

Schroder ISF* European Smaller Companies

Fund Managers: Hannah Piper & Andy Brough | Fund update: Q3 2021

Performance overview

- European smaller companies posted gains in Q3. The fund underperformed the EMIX Smaller European Companies index.

Drivers of fund performance

- Among the main individual detractors was **Mister Spex**, a company that listed during the quarter. The firm sells glasses both online and in stores. We expect it to benefit from growing demand for glasses as Europe's population ages. We also anticipate growth in the online segment as more consumers become accustomed to buying glasses online. However, the shares proved volatile in the period after the IPO.
- **Ubisoft Entertainment** was again among the detractors. It had to delay some game releases for a second year in a row due to working from home productivity issues during the pandemic. While this has been an industry wide issue, this has weighed on earnings and dented the group's credibility. It also meant there were no big game releases in Q3. However, the group does have a release to come in early Q4. We believe we are coming to the end of delays and disappointments. Our other computer games holdings **Embracer** and **Nacon** were also among the detractors.
- Online pharmacy **Shop Apotheke** weighed on relative returns. During the quarter it experienced difficulties with the ramp-up of a new warehouse, though these issues have now been resolved. There remains some uncertainty over potential delays to mandatory electronic prescriptions in Germany, due to begin in January 2022. However, a delay of a few months would have a limited impact on the investment case.
- The main individual contributor was specialty chemicals firm **Wacker Chemie**. The group is enjoying strong demand in all its end markets. It has been affected by rising raw material costs but has the pricing power to lift prices in response.
- Several of our healthcare holdings – **Arjo**, **Dermapharm**, **DiaSorin** – also supported relative returns in the quarter.

- Capital goods holding **Keller Group** was a positive contributor. The group reported strong trading performance in the first half of the year.
- Also making a positive contribution was bookmaker **Flutter Entertainment**. This was a new position in the fund during the quarter. The stock had underperformed in Q2 due to a number of one-off issues. One of these – litigation in Kentucky – has now been resolved. This allowed the market to re-focus on what continues to be excellent operational performance. Flutter owns FanDuel which is the market leader in the US. There is a huge growth opportunity in the US in the medium to long term as more states open up to sports betting. Flutter plans to list a stake in FanDuel which will crystallise the value in this segment of the business. We note Flutter has strong market positions also in the UK and Australia. We have high conviction in the stock.

Portfolio activity

- Aside from Flutter, another new holding is specialty chemicals distributor **Azelis Group**. We expect it to benefit from the trend towards market concentration. Azelis also distributes chemicals as formulations, giving it added value.
- We sold out of computer games firm **Embracer**, reallocating proceeds to Ubisoft and Nacon where we have higher conviction.

Outlook/positioning

- Our focus remains on the longer-term outlook for companies. We are looking to the next three years, not the next three months. We aim to take advantage of market volatility, should it arise, in order to build positions in stocks that become attractively mispriced. We will continue to take a fundamental approach to stock picking and look for well managed, high quality businesses that can generate cash and grow sustainably in the long run.

Calendar year performance (%)

Year	Fund	Target
2020	13.7	7.8
2019	13.7	29.3
2018	-22.1	-14.1
2017	21.6	17.6
2016	3.7	2.9

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.

Please see factsheet for other share classes. Target benchmark is EMIX Smaller European Companies TR.

Risk considerations

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.

Operational risk: Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund.

Currency risk: The fund may lose value as a result of movements in foreign exchange rates.

Concentration risk: The fund may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down.

Derivatives risk – Efficient Portfolio Management and Investment Purposes: 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.

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.

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.

IBOR: 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.

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