Schroders

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Schroder ISF* European Smaller Companies

Fund Managers: Hannah Piper | Fund update: Q4 2022

Performance overview

– European smaller companies gained in Q4.
– The fund outperformed the EMIX Smaller European Companies index.

Drivers of fund performance

– It was a strong quarter for smaller European companies. The fund outperformed the benchmark's strong gains, supported by stock selection in financials and industrials.
– In financials, our holding in **Bank of Ireland** aided relative returns. Banks remain lowly valued with attractive dividend yields. They benefit from rising interest rates, as they can reprice loans higher. European Central Bank President Christine Lagarde said in December that there were still more rate hikes to come, despite some signs that inflation may have peaked. **DoValue**, a lowly valued Italian manager of non-performing loans, also supported fund performance.
– In industrials, a leading individual contributor was **Befesa**, in a partial reversal of its weaker performance earlier in the year. Befesa recycles hazardous steel dust, extracting zinc which it then sells back to steel companies. We think it is an excellent play on the circular economy. However, the business is energy intensive and concern over potential energy rationing, as well as high costs, had impacted the share price. In Q4, milder weather and energy savings measures helped reduce gas prices and allay fears over shortages. The relief on gas prices also helped support our holding in **Montana Aerospace**.
– The top individual contributor for the quarter was **Games Workshop**. The retailer signed a deal with Amazon to develop films and TV programmes based on its popular Warhammer games. The agreement demonstrates the strength of Games Workshop's intellectual property.
– On the negative side, computer games publisher **Nacon** was the main individual detractor after announcing some game delays. This is an issue that has plagued the sector since the Covid lockdowns and rise of home-working. Labour churn across the IT sector has also contributed as new staff take time to come up to speed and produce high quality work. We still have confidence in the long-term outlook for the sector and company.
– Another detractor was filtration specialist **GVS** in the wake of a profit warning. The company made a poorly timed acquisition that loaded the balance sheet with too much debt. There has been a lack of communication from management and visibility around what should be a relatively defensive stock. We have now exited the position.
– Digital advertising specialist **Tremor International** was a detractor after downgrading guidance due to weak advertising spending. The company made an acquisition last year and we see good prospects for extracting value from the deal. There is a share buyback ongoing.
– Another detractor was electronics distributor **RS Group** following the resignation of the highly-regarded CEO. However, we think he had a good management team beneath him.

Portfolio activity

– Among our new holdings is speciality chemicals producer **Elementis**. It has sold its chromium business which was acting as a deterrent to investors given its poor environmental credentials. The sale was achieved at a good price, enabling a reduction in leverage, but the share price is not yet taking account of the group's improved profile.
– We added to our banking sector exposure, initiating a position in **Bankinter**. Spanish banks are among the quickest to reprice their loans in response to rising rates, so they draw the benefit of higher interest rates.
– Aside from GVS we also exited a umber of businesses that had reached fair value, or where we saw better opportunities to deploy our capital elsewhere. Exists included **Weir Group** and **Basic-Fit**.

Outlook/positioning

– The end of 2022 saw better momentum for European shares after a difficult year. European shares look attractively valued compared to some other global regions. However, the macro outlook remains very uncertain given elevated inflation, rising interest rates

*Schroder International Selection Fund is referred to as Schroder ISF throughout and the ongoing war in Ukraine. Given this, we expect further volatility ahead.

– Our focus remains on the longer-term outlook for companies. We are looking to the next three years, not the next three months. We continue to take a fundamental approach to stock picking. Pricing power and strong balance sheets are key attributes that we look for. We aim to take advantage of market volatility, when it arises, in order to build positions in stocks that become attractively mispriced.

Calendar year performance (%)

Year	Fund	Target
2021	9.6	23.4
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
2015	22.3	21.7
2014	2.5	5.1
2013	39.0	32.2
2012	28.7	24.0

Source: Schroders, as at 31 December 2021. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc shares. Please see factsheet for other share classes. The fund's performance should be assessed against its target benchmark being to exceed the EMIX European Smaller Companies (TR) index. The fund's investment universe is expected to overlap materially with the components of the target benchmark. 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 target benchmark. Target benchmark is EMIX Smaller European Companies TR.

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

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: 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.
Smaller companies risk: Smaller companies generally carry greater liquidity risk than larger companies, and they may also fluctuate in value to a greater extent.
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.