

#### Summary

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Schroders' Municipal Bond investment strategy seeks to maximize after-tax yield and income by investing across the spectrum of investment grade municipal debt. The strategy seeks to capitalize on structural inefficiencies in the marketplace

and focuses on fundamental, bottom-up security selection. We use a team approach in constructing investment strategy and portfolio decisions are supported by fundamental and technical research.

#### Why Schroders for Municipal Bonds?

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- Focus on capital preservation and income
- Unique relative value approach
- Research-intensive, bottom-up process
- Diversified portfolios of high-quality issues
- Duration-neutral strategy to minimize risk

#### Firm highlights

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- 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

#### Team highlights

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- Approximately \$136 billion of fixed income assets under management globally
- Manage dedicated municipal accounts as well as integrated municipal expertise within fully global investment platform
- Diverse team with trading and research backgrounds and over 20 years investment experience

#### Key features

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- Research-driven investment process that emphasizes high quality and seeks to capitalize on market and pricing inefficiencies
- Security selection is the key driver of return
- Proprietary database covering over 1,000 prerefunded/escrowed-to-maturity issues (advance refunded bonds generally backed by US Treasuries)
- Seeks consistent process over multiple market cycles
- Strategy seeks to perform well in a rising rate environment due to the high level of income generation
- Duration-neutral
- Risk management is embedded in our culture

## Investment objective

Schroders' Municipal Bond strategy seeks principal preservation with a high level of after-tax yield and income.

<sup>1</sup>There can be no guarantee that any investor objective or outcome will be achieved.

## Investment philosophy

Municipal markets are generally inefficient and lack a centralized, regulated information depository, providing investment opportunities.

We believe that an integrated team of research-driven municipal bond investors is the ideal structure to take advantage of these inefficiencies.

Using a disciplined investment process, we seek to generate consistent above benchmark returns with lower than average volatility.

## Investment process

### Our tax-exempt fixed income process consists of four distinct steps:

- 1 Conduct in-depth proprietary market research (fundamental, quantitative and technical) to develop investment themes that we believe will dominate the municipal market.
- 2 Develop and prioritize investment strategies, based on investment themes and bottom up research, to pursue the highest level of return/yield per unit of risk.
- 3 Implement investment strategies within the portfolio, using a relative value framework to prioritize investment ideas and execute security selection.
- 4 Continually review portfolio within rigorous risk management framework, incorporating quantitative and qualitative analytic tools.

The foundation of our investment process is our weekly US Tax-Exempt Fixed Income meeting. Here, portfolio managers combine the outputs from our economic, quantitative and credit research to establish investment themes and resulting strategies. Relative value opportunities are discussed and prioritized. Portfolio construction, including security selection, follows and is implemented by portfolio managers.

## Fundamental research

Schroder's municipal bond investment process begins with fundamental research. The goal of the process is to identify a bond's intrinsic value which may be independent of the market price. There are two components to determining a bond's intrinsic value: structure premium (i.e., liquidity, cash flow characteristics such as calls, puts, and prepayments) and credit risk premium. A target yield is determined based upon the bond's intrinsic value and compared to the yield of a "risk-free" municipal bond.

Municipal bonds are issued for many purposes. The basic infrastructure needs of state and local governmental entities, together with many other uses that provide public benefit, have led to a highly fragmented and diverse market. According to the Government Accounting Office, there are more than 50,000 issuers of debt in the US tax exempt marketplace. Each sector of the market has different factors that must be analyzed to provide an ongoing credit opinion. Key factors include financial performance, debt management, local economic and demographic characteristics, and administrative management.



Source: Schroders.

## Fundamental research (continued)

**Structure** The structural components of each security are thoroughly evaluated. We examine call or put features, sinking fund repayment schedules, partial principal repayments as well as other cash flow characteristics to determine a bond's intrinsic value. Understanding complex municipal bond structures and their effect on valuation is a key component of investment process.

**Credit** As part of the investment management process, municipal bonds purchased in both the new issue and secondary markets are reviewed for credit quality. Approval by a Credit Analyst, depending upon rating or sector, is required before purchasing any security. Credit Analysts draw from audited financials, continuing disclosure, preliminary official statements and/or management calls to establish the credit profile, consider the strengths and challenges, and form an opinion.

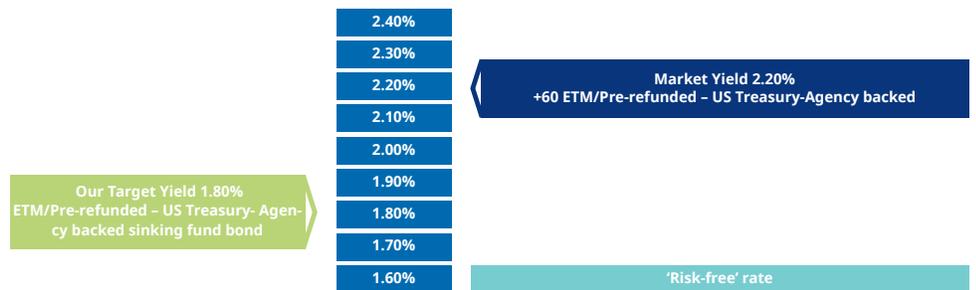
An important distinction of our credit quality analysis is that it assesses the expected evolution of the issuer's credit quality over an investible time horizon. This differentiates our process from the credit rating agencies whose opinion is taken at a point in time. Our process combines both quantitative and qualitative analysis and fully uses our analysts' experience and industry knowledge.

Analysts determine a current internal rating and an absolute view of the issuer's credit quality over the next 6-12 months scored on a five-point scale from 'improving' to 'declining'. Factors are weighted according to the credit analyst's view of its importance and in light of the relative risk.

## Security selection

Individual security selection is based on identifying those securities that provide the highest level of return/yield per unit of risk. Based on our fundamental research, the

team sets a target yield for each bond using a rigorous, relative-value approach. The diagram below illustrates the framework used to make these decisions:



Source: Schroders.

Security mentioned is for illustrative purposes only and is not a recommendation to buy or sell. The yield comparison shown is for illustrative purposes, is not intended as a comparison of any security held in a managed portfolio and should not be viewed as an investment recommendation.

The light blue shows a sample "risk-free" rate, which serves as a reference point for all valuations.

The green box shows Schroders' target yield based on a thorough review of an issue (in this example, ETM/Prerefunded-US Treasury Backed Sinking Fund Bond). Our analysis indicates the yield on this issue should be closer to the risk free rate. However, the market is pricing this bond

at a much higher yield (dark blue box)- indicating it is undervalued and hence a buying opportunity.

Using this relative-value methodology, Schroders' municipal bond team invests across the full spectrum of sectors and geographic regions to build diversified portfolios that offer competitive returns and high levels of credit quality.

## Risk management

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Inherent within the fixed income process is a total risk management mentality. Our structured approach to risk management and monitoring utilizes a combination of formal and informal rules and guidelines, as well as proprietary quantitative models and externally supplied software tools, including, Charles River, Investor Tools Perform, and Barclays Point.

At a total portfolio level, the team seeks to reduce risk through diversification. For individual issues, position size is determined by an assessment of risk and reward across different strategies and is rigorously controlled based on the issuer's risk profile.

## Risk disclosures

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All investments involve risks including the risk of possible loss of principal. The risk of a municipal obligation generally depends on the financial and credit status of the issuer. Changes in a municipality's financial health may make it difficult for the municipality to make interest and principal payments when due. Under some circumstances, municipal obligations may not pay interest unless the state legislature

or municipality authorizes money for that purpose. The market value of the portfolio may decline as a result of a number of other factors, including volatility of the municipal bond market, interest rate risk, credit risk, liquidity risk and inflation/deflation risk. Some investors may be subject to state and/or local taxes and to the federal alternative minimum tax. For more information consult your tax advisor.

**Important information: The views and opinions herein are those of Schroders' investment professionals, and are subject to change over time.**

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