Schroders

Schroder Strategic Bond

Strategy Overview

Summary

Schroders' Strategic Bond strategy seeks to generate absolute returns through the exploitation of opportunities across a range of alpha sources. These include duration, yield curve, country, currency, credit beta, credit sector and relative value. The strategy has the flexibility to invest in investment grade and high yield sovereign and corporate debt in developed and emerging markets, currencies, securitized bonds and derivatives. This allows for significant diversification and scope to deliver alpha. To seek sustainable long term performance, we diversify by style of alpha source and time horizon.

An unconstrained approach is implemented to source what we view as the best opportunities in global bond and currency markets with a strong focus on drawdown sensitivity and on generating high Sharpe and Sortino ratios. We use a team based approach in constructing investment strategy and decisions are supported by extensive fundamental research, technical analysis and decision support tools.

Why Schroders for an absolute return strategy?

- Globally integrated platform of experienced regional teams with local market expertise
- Consistent investment process that seeks to capitalize on differentiated sources of risk adjusted return
- Opportunistic, active investment approach enables us to execute ideas efficiently
- Successful performance track record over a full market cycle with repeatable, strong risk adjusted return profile with low correlation to other major asset classes
- Depth of experience within both macro (interest rates/FX) and credit team

Firm highlights

- Founded in 1804, with a strong family presence to this day
- Asset management is our main business
- Over 700 investment professionals worldwide
- Truly global reach: based in London, with offices in 27 countries
- Expertise in Fixed Income, Equities, Multi-Asset, Solutions, and Alternatives

Key features

- Actively managed portfolio with the flexibility to invest in the best opportunities in government and corporate bond markets
- Offers investors the potential for total return in different market environments—including periods of rising rates
- May also utilize active currency management in both developed and emerging currencies for the generation of alpha and diversification of risk
- Derivatives are allowed and used to hedge and obtain active risk. Derivatives used include: interest rate futures, interest rate swaps, credit default swaps and currency forwards.

Investment objective

The performance aim of the Schroder Strategic Bond strategy is to deliver Libor +4% per annum over a full market cycle.

[1]This is an internal portfolio management target and is not a guarantee or indication of future portfolio returns.

Investment philosophy

The strategy's management team follows the philosophy that sustainable alpha generation is driven by skill and diversification. We believe that diversification is achieved by alpha source and time horizon. We actively manage portfolios using a risk budgeting approach, allocating risk to positions where we believe there is sufficient mispricing to warrant an allocation of risk to a view or market.

To help us try to identify such mispricings we use fundamental, research-driven analysis together with technical analysis. Care is taken to diversify the positions in the portfolio which is a blend of risks often including cost effective offsetting positions. These offsetting positions are expected to perform should the central themes not materialize.

Finally, given the global nature of economies and markets it is critical that the team draw upon the expertise offered to us by our regional specialists thereby allowing us to access local market intelligence.

Investment process

The investment process is built around a team-based approach dedicated to the successful pursuit of attractive risk adjusted outperformance. We are able to do this by focusing on robust diversification across the portfolio by both alpha source and time horizon—combining different sources of skill represented by judgmental approaches and through a rigorous portfolio construction methodology.

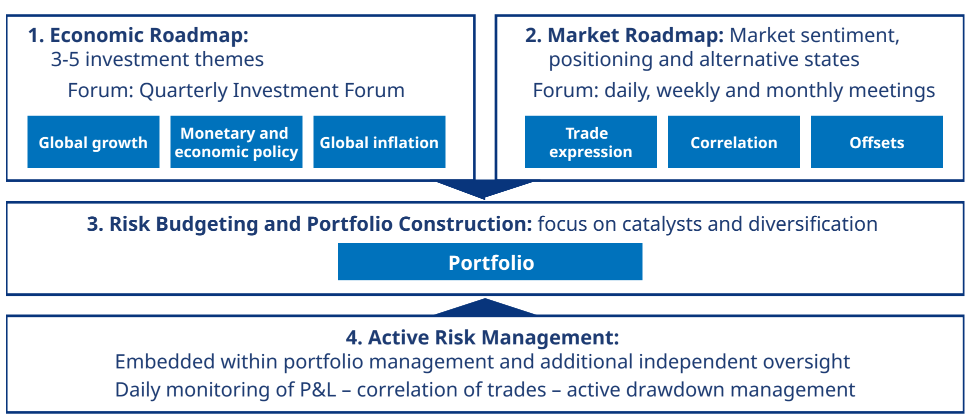
The ingredients that make up our investment process can be divided into four main categories:

- Maximizing breadth and diversification across time horizon and risk factors
- Delivering skill through a combination of judgmental and technical approaches
- Rigorous portfolio construction
- Risk Management & Control – an integral part of the process

1 Maximizing breadth and diversification across time horizon and risk factors

We believe that diversification is key to consistent alpha generation and we use a risk budgeting approach to managing the portfolio. We seek to deliver alpha through duration, yield curve, country, currency, credit beta, credit sector and relative value. We allocate risk to each of these factors based on the target return of the strategy, the expected return from each factor and an assumed information ratio based on the team's long term investment experience.

Diversification is further achieved across time horizons through dividing our investment horizon into strategic views from our Economic Roadmap and tactical views driven by our Market Roadmap. The investment horizon of strategic themes are typically three months to one year. The investment process aims to deliver across both time horizons and risk factors and is outlined in the chart below.



Source: Schroders. For illustration purposes only.

2 Delivering skill through a combination of judgmental and technical approaches

Market Roadmap – Investor sentiment, positioning and alternative states

Financial markets are driven not only by fundamental economic factors, but also non-economic, market-based factors. Therefore, when considering how best to implement an investment theme, it is of critical importance to understand the interaction of the underlying economic rationale with the landscape of potential investment opportunities.

In order to supplement the investment ideas from the Economic Roadmap, the team researches market positioning and sentiment, with technical analysis and proprietary decision support tools being employed to better isolate specific mispricing opportunities. The objective of the Market Roadmap is to provide a challenge to the Economic Roadmap and to illustrate the best way to implement the conclusions of the team's economic research within client portfolios.

The Market Roadmap also considers alternative states of the world which – while not the central scenario underpinning our strategic investment themes – are identified as being potential scenarios that could adversely affect our portfolio positioning. Building upon the catalysts and violations of strategic investment themes identified in the Economic Roadmap, the consideration of alternative scenarios illustrates both opportunities and risk offsets for the portfolio, should the path of the global economy or reaction of financial markets not correspond to our central scenario.

In practical terms, in an environment where the Economic and Market Roadmap converge, with the market responding to changes in global economic fundamentals in a traditional manner the Market Roadmap will ultimately support a greater proportion of the portfolio's active risk through longer-term strategic opportunities identified in the Economic Roadmap. However, in an environment in which the market response to changes in the global macro outlook is driven more by non-economic factors, a greater proportion of active risk profile of the portfolio will be informed by the Market Roadmap.

3 Rigorous portfolio construction

As is clear from our investment philosophy, much emphasis is placed upon diversifying positions by style and time horizon and the interaction of individual positions is a critical area of focus.
As part of our investment process we seek to identify the trade ideas in which a particular view can be implemented as well as the risks to this view. The decision in terms of which strategy is implemented is a function of the portfolio guidelines, our conviction level for the strategy and the expected interaction of the strategy with other strategies in the portfolio. When discussing both existing and potential risks in the portfolio we examine which alpha source is most attractive from a number of angles including the contribution of the new position to diversification (particularly in adverse market moves).

Having also identified the potential risks to the investment themes within the Road Map another important part of the construction process is the inclusion of cost effective offsets to the central theme in the strategy. These positions help to mitigate the impact of the market moving against our central strategic position.

The portfolio construction process relies heavily on a risk budgeting based approach with the maximum allocation to each alpha source or risk factor based on the return target, risk limit and investment guidelines. As part of this dynamic approach might mean that during periods where we do not have a strong conviction in a particular strategy we will not actively decide to allocate less risk to that strategy or alpha source, prefering instead to remain neutral versus the benchmark.

4 Risk management

We distinguish two different levels to risk management:

- The investment desk / portfolio management
- Compliance, operational and investment risk specialists

We believe that risk tools are useful in setting appropriate boundaries for investment strategy, however, they do have one major flaw; they are effective measures of risk only when history is an accurate guide to the future. With this in mind we carefully watch our daily and intraday performance. Performance is monitored on a continuous basis using proprietary systems. Given our risk allocation based approach and each position being allocated risk budget we can monitor not just the success or failure of each position but also how it is performing in relation to the rest of the portfolio and intended risk budget. While we are obviously incentivized to generate incremental return we like to make sure the performance is within our expectations.

At a portfolio level, as well as closely monitoring their Profit and Loss, managers are able to make use of a number of both proprietary and external risk systems to monitor positions which are detailed later in this document.

Integrated team

Bob Jolly
Head of Global
Macro Strategy

Paul Grainger
Head of Global
Multi-Sector Fixed Income

Strategy	Relative Value	Asset Allocation, Rates, FX, Technical Analysis and Liquidity Funds		Credit Sector and Security Selection	
James Bilson Alice Leedale Jean-Christophe Alario Marcus Jennings	David Gottlieb Whitney Tindale	Tom Sartain James Lindsay-Fynn Jamie Fairest James Ringer	Craig Kirby Vikram Mathur Edmund Weeks	Chris Ames Rick Rezek Wesley Sparks	Michael Scott Alix Stewart

Specialist Fixed Income Portfolio Management Teams (no. portfolio managers)				Specialist Analyst Teams (no. analysts)					Specialist Product Team (no. specialists)[2]	
Credit	Rates	EMD	Extended sectors[1]	European Credit	North American Credit	Asia, Australia and EMD Credit	Quant, Strategy and Economy	Portfolio-specific	Multi-Sector	Credit
16	23	8	16	9	18	11	16	9	6	5

Source: Schroders, as of August 2017.
[1]Includes municipals, securitized, insurance-linked and convertibles.
[2]London-based resources only.

Risk management

Risk management is embedded into our process and portfolio construction. We actively manage portfolio risk by labelling each strategy to an alpha source, identifying the catalysts for entry and exit and understanding the risk of each position and how it interacts with other positions in the portfolio. Additionally, the investment team carefully monitors the daily and intraday profit and loss of each position on a continuous basis. We analyze whether the themes and positions are appropriately sized given contributions to the profit and loss of the portfolio.

Also, an important part of risk management is the use of inexpensive offsetting positions. This approach seeks to ensure that the overall risk profile of the portfolio isn't skewed to only a few outcomes. A period of very positive performance relative to expectations may imply we have a single theme too heavily dominating the strategy, something which may be at odds with the structure we have in place. Should such a scenario occur, the team will meet to discuss whether the risk budget is correctly allocated and whether we should be introducing new offsetting trades or reducing some of the existing positions. If certain positions are negatively contributing to the portfolio, the team analyzes the thesis behind the trade, whether the sizing is appropriate, the balance versus other positions in the portfolio, insufficient offsets or none of the above.

The investment team's risk management process is distinct from our independent investment risk, operational and compliance risk management teams' processes. Specific responsibility for supervising investment directives is that of the Fixed Income operational risk team which reports to the Chief Operating Officer for Investments.

Risk disclosures

All investments involve risks including the risk of possible loss of principal. The market value of the portfolio may decline as a result of a number of factors, including interest rate risk, credit risk, inflation/deflation risk, mortgage and asset-backed securities risk, US Government securities risk, foreign investment risk, currency risk, derivatives risk, leverage risk and liquidity risk. The use of derivatives involves risks different from, or possibly greater than, the risks associated with investing directly in the underlying assets.

Investing overseas involves special risks including among others, risks related to political or economic instability, foreign currency (such as exchange, valuation, and fluctuation) risk, market entry or exit restrictions, illiquidity and taxation. Frequent trading of the portfolio may result in relatively high transaction costs and may result in taxable capital gains. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.