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Schroder ISF* European Dividend Maximiser

Fund Managers: Nicholette MacDonald-Brown and Structured Fund Management Team |
Fund update: January 2023

Performance overview

– The fund seeks to provide an income of 7%[1] p.a. via a call option overlay and an actively managed European equity portfolio.
– Pan-European equities gained in January.
– In performance terms, the fund also rallied, but lagged the MSCI Europe Index and the Morningstar Europe Equity Income sector average.

Drivers of fund performance

– At stock level, Finnish utility **Fortum** was the main individual detractor. The shares performed well in late 2022 after the nationalisation of Uniper by the German government. Fortum is now a pure play on renewable power in the Nordics. The EU is trying to incentivise renewable energy but there remains a risk of windfall taxes being used to fund this. Finland has already proposed a 30% windfall tax on power company profits in 2023.
– Another detractor was payments group **Network International**. The firm announced Q4 revenue growth of 17% but said 2023 profit margin expansion would be lower than in 2022 as a result of inflationary pressures, especially employee costs.
– Within consumer discretionary, lack of exposure to LVMH was a detractor, although this was partially offset by our position in **Moncler**, which made a positive contribution. The luxury goods sector will be one of the main beneficiaries of China's reopening after abandoning the zero-Covid policy.
– Among banks, lack of exposure to HSBC Holdings weighed on fund performance, while the position in **Svenska Handelsbanken** was also a detractor. Our holding in **Intesa Sanpaolo** supported fund performance.
– Semiconductor tools maker **ASM International** was the top positive contributor. The sector came under some pressure last year amid cyclical concerns over demand and worries over potential restrictions on technology sales to China. Sentiment is now turning. The market is realising that China will buy tools ahead of any potential ban. In addition, ASMI last year acquired LPE, a firm specialising in silicon carbide epitaxy, which is performing strongly. In January, ASMI announced that Q4 revenues were ahead of its previous expectations, largely thanks to LPE. However, not owning fellow semiconductor tools firm ASML Holding detracted from relative returns.
– In the healthcare sector our holding in **Bayer** performed well during the month. A second activist investor is now calling for a faster change of management, and for the business to be split up. Lack of exposure to Roche was also advantageous.
– While continuing to deliver the required income, the options weighed on performance in January (-0.53%) when measured on a mark-to-market basis (reflecting both expired trades and those with time still to expiry). This behaviour is within expectations given the gains in the underlying shares.
– Looking only at those options that reached their expiry date during January, there was a negative contribution of -0.40% (in net cash terms) from three maturing tranches. From 118 option positions sold across these three tranches, 48 finished above their strike prices at expiry. These included **Siemens**, **Hiscox** and Intesa SanPaolo,

Portfolio activity

– A new position in the portfolio is **Trainline**. It is a rail ticket reseller operating in the UK and Europe. We believe the valuation fails to capture both the growth of the market from the transition from car journeys to rail, and Trainline's ability to gain market share as it works with a greater number of operators across a larger number of routes.

Outlook/positioning

– After a poor 2022, European shares have been strong recently. The economy has proved more resilient than feared. Eurozone consumers appear more likely to spend than in some other regions, largely thanks to government support with energy prices.
– Inflation may have already reached its peak, although the European Central Bank has signalled its intention to keep tightening monetary policy.

[1] The gross yield is an estimate and is not guaranteed.

*Schroder International Selection Fund is referred to as Schroder ISF throughout

Gas prices have fallen amid warmer weather and energy saving measures, reducing the pressure on corporates and consumers.

– Europe is due a rebound if the worst case scenario of a steep, prolonged recession can be avoided. This would support better sentiment towards the region, particularly as Europe remains extremely out of favour with equity investors.

– Our Blend approach means we are not relying on taking large style or factor bets, but focus instead on individual mispriced opportunities while retaining diversification.

– Within the overlay, we currently employ seven overlapping tranches (overwriting ~9.5% of the NAV in any single tranche). This creates regular expiries and hence regular opportunity to trade new options.

– The current overwritten ratio is around 65%. In other words, while continuing to deliver the income, the fund can capture upside up to the level of the individual strike prices on the 65% overwritten, and the full extent of any upside on the 35% without options.

– We are typically seeing higher single stock volatility, which gives us relatively higher strike prices and greater flexibility in terms of how much of the portfolio we overwrite and the income we take. This can also help the fund's participation in any rebound.

– We remain very aware of spike risk, applying notional decisions on several names, including Novo Nordisk and Swiss Re.

Calendar year performance (%)

Year	Fund	Comp 1	Comp 2
2022	-12.2	-9.5	-8.1
2021	14.4	25.1	20.7
2020	-25.0	-3.3	-6.8
2019	16.2	26.0	21.8
2018	-5.1	-10.6	-11.7
2017	4.8	10.2	7.9
2016	2.9	2.8	0.4
2015	3.6	8.2	9.9
2014	4.0	6.8	6.7
2013	21.9	19.8	20.2

Source: Schroders, as at 31 December 2022. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc shares. Please see factsheet for other share classes. Comparator 1 is the MSCI Europe index; comparator 2 is Morningstar Europe Equity Income sector. The fund's performance should be assessed against the income target of 7% per year, and compared against the MSCI Europe (Net TR) index and the Morningstar Europe Equity Income Category. The comparator benchmarks are only included for performance comparison purposes and do not determine how the investment manager invests the fund's assets. The investment manager invests on a discretionary basis and there are no restrictions on the extent to which the fund's portfolio and performance may deviate from the MSCI Europe (Net TR) index.

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.

Risk considerations

Capital risk / distribution policy: As the fund intends to pay dividends regardless of its performance, a dividend may represent a return of part of the amount you invested.
Currency risk: The fund may lose value as a result of movements in foreign exchange rates.
Derivatives risk: Derivatives may be used to manage the portfolio efficiently. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. 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.
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.
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 chosen by the investment manager. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.
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.
Maximiser funds: Derivatives are used to generate income (which is paid to investors) and to reduce the volatility of returns but they may also reduce fund performance or erode capital value.
Operational risk: Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund.
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 macroeconomic environment, investment objectives may become more difficult to achieve.
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.
Higher volatility risk: The price of this fund may be volatile as it may take higher risks in search of higher rewards.
Market risk: The value of investments can go up and down and an investor may not get back the amount initially invested.

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