Schroders

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Schroder ISF* European Large Cap

Fund Manager: Nicholette MacDonald-Brown | Fund update: October 2021

Performance overview

- European equities gained in October.
- The fund posted a positive absolute return but underperformed the MSCI Europe index.

Drivers of fund performance

- Some of our midcap holdings were weaker in the month. The main individual detractor was clothing retailer **About You**. The company reported strong trading and raised full-year revenue guidance. However, it is continuing an expansion into southern Europe and marketing spend on this will result in a negative impact on profit margins. We think the market underappreciates the group's potential for growth.
- **Software AG** was another midcap detractor. The group upgraded EBIT margin guidance as the legacy business is not shrinking as fast as feared. However, the digital division had slower bookings growth than expected and it cut full-year guidance for this. Digital is clearly the future for Software AG and so the market took the news badly. However, bookings can be volatile and we would caution against reading too much into one quarter's numbers.
- Another detractor was payments group **Network International.** The whole payments sector struggled in the month after the largest stock in the segment had weather had both disappointing results and capital markets day which raised concerns about increasing competition in the space. We don't think these risks apply to Network given their alternative route to market in EMEA.
- On the positive side, stock selection within industrials added value. Our position **Kion Group** made a positive contribution to relative returns. Kion specialises in warehouse automation and supply chain solutions. There had been fears that it would suffer from disruption but these worries were allayed. We see Kion as well placed for a future of greater automation.
- Our semiconductor equipment holding **ASM International** (ASMI) also supported relative returns; this was only partially offset by not owning ASML. Demand for semiconductors remains extremely buoyant and firms are continuing to invest in new capacity, benefitting the equipment makers. Additionally, ASMI has a strong product line up including new Atomic Layer Etching technology which enables very precise control in the manufacturing process.
- Luxury goods group **Moncler** also added value. The whole sector was negatively affected in the summer by uncertainty over what China's "common prosperity" goal would mean for consumer spending. However, a broadening out of wealth could result in greater numbers of potential luxury goods consumers. Moncler's Q3 results were solid.

Portfolio activity

- We added a position in **Lloyds Banking Group** as we believe that - in contrast to domestic eurozone banks - they will benefit from rising domestic rates and positive momentum from a P&L perspective.
- Among sales, we sold out of **Avast** following a bid from NortonLife. We exited **Experian** on valuation grounds following a good rerating. We sold out of **IWG** on concerns that a change in corporate strategy to break up the business rather than seek more franchise agreements may delay the realisation of value.

Outlook/positioning

- European shares have continued to push higher. The demand environment remains very buoyant but cost pressures are starting to be felt. We may in fact be at the peak in terms of costs, with some metals price rises now abating. However, we do think higher costs are here for the longer-term. Companies who can raise their prices without denting demand will be best placed.
- The impact on consumers is the key area to watch. Many consumers are still spending savings built up during lockdowns. However, with higher prices for essentials such as energy and food, disposable incomes may be squeezed unless wage rises come though.
- Central banks have a crucial role to play at this time. They have to find a balance between rising inflation on the one hand and highly indebted

*Schroder International Selection Fund is referred to as Schroder ISF throughout governments and the risk of derailing the recovery on the other.

– A small amount of inflation is generally good for equity markets, but prolonged higher inflation is generally negative. We could see an environment where relative valuations are what counts. Europe is relatively well-placed in this regard, and sectors such as banks could be winners whereas growth stocks may be more vulnerable. Careful stock selection will be needed.

Calendar year performance (%)

	Fund	Target	Comparator
2020	1.1	-3.3	-0.9
2019	24.0	26.7	24.5
2018	-13.0	-10.9	-12.7
2017	10.0	10.2	10.1
2016	2.1	2.6	-0.2

Source: Schroders, as at 31 December 2020. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc shares.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.

Target benchmark is MSCI Europe NR and comparator is Morningstar Europe Large Cap Blend Equity sector.

Please see factsheet for other share classes.

Risk considerations

Counterparty risk: The fund may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the fund may be lost in part or in whole.
Currency risk: The fund may lose value as a result of movements in foreign exchange rates.
Currency risk / hedged share classes: The hedging of the share class may not be fully effective and residual currency exposure may remain. The cost associated with hedging may impact performance and potential gains may be more limited than for unhedged share classes.
Derivatives risk – efficient portfolio management: Derivatives may be used to manage the portfolio efficiently. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the fund.
Higher volatility risk: The price of this fund may be volatile as it may take higher risks in search of higher rewards.
IBOR Risk: The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the fund.
Liquidity risk: 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.
Market Risk: The value of investments can go up and down and an investor may not get back the amount initially invested.
Operational risk: Failures at service providers could lead to disruptions of fund operations or losses.
Performance risk: Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve.
Sustainability risk: The fund has environmental and/or social characteristics. This means it may have limited exposure to some companies, industries or sectors and may forego certain investment opportunities, or dispose of certain holdings, that do not align with its sustainability criteria. Therefore, the fund may underperform other funds that do not apply similar criteria. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.