current volatility. There are statistical reasons to back this up, he has observed a correlation between a corporate bond's risk premium at the start of the year and excess returns as the year progresses. "Bull markets in the credit sector start with high risk premiums; panic escalates and politicians start to support the economy", explains Stuttard. At the start of 2009, the risk premium over government bonds was an unprecedented 500 basis points, so income followed suit and rose to record levels. At the start of 2010, the risk premium was still a sizeable 170 basis points, well above the threshold at which excess returns can be expected. Stuttard's prediction is therefore as follows: "Corporate bonds should outperform government bonds once again in 2010, generating superior returns compared with the average for the previous 12 years." Having gained 5.0%<sup>3</sup> in the first seven months of the year, the Schroder ISF Global Corporate Bond is well on the way to this target. ■

## Impressive performance



## Wanted: the best from more than 13,000 securities



November 2010

**Schroders**

**Schroder Global Corporate Bond Fund**  
**Fund Update**

The latest newsletter for the

**Schroder ISF\* Global Corporate Bond Fund**

is now available.

Included in this month's edition...

- The potential for quantitative easing was the main focus for bond markets in October, with investors continuing to speculate about a second Fed attempt. As a result, the dollar continued to weaken and core government yields continued to edge lower.
- There was an evident change mid-month, however, courtesy of a surprise increase in US retail sales and a speech by Fed chairman Ben Bernanke, which left markets lacking clarity on the likely magnitude, method and timing of 'QE2'.
- Yields subsequently started to back up as investors questioned the potential for disappointment, and spotted an excuse to take profits on the increasingly crowded treasury trade.

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

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newsletter distribution by emailing us at:  
**dorthe.kjaerulf@schroders.com**

**Schroders Expertikon**

The **capital structure** shows the split within a company's capital between equity and external debt. It is shown on the liabilities side of a balance sheet. When a company is liquidated, creditors are paid out before equity investors.

**High-yield bonds** (also called junk bonds) are all bonds below investment grade, i.e. with a rating of BB or worse.

<sup>3</sup> Source: Schroders, Mercer. Data as at 31 July 2010. Performance based on the net asset value of unit class A, hedged in EUR, acc. Calculation net of annual management fee, but does not include initial fee, any other charges, transaction costs or taxes, which would have a negative impact on the performance figure if included. Past performance is not a reliable indicator of future performance. <sup>5</sup> Source: Morningstar, Standard & Poor's. Data as at 31 July 2010. Morningstar rating based on unit class A, USD, acc. <sup>6</sup> Source for all information about portfolio structure: Schroders. Data as at 31 July 2010. <sup>7</sup> Source: Schroders. Data as at 31 July 2010. Performance based on the net asset value of unit class A, hedged in EUR, acc. Calculation net of annual management fee, but does not include initial fee, any other charges, transaction costs or taxes, which would have a negative impact on the performance figure if included. Past performance is not a reliable indicator of future performance. <sup>8</sup> Source: Schroders. Data as at 30 July 2010. <sup>9</sup> Source: Merrill Lynch, Bloomberg. Data as at 31 December 2009. The corporate bond universe is defined as the Merrill Lynch Global Broad Market Corporate Index (GOBC) and the Merrill Lynch Global High Yield Index (HW00). <sup>10</sup> Source: Markit. Data as at 31 December 2009; CDSs = credit default swaps.

# Europe revs up – but for how long?

Europe is experiencing a surprising growth spurt: Germany and other states have outstripped expectations by a clear margin, mainly thanks to exports. But if these slow down, German consumers would then play a key role.

Is there a debt crisis in the Mediterranean or not? Europe's real economy has performed extraordinarily well in recent months. The German economy has led the way, posting its strongest quarterly growth since reunification at 2.2%; but even Spain, despite its austerity measures and 20% unemployment, turned in decent growth figures. Never has Germany's role as political and economic flagship been more important than now. But what happens if global growth tails off – will Europe's economies fall like dominos? Provisional figures show that external demand played a key role in the second-quarter upturn. Export-oriented economies like Germany, the Netherlands and Austria – but also the UK – have performed far better than countries like Portugal, Spain and Greece. The second half of the year is generally expected to bring slightly softer growth, but the really critical question is how Europe's economy would react if growth elsewhere in the world, particularly the US and China, were to weaken. Europe's purchasing managers indices – key forward-looking indicators – have proved robust to date. Companies and consumers have been feeling much more positive since summer 2009, although there are distinct differences. Industry and retail were more confident in July 2010 than the long-term average, while

service providers, construction and consumers were less so. Although consumers are cautious, the retail sector is still expecting good trading. The euro shed around 13% of its value in the ten months to the end of August 2010 **in trade-weighted terms**, making eurozone goods cheaper elsewhere, which is good news for exporters. Around 41% of exports of eurozone countries, which actually leave the eurozone end up in the US and China. If the economies of these two nations slow, the benefits of the euro's relative weakness will be lost.

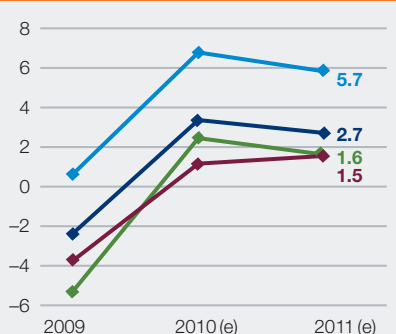
## Germany, the sleeping giant

German purchasing managers are expecting foreign orders to fall, but domestic orders for industrial goods to grow. This is an encouraging sign. Germany has become something of a sleeping giant and if its consumers and companies really are prepared to spend money, this will have a positive impact on the whole of the European Union. Germany's unexpectedly strong growth should boost employment, reduce the number of part-time workers and thereby raise confidence amongst German consumers. It doesn't pay to invest in safe cash deposits because real interest rates are currently negative. Private households have saved plentiful amounts of money – so there is a chance

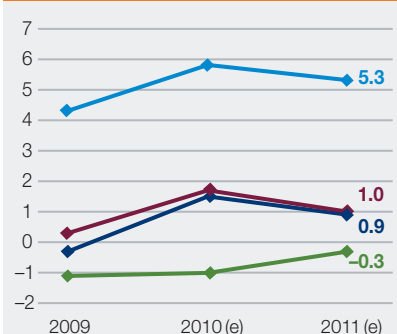
that German consumers will spend more and contribute to both European and global growth. This apart, Europe's economy still has a number of hurdles to overcome. The US economy is causing fresh concerns, more so than southern Europe's debt. With Greece set to pass its lenders' first quarterly test of its reforms, the European Commission is likely to release the second tranche of its rescue package in September. The stress tests European banks underwent have helped to dissipate fears that the big banks are over-indebted – not because of the tests themselves, which are generally thought to have been too easy, but because the banks had to provide detailed information about their bond portfolios in the process. The banking system remains vulnerable and further restructuring is required. By next year at the latest, when governments have to refinance expiring loans, the sovereign debt of southern European countries will be back on the radar. The ailing countries are currently balancing their budgets; this process is likely to accelerate in 2011 as they follow the example set by Germany. For these reasons, the European Central Bank will probably keep its key rate low for at least another 12 months. ■

## Schroders Expertforecast and portfolio

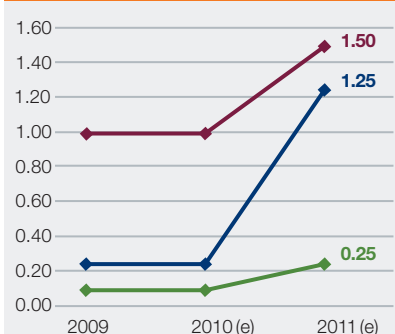
### GDP growth in %



### Inflation in %



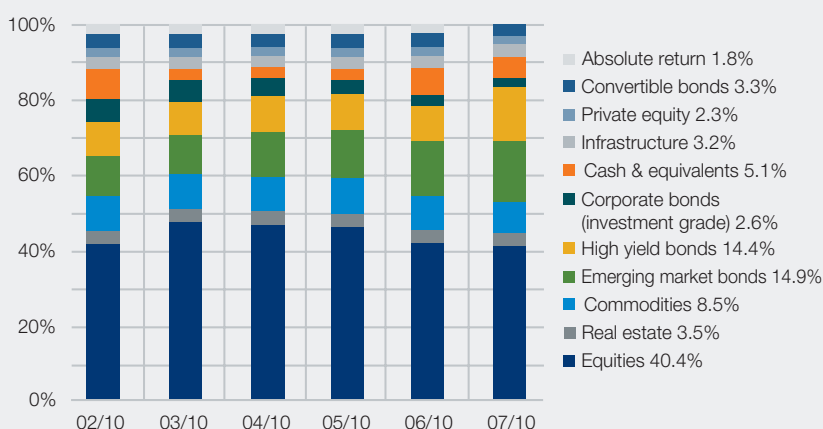
### Key rates in %



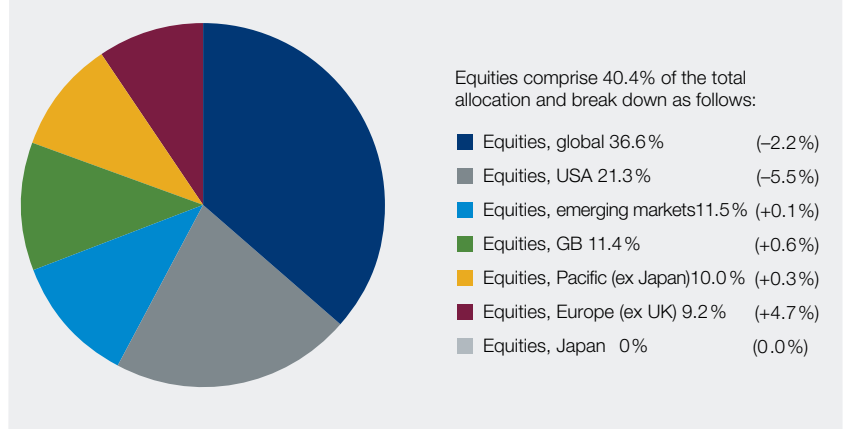
### Currencies/oil price

	Current	12/2010 (e)	12/2011 (e)
USD/EUR	1.27	1.20	1.18
USD/GBP	1.55	1.40	1.45
JPY/USD	85.1	95.0	97.5
GBP/EUR	0.82	0.86	0.81
Oil (Brent crude) in USD	73.0	78.1	79.5

### Weighting of asset classes since February 2010



### Equity allocation (current)



Source: Schroders, Datastream, IMF. Data for GDP, inflation and key figures as at 30 June 2010. Data for key rates as at 20 August 2010. Key figures for 2010 (e) and 2011 (e) are estimated figures for the year-end. Emerging markets comprise Argentina, Brazil, Bulgaria, Chile, China, Colombia, Croatia, the Czech Republic, Estonia, Hungary, India, Indonesia, Latvia, Lithuania, Malaysia, Mexico, Peru, the Philippines, Poland, Romania, Russia, Slovakia, South Africa, South Korea, Taiwan, Thailand, Turkey, Ukraine and Venezuela. Asset allocation (total and equities) refers to the Strategic Solutions – Schroder Global Diversified Growth Fund. Data as at 31 July 2010.

# New heir to the throne in the Far East

China finally supplanted Japan as the world's second-largest economy this June. Nathan Gibbs, a Schroders expert in Japanese equities, thinks this may be no bad thing.

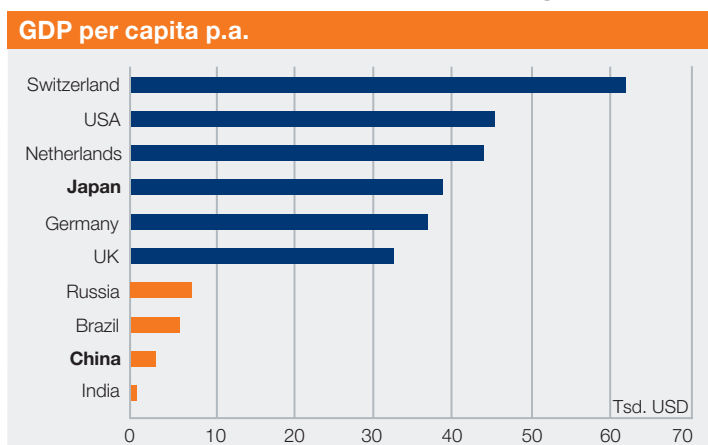
China overtook Japan when its second-quarter economic output came in at USD 1,337 billion, compared with USD 1,288 billion for Japan. This was not in fact the first time that China had surpassed Japan, but 2010 looks set to be the first full calendar year in which it has been the world's second-biggest economy. Chinese gross domestic product (GDP) grew at an annualised 10.3% in the second quarter. If the country were to maintain this pace, it would probably overtake the US at some point in the mid-2020s to become the biggest economy on Earth. Even though the Chinese giant has become the world's foremost power in production and export, wealth is still very unevenly distributed within China and its economy remains extremely inefficient by international standards. If we consider its population of 1.3 billion – almost exactly ten times the size of Japan's – then China's economy ought to be much larger still. China's per-capita GDP is still only USD 3,600, which is less than one-tenth of the Japanese figure of USD 40,000. Even if China were able to maintain its current growth for the next 25 years, which is highly improbable, its per-capita GDP would still only just draw level with Japan's. Although the Chinese economy is growing dynamically at a low level, its structure remains highly inefficient in many respects. Japan has the opposite problem: a very efficient economy, but one lacking any dynamism because markets are saturated. That is in evidence once again in 2010. A weak economy, sluggish domestic and foreign demand and a strong yen stifled the earnings of Japanese exporters and led to disappointing second-quarter GDP. The Nikkei 225 has fallen by roughly 13% year-to-date.

## An important trading partner

If there are grounds for optimism in Japan, then that is linked not least to the strong growth in the emerging countries of Asia. The rise of China in particular represents a huge opportunity for Japan and for Asia as a whole. China is already Japan's biggest trading partner, in terms of imports and exports and also of investment. As growth in China is shifting away from capital investment and towards consumer spending, Japanese and other Asian companies will be able to benefit increasingly from their trade contacts with China. ■

Nathan Gibbs,  
Fund manager for Japanese equities

## China has plenty of scope for growth



Source: IMF. Data as at 2009



Number two – but for how long? It is only a matter of time before China becomes the largest economy in the world. Pictured: Shanghai.

### Ticker

#### Equities

➤ **USA** Strong cash balances at US companies remain a positive catalyst for the markets, particularly through the medium of share buybacks and takeovers.  
**Schroder ISF US All Cap**

↘ **Europe** The UK is relatively attractive, as the new government's tough budgetary measures will come at the cost of short-term growth but deliver greater stability.  
**Schroder ISF UK Equity**

➔ **Japan** Earnings prospects for Japanese companies are relatively good; yen depreciation would support equities.  
**Schroder ISF Japanese Equity Alpha**

➔ **Pacific (ex Japan)** Hong Kong and Australia in particular are reacting sensitively to China's monetary tightening because of their close trade ties with the country.  
**Schroder ISF Asian Total Return**

➔ **Emerging markets** Investor sentiment towards emerging markets is cautious; positions may be rebuilt as soon as sentiment brightens.  
**Schroder ISF Global Emerging Market Opportunities**

#### Fixed income

➔ **Government** Yield curves are set to remain steep, as central banks will probably not be hiking their short-term interest rates for the time being.  
**Schroder ISF Global Bond**

➤ **Corporate** Given that yields on government bonds remain doggedly low, corporate bonds continue to represent a better-yielding alternative.  
**Schroder ISF Global Corporate Bond**

⬆ **High yield** The general recovery in corporate earnings is having a positive impact on the bond market.  
**Schroder ISF Global High Yield**

➔ **Index-linked** Core inflation is likely to remain low in the US and Europe in particular, owing to a significant production gap.  
**Schroder ISF Global Inflation Linked Bond**

#### Alternative investments

➔ **Real estate** Valuations are low by historical standards and fair relative to other asset classes; growth prospects are limited.  
**Schroder ISF Global Property Securities**

➔ **Commodities** There are good long-term structural arguments in favour of investing in agricultural commodities, namely population growth, climate change, increased meat consumption and greater competition for land to produce crops for biofuel.

#### Expected performance:

Positive Neutral Negative  
 ⬆ ⬇ ⬆ ⬇ ⬆

### Schroders Expertikon

A currency's **trade-weighted** (effective) exchange rate is calculated using the exchange rates of its most important trading partners, weighted according to their share of external trade. The European Central Bank calculates the euro's trade-weighted exchange rate on a daily basis.

# The debate: What chance is there for the euro?

## Political will is what matters

The EU's rescue package to stabilise the euro has worked, says Dr Ulrich Stephan, Global Chief Investment Officer for Private and Business Clients at Deutsche Bank.



**Dr Ulrich Stephan** is Global Chief Investment Officer for Private and Business Clients at Deutsche Bank, with responsibility for market analysis and investment strategy.

When the European Union (EU) and International Monetary Fund (IMF) announced their EUR 750 billion second rescue package in the early hours of 10 May, it was initially unclear whether this massive programme would succeed in stabilising the markets. Critics feared that after a brief respite, Greece and other southern European countries would continue their decline and force even more money to be committed. From today's standpoint, however, the package of measures has fulfilled its objective: the market demanded a "big solution", and it got one. There are now signs that normalisation is underway. Over the summer, the crisis-hit countries were able to raise billions of fresh capital

on the capital markets without difficulty. The purchases of Greek government bonds by the European Central Bank (ECB), which initially attracted heavy criticism from some quarters, have now been scaled back to just tens of millions per week. Not least, the euro has stabilised considerably; Deutsche Bank sees a US dollar exchange rate of EUR 1.35 on a 12-month horizon.

## Change of mentality in southern Europe

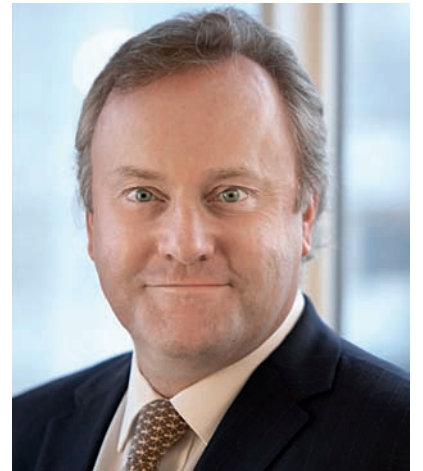
The EU, the IMF and the ECB have signalled through their coordinated actions that they take the performance of European government bonds seriously. The governments of the countries in question, above all Greece and Spain, have for their part begun to seriously implement the EU's plans and consolidate their public finances. There has been little damage to the popularity of prime ministers George Papandreou and José Luis Rodríguez Zapatero, who have had to push through big budget cuts. That suggests that a change of mentality has taken place among the people of southern Europe.

The task at hand now is to keep driving consolidation forward, not just in Mediterranean countries, but also in northern Europe. The public debt ratio in the eurozone is set to rise to around 85% in 2010, significantly in excess of the Maastricht limit of 60%. That is not sustainable. It is imperative that the debt burden be reduced fast; bringing in national budget rules along the lines of the German "debt brake" could help achieve this.

Following the nightmare scenarios of the spring, a positive outlook for the eurozone is quite justified. The euro has even surpassed the Deutschmark in terms of stability since its launch, and that is not about to change. The capital markets will reward the successful overhaul of budgets with lower refinancing costs. Lower interest rates in turn mean greater incentives for the private sector to kickstart investments and bolster growth. The eurozone is about to expand: Estonia, which has one of the soundest budgetary policies in Europe, will become the latest country to adopt the single currency in 2011. The crux of the matter is that the euro was always a political project. If the political decision-makers continue to have the will and the resolve to drive through reforms, then the single currency has a good future.

## Germany could be the euro's downfall

The collapse of the eurozone remains a possible scenario despite the rescue package, argues Alan Brown, Group Chief Investment Officer at Schroders.



**Alan Brown** is Group Chief Investment Officer and a Director at Schroders

Watching events in the eurozone unfold is rather like watching a train derail in slow motion. It all appears depressingly inevitable, predestined by simple mathematics and by Germans' enduring desire to save and their lack of appetite to stimulate their own economy. The PIIGS states (Portugal, Italy, Ireland, Greece and Spain) have lost a lot of their competitiveness over the last decade. Their real effective interest rates and unit labour costs have decreased by about 30% relative to Germany. A similar scenario emerged in Germany after reunification.

In order to become more competitive, Germans endured years of weak growth, 10% unemployment and stagnant wages. The desire now is to prescribe the same medicine to southern Europe, thereby condemning the entire eurozone to lower growth. Greece in particular has a Herculean task on its hands. If it meets all conditions, its sovereign debt will rise to around 150% of gross domestic product (GDP). Its debts are likely to keep growing, and its GDP to fall as the country suffers another cycle of recession and deflation. It would not be surprising, therefore, if Greece were to find restructuring (i.e. payment default) and withdrawal from the euro a more attractive course of action. After all, that would be nothing new: since Greece entered the modern age with its independence in 1829, it has declared bankruptcy on 12 occasions and been insolvent more than half the time.

## A new Deutschmark would be popular

It is often argued that so much political capital has been invested in the euro that its failure would be unthinkable. It is argued too that the exit of a weak member state would ruin that country overnight, as the bulk of its liabilities would be in euro, while its assets would suddenly be denominated in a devalued "new currency". That analysis neglects two possibilities, however. Firstly, everything is up for negotiation if a country leaves the euro, as happens if any state defaults. Secondly, it might actually be the countries with strong currencies that leave the euro, leaving the

PIIGS group in the single currency. That would not cause any damage in itself, as the situation in southern Europe would be unchanged, while the "refugees from the euro" would benefit from revalued "new currencies". And what could be more popular than the return of the Deutschmark? Exchange rates between the PIIGS currency and the Deutschmark bloc would then move very dynamically, which would probably reduce the current chronic imbalances and spell a faster return to growth. Would that hurt German exports? Yes, but ultimately Germany needs to generate more growth from domestic demand for Europe to get back on a sound footing. So will all this come to pass? Certainly not for the moment, but in the medium term it is a perfectly feasible scenario. The curtain has not fallen yet, and we await the next act! ■



## Notices

➔ **Schroder ISF Asian Bond Absolute Return** is the new name for the former Schroder ISF Asian Bond. The addition of “Absolute Return” makes the fund’s objective clear from the very outset. Its investment objective and strategy remain unchanged.

➔ **Schroder ISF Middle East** (class A, EUR, acc., ISIN: LU0316459139): The benchmark index is changing with effect from 1 October 2010 to the “Customised MSCI/S&P Middle East Index (MSCI Arabian Markets + MSCI Turkey + S&P Saudi Arabia Large/Mid Cap [fixed at 20%])”. Its investment objective and strategy are unaffected.

➔ **Distribution arrangements changed:** For many unit classes of its funds, Schroders strives to achieve an annual distribution yield of a set figure at set times. If a unit class has not earned the amount distributed, the difference is taken from the net asset value of the unit class. The size of distributions is not guaranteed. These changes help to establish a regular income element for fund investments. The Schroder ISF Emerging Markets Debt Absolute Return A, EUR hedged, dist. already offers this, with a target dividend yield of 7% p.a. The individual unit classes are as follows:

- **Schroder ISF Asian Equity Yield, A and A1, USD, dist.**  
*Previously:* unspecified amount, quarterly  
*In future:* intent to pay quarterly dividends, with yield totalling 4% p.a.
- **Schroder ISF Global Corporate Bond, A, EUR, dist.**  
*Previously:* unspecified amount, annually  
*In future:* intent to pay quarterly dividends, with yield totalling 3% p.a.
- **Schroder ISF US Dollar Bond**  
*Previously:* unspecified amount, quarterly  
*In future:* intent to pay quarterly dividends, with yield totalling 4% p.a.
- **Schroder ISF EURO Corporate Bond, A, A1 and B, EUR, dist.**  
*Previously:* unspecified amount semi-annually (A and B dist.)/monthly (A1 dist.)  
*In future:* intent to pay semi-annual dividends, with yield totalling 3% p.a.

The frequency of distributions by the Schroder ISF EURO Bond is also changing from annual to semi-annual.

➔ **Product development: Frontier Markets:** It used to be exotic to invest a portion of ones assets in Emerging Markets but over the past few years many have realised that the economies in those countries in different aspects are stronger than in the Western world. The new Emerging Markets are called Frontier Markets and at Schroders we are planning to launch a fund focussing on investing in these countries.

In other words: today’s Frontier Markets are tomorrow’s Global Emerging Markets (GEMs). Therefore early involvement will give investors a chance of benefitting of the rapid growth we expect in the area. The Middle East currently accounts for 63% of the MSCI Frontiers Index and we have already established a strong competitive track record managing assets in this region with a team based in Dubai specialising in these markets (running the Schroder ISF Middle East). Many of the other markets are also followed by Schroders as part of our off-benchmark coverage for our existing products.

The Schroder ISF Frontier Markets fund is already included in the current prospectus but in some countries it will only be registered for marketing once it has been launched. Please contact our offices for further information on the fund and the registration status.

### Award winner

#### Schroder ISF EURO Corporate Bond

##### The investment story

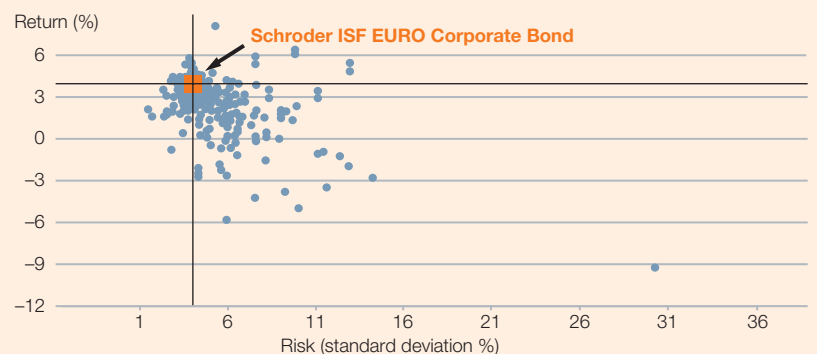
Morningstar / Standard & Poor’s Rating<sup>1</sup>  
 ★ ★ ★ ★ / AA

For the foreseeable future, investing in secure government bonds offers little prospect of anything more than capital preservation. Corporate bonds represent an attractive alternative for investors seeking to better diversify their portfolio and secure extra return opportunities. The European corporate bond market has grown enormously in recent years, covering all manner of sectors, companies and credit ratings. Numerous companies outside Europe also issue bonds in euro. Mispricings can arise in this fast-growing, broadly diversified market, and an experienced investment team can exploit these.

##### The fund

The Schroder ISF EURO Corporate Bond invests predominantly in high-quality bonds issued by European investment-grade companies. It also includes euro-denominated bonds from other regions. The fund is managed actively and very flexibly. As it focuses on issuers with solid finances, the fund has a low to medium risk profile. It is an “all-weather” fund designed to achieve attractive returns at all stages of the market cycle. The fund is ideal for investors that want regular income for limited risk and are not content with the yields on safer government debt. Fund manager **Adam Cordery** is Schroders’ Head of European and UK Credit Strategies and has run the Schroder ISF EURO Corporate Bond since 2006.

##### Risk/return profile over five years<sup>2</sup>



##### Investment risks

- The Schroder ISF EURO Corporate Bond invests primarily in corporate bonds, which carry higher default risks than safer government bonds.
- Up to 20% of the fund assets can be invested in high yield, emerging market and convertible bonds.
- The fund’s performance essentially depends on the manager’s ability to identify and acquire securities within the market which have attractive yields and low default risks.
- The fund does not offer any capital protection. The value of the units in the fund may at any time fall below the price that the investor paid for the shares, resulting in losses.

<sup>1</sup> Source: Morningstar, Standard & Poor’s. Data as at 31 July 2010

<sup>2</sup> Source: Morningstar Direct. Data as at 31 July 2010. Return and risk based on class C units, EUR, acc., compared to 70 funds/unit classes in the Morningstar peer group (Fixed Income EUR Corporate). Calculation net of annual management fee, but does not include initial fee, any other charges, transaction costs or taxes, which would have a negative impact on the performance figure if included. Past performance is not a reliable indicator of future performance.

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## Schroders plc Interim management statement

Schroders plc the 9th November 2010 issued its interim management statement covering the nine months to 30 September 2010. Consistent progress continues. These are our best ever results for the first nine months with fantastic net inflows and funds under management up over 30% on a year ago. The key figures are:

- **Profit before tax £282.7 million (2009: £79.9 million\*)**
- **Net inflows £21.5 billion (2009: £8.7 billion)**
- **Total funds under management £181.5 billion (30 September 2009: £138.9 billion)**

The £21.5bn net inflows is roughly split with 2/3 from Institutional and 1/3 from Intermediary and Private Banking business, and reflects competitive 3 year investment performance with 76% of all funds outperforming to end September 2010. All regions saw positive net inflows, and more than 90% arose from outside of the UK.

We do not provide forecasts; however, the pipeline of new business remains good and well diversified, by region and product, including LDI, fixed income and alternatives.

For further information on Schroders results please refer to our website [www.schroders.com](http://www.schroders.com) under "Investor Relations". ■

Funds under Management	Total £bn	Funds under Management	Total £bn
<b>30 June 2010</b>	<b>164.0</b>	<b>31 December 2009</b>	<b>148.4</b>
Net flows	5.4	Net flows	21.5
Investment returns	12.1	Investment returns	11.6
<b>30 September 2010</b>	<b>181.5</b>	<b>30 September 2010</b>	<b>181.5</b>

Revenue	Total YTD 30/9 2010 £m	Hereof Asset Management £m	Total YTD 30/9 2009 £m
<b>Net revenue</b>	<b>819.2</b>	<b>709.5</b>	<b>498.9</b>
Operating expenses	(555.6)	(456.2)	(441.4)
<b>Operating profit</b>	<b>263.6</b>	<b>253.3</b>	<b>57.5</b>
Net finance income	6.4	2.7	9.7
Share of profit of associates and joint ventures	12.7	7.2	12.7
<b>Profit before tax</b>	<b>282.7</b>	<b>263.2</b>	<b>79.9</b>

### Schroders chronicle

## George Mallinckrodt at 80



**George Mallinckrodt**  
KBE, President of Schroders.

George W. Mallinckrodt celebrated his 80th birthday on 19 August 2010. He is one of the leading German bankers in the Square Mile and has enriched the traditional banking business with vision and modern strategies. Mallinckrodt joined Schroders in 1954, learning his trade in Hamburg, London and New York. During his career, he was tasked with developing Schroders' business in continental Europe and the US. After joining the board of the parent company in 1977, he was appointed executive chairman of Schroders plc in 1984 and has been president of Schroders since 1995. His decisions have consistently

been geared around the long-term success and stability of Schroders, especially the difficult choice to concentrate on asset management and sell off the investment banking operation – which had been a core business area for Schroders – in 2000. Mallinckrodt was able to avert the possibility of Schroders, like other City institutions, being swallowed up by a major banking conglomerate, successfully safeguarding its independence. In 1997 he was made an honorary Knight Commander of the Most Excellent Order of the British Empire (KBE) by Queen Elizabeth II in recognition of outstanding services rendered over many years to banking and finance and to society, of his strengthening of inter-cultural relations, and of the preservation and networking of valuable library holdings. ■

### Schroders Expertsmall talk

... just between ourselves, Mr Jelgren



**Lars K. Jelgren** is responsible for the Intermediary business in the Nordic region.

#### Have you set up savings plans for your children? If so, where do you invest?

Since my daughter and son were born, I have had a monthly savings plan for both of them. The money is partly in cash deposits and partly in mutual funds. Recently we have bought a flat they can live in while completing their studies.

#### Are you yourself more of a dynamic or a cautious investor?

I do the same for myself as for my children – I combine conservative and dynamic investments. Part of the money is invested long-term in emerging regions, while another part is a broadly diversified asset management product. In addition I have a fair amount invested in commodities.

#### How do you like to relax?

Spending weekends and holidays with my family, and whenever possible playing on the "all boys" team of a local football club I have started 6-7 years ago with some friends of mine. Our age span from 16 to 62 years, and I still pretend to be in the younger part of that range!

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