

# Schroder US Corporate Bond Product Overview

## Strategy overview

The Schroder US Corporate Bond strategy is an actively managed strategy, focusing on individual security selection and industry weightings based on our analysts' fundamental work and our own internal quantitative tools and valuation screens. All potential candidates for inclusion in the portfolio are evaluated on a relative value basis. We do not have favorite sectors or industries; rather we seek to find those securities which offer the most attractive trade-off between risk and reward.

## Firm highlights

- Schroders manages over \$158 billion in assets worldwide
- A wide range of fixed income strategy offerings are available across all major markets
- Schroders has over 50 years of bond expertise and manages USD \$28 billion globally across fixed income products in Europe, US, Japan, Asia and emerging markets

## Team highlights

- Managed by an investment team of portfolio managers and research analysts with each member contributing specialist expertise allowing for focused coverage of all sectors
- Schroders focus on credit research leverages a global team of 24 credit analysts and 4 quantitative analysts with the result that approximately 85% of research is generated in house

## Key features

- Research-driven process using a relative-value approach to decision making
- Fundamental credit opinion, backed by state of the art quantitative tools
- Risk budget varies based on expected returns, volatility and confidence
- Opportunistic, nimble approach in changing market conditions

## Investment objective

Schroders US Corporate Bond strategy aims for a gross outperformance of 75 basis points per annum versus the Barclays Capital Global Corporate – Credit USD Bond Index over a full investment cycle (3-5 years).

## Investment philosophy

Schroders is an active fixed income manager, seeking return primarily through sector rotation and security selection. We are research-driven bond investors who believe:

- Risk control is paramount
- Bond markets are global, interrelated and generally efficient, but overreact to events
- Evaluating bonds from the point of view of a lender makes us better investors
- A performance advantage can be gained through in-depth local market research, conducted by a globally integrated team of specialist analysts and portfolio managers

In-depth, fundamental research that helps us identify investment opportunities combined with disciplined risk control is essential in generating consistent successful performance. Further, we believe a robust risk management framework is essential to efficiently integrate a diversified set of investment decisions into a portfolio.

All data and statistic as of December 31, 2008

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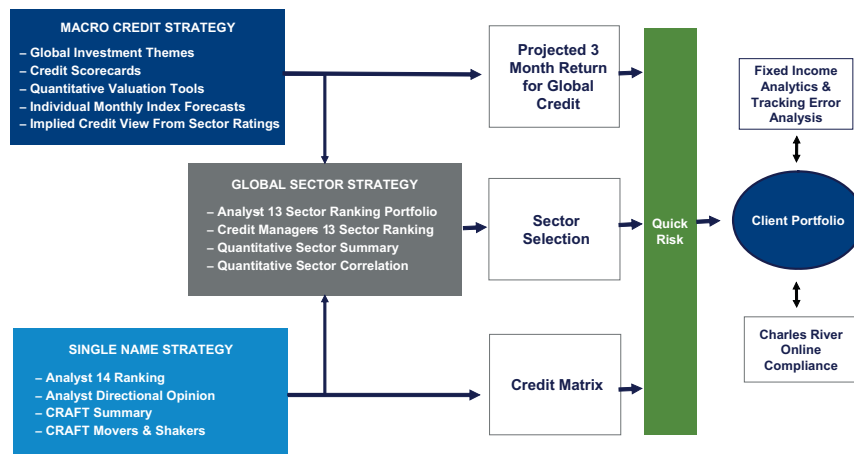
# Schroders

## Investment process – overview

The US Corporate Bond process emphasizes active management using internally generated research and a rigorous risk management process. Our overall investment process in corporate credit can be broadly split into three sub processes:

- Macro Credit Strategy: Top-down
- Corporate Sector Strategy: Mid-level
- Single Name Strategy: Bottom-up

These stages combine our strengths in both fundamental and quantitative research. Employing three distinct steps in the overall credit process helps ensure independent sources of alpha generation in credit portfolios. There is active debate and discussion among various team members on each of these strategy steps. Provided below is a summary of each of these three areas of our investment process.



Source: Schroders

## Credit Research

Credit research is core to our investment philosophy and we believe constitutes a major contributor to our ability to deliver superior risk-adjusted performance.

Credit research is the responsibility of Schroders Global Credit Research Team. The team, headed up by Jack Davis, with 36 years of experience in credit analysis, consists of 24 dedicated analysts organized regionally and by sector on a global basis. Analysts are based in London, New York, Singapore, Hong Kong, Sydney and Tokyo. Research responsibilities are based on geographic location of the issuer. In addition, within each regional team there is also an industry specialization. The Global Credit Team covers the full spectrum of bonds both investment grade and below investment grade (High Yield) covering over 1,400 bond issuers.

Fundamental to our belief in the importance of credit research is the level of dedication within the team. As dedicated analysts, they have no portfolio management or trading responsibilities. Our credit research process is structured such that the quality of research and recommendations is recorded and monitored, feeding directly into the annual appraisal and remuneration process.

Schroders processes for evaluating corporate and securitized bonds relies entirely on internally generated, fundamental credit research. Internal ratings are produced for corporate issuers.

## Corporate bond selection process, research and ratings

The Global Credit Team, defines the issuer universe within which portfolio managers construct portfolios. Schroders credit analysts have excellent corporate contact with senior management due to our exceptional franchise and close co-operation with Schroders' network of 90 equity analysts covering the stocks of more than 3,000 companies.






Every covered issue is thoroughly analyzed using a common and robust process. This process includes a detailed due-diligence examination of each issuer and detailed financial modeling to assess credit worthiness. Above all, analysts adopt a 'risk averse mentality',

## Corporate bond selection process, research and ratings (continued)

with particular focus on a company's current and future ability to service debt from cash flows. Issues are then rated and an investment recommendation is made to portfolio managers. This rating process for all corporates involves three key elements.

The table below provides an overview of the unique process we use to rank credits according to various aspects or views of the issuer.

### Representation of the scoring process

View	Scale	Description
Credit Quality Direction	Improving Moderately Improving Stable Moderately Declining Declining	<ul style="list-style-type: none"> <li>– Fundamental view on direction of credit quality</li> <li>– 6 to 12 month outlook</li> <li>– Not a measure of absolute quality</li> <li>– All credits force ranked within sector: strongest to weakest</li> </ul>
Ranking of Issuers Within Sectors	1. Strongest 2.  3.  4. Weakest 4D Toxic	<ul style="list-style-type: none"> <li>– Measure of relative strength of Schroders' view vs. the market's – in both magnitude and direction</li> <li>– Cannot add issuers ranked "4"</li> <li>– All 4D issues must be sold or protection bought</li> </ul>
Issuer Concentration Limit	A. Highest Limit B.  C.  D.  E. Lowest Limit	<ul style="list-style-type: none"> <li>– Concentration limits based on credit migration with adjustment for analyst rankings</li> <li>– Risk management step applies to total portfolio</li> </ul>

Source: Schroders

### Credit Quality Opinion & Industry View

A "Credit Quality Opinion" is an absolute view of the issuer's credit quality over the next 6-15 months on a five-point scale from 'improving' to 'declining,' based on a two part assessment: business profile and financial profile. The inputs into each part are: for smaller firms or those with BBB grade debt, the analysts focus on the financial profile. For large, stable and highly rated companies, more value is added by taking a qualitative approach; looking at industry and market trends, strategy and quality of management. For both business and financial profiles, each factor is weighted according to the credit analyst's view of its respective importance and relative risk. An "Industry View" is determined by the fundamental outlook for each issuer in that industry and by examining and discussing with the team the dynamics affecting the industry as a whole. Industry recommendations are rated as positive, neutral or negative.

### Recommendation

The second key step is the credit 'Recommendation'. This is a relative value recommendation, where a linkage is made between the credit opinion and what is forecast to happen to the issue in the market.

Each issue covered is ranked against the sector benchmark on the basis of expected relative industry performance. Recommendations are provided on a scale of 1 to 4, where 1 is the most positive investment recommendation. Portfolio managers should expect to see a distribution of bonds across the rankings. Because the ranking is relative, it is used in conjunction with the Industry View to enable a comparison to the overall market.

Four ranking levels are deliberately used to force analysts to form a view: the lack of a neutral position create a more noticeable flag when recommendations change.

### Concentration Limits

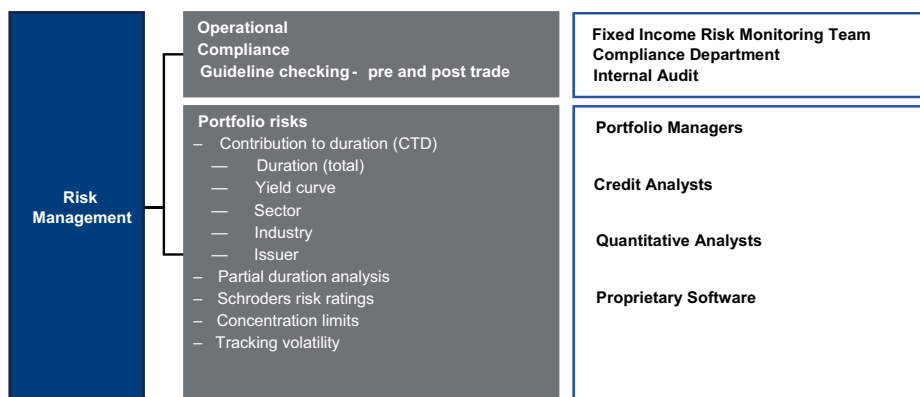
As a final component each security is assigned a volatility-adjusted risk ranking which determines the associated Concentration Limit. These risk rankings are guided by the quotes of rating agencies, but allow for discretion when analysts have strong negative views or when rising volatility for given issuers in advance of actual rating agency downgrades justifies a smaller cap on the exposures we allow in such issuers. Ratings are scaled and linked to benchmark and/or guideline limits and portfolio managers must not exceed the maximum relative weighting for each issuer.

## Risk controls

Inherent within the process is a total risk management mentality in which risk levels are continuously monitored. Across each step of the process there is a structured approach to risk management and monitoring which utilizes a combination of formal and informal rules and guidelines and uses proprietary quantitative models as well as externally supplied software tools.

At a total portfolio level, the team seeks to reduce risk through the diversification of noncorrelated investments. For individual issues, position size is determined by an assessment of risk and reward across different strategies, and is rigorously controlled based on the issuer's risk profile. All positions are measured in both percentage and contribution-to-duration (CTD) terms.

The use of structured risk controls is critical in limiting the volatility of returns versus the benchmark while achieving the portfolio performance target. Our process tracks individual exposures and positions, as well as comparing positions against their benchmarks, quantifying such exposures as: modified and effective duration, yield to maturity, Option Adjusted Spread (OAS), yield curve exposure, sector and sub-sector allocation and credit rating category.



Source: Schroders

## Why Schroders for US Corporate Bond

- Experienced global team of credit research professionals
- Structured approach to risk management and control
- Ability to adjust portfolio positions based on changing market environments
- Ability to underweight lower-rated credit and high beta issuers.

### Schroders plc

Schroders is a global asset management company with \$158 billion under management as of December 31<sup>st</sup> 2008. Our clients are major financial institutions including banks and insurance companies, public and private pension funds, endowments and foundations, high net worth individuals, financial intermediaries and retail investors. Our aim is to apply our specialist asset management skills in serving the needs of our clients worldwide and in delivering value to our shareholders. With one of the largest networks of offices of any dedicated asset management company and over 350 portfolio managers and analysts covering the world's investment markets, we offer our clients a comprehensive range of products and services.

Further information about Schroders can be found at [www.schroders.com/us](http://www.schroders.com/us)

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