Schroders

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Schroder ISF* European Equity Yield
Fund Update
A look back on September 2019

At a glance

Fund managers: Andrew Lyddon and Andrew Evans.

Performance: The fund returned 5.9% (C Acc share class) over the month compared to the MSCI Europe index return of 3.8%**.

Largest contributors: WM Morrison supported fund returns.

Largest detractor: Pearson weighed on fund returns.

**Source: Schroders, as at 30 September 2019. Net of fees, bid-bid, with net income reinvested. Index source: Schroders and MSCI as at 30 September 2019.

Calendar year returns (%)

	Fund	MSCI Europe
2018	-4.1	-10.6
2017	6.5	10.2
2016	5.1	2.6
2015	6.1	8.2
2014	5.4	6.8

Source: Schroders and MSCI. Net of fees, NAV to NAV with net income reinvested, C Acc share class, as at 31 December 2018. The fund is not managed with reference to a benchmark but its performance may be measured against one or more.

Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get the amount originally invested.

Some performance differences between the fund and the benchmark may arise because the fund performance is calculated at a different valuation point from the benchmark.

Please see the respective fund factsheets for the performance of other share classes.

Market review

European equities gained in September with the MSCI Europe index returning 3.8%.

Portfolio overview

The fund outperformed the index in what was generally a better month for value areas of the market.

Supermarkets group **WM Morrison** was the leading individual contributor. The group's turnaround efforts are bearing fruit as it reported six-month profits up 5.3%. This is despite sales declining in the second quarter compared to a strong performance in the same period a year ago. Morrison continues to focus on delivering competitive prices for customers and is expanding its grocery delivery service with Amazon.

Fellow grocery chain **Tesco** was also among the leading contributors. Like Morrison, Tesco has undergone a multi-year restructuring to turn its business around and fend off the threat from discounters. In September, Tesco announced the sale of its mortgage portfolio to Lloyds Banking Group for £3.8 billion. The proceeds will be reinvested into the business.

The banks sector performed well in September and our holdings in emerging markets focused lender **Standard Chartered** and the UK's **Royal Bank of Scotland** were among the top individual contributors. Both stocks had been among the laggards in August. Banks' balance sheets and capital positions are in far better shape than they were ten years ago but this is not reflected in share prices.

Pharmaceutical group **Sanofi** also performed well in the month. The group's new CEO took the reins in September. We continue to believe Sanofi is among the most attractive pharmaceutical firms in the world with a solid balance sheet.

On the negative side, educational publisher **Pearson** was the main individual detractor. The group warned that profits for 2019 are likely to be at the low end of expectations. This is due to weak demand affecting the US Higher Education Courseware business which

*Schroder International Selection Fund is referred to as Schroder ISF comprises 25% of revenues. Pearson is already taking steps to address the changing structure of demand in this segment, for example making more courseware available digitally rather than in print. However, it will take time for these changes to have an impact. Pearson continues to expect revenues for the group to stabilise this year.

In terms of new investments, we have initiated a new position in **Software AG**. It has been left behind by the rally enjoyed by other parts of the software sector in recent years. This is largely because the backbone of its business is in software to help companies maintain their mainframe databases. This is a market that is in decline although the fall in revenues has proved gentle so far. Software AG also has a digital division for companies modernising away from mainframes. This carries lower profit margins but is a growth area. It also has a small but high growth business producing software to interact with the Internet of Things and the cloud. We think this shows that the company is repositioning itself towards how the world will work in the next ten years. In the meantime, it has a net cash balance sheet and a 9% free cashflow yield.

Risk considerations

The capital is not guaranteed.

The fund intends to make regular yield payments to investors and, if its income is insufficient to cover these payments, these payments may reduce the fund's capital.

Investments denominated in a currency other than that of the share-class may not be hedged. The market movements between those currencies will impact the share-class.

The fund will not hedge its market risk in a down cycle. The value of the fund will move similarly to the markets.

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