Schroders

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Schroder ISF* Global Recovery

Fund managers: N. Kirrage, A. Lyddon & S. Adler: Q4 2022

Performance overview

- Global equities gained during the quarter.
- The fund outperformed the benchmark.

Drivers of fund performance

- Stock selection was positive in Q4 across a number of sectors including consumer discretionary, financials and energy.
- The leading individual contributor was oil services firm **Saipem**. We purchased shares in Saipem in September after the rights issue, which was not fully subscribed. The market had become concerned about the deterioration of the Italian oil service company's financial position over the year owing to a number of bad contracts. A new CEO joined in summer 2022, and in October, Saipem announced a $4.5 billion contract in Qatar, representing its largest single offshore contract win in its history. Elsewhere in the energy sector, oil majors **Repsol** and **ENI** also supported fund performance. Repsol announced strong results in October, increasing the dividend to 70 cent as well as implementing a buyback programme with the extra cash that the underlying business is producing.
- Power supplier **Centrica** also added value. The group announced a £250 million share buyback in November. Centrica both produces gas and electricity, and supplies households with power.
- The more positive "risk-on" sentiment during the quarter helped to support our automotive parts holdings **Schaeffler** and **Continental**. For German stocks generally, worries over high power prices and potential shortages have been allayed thanks to reductions in overall usage, plus generally mild winter weather which has seen gas prices fall. Materials group **Heidelbergcement** also benefited from these reduced worries over energy supply.
- Among financials, a number of our bank holdings made a positive contribution to relative returns. These included **UniCredit, Intesa Sanpaolo** and **ING Groep**. Banks continue to benefit from the rising interest rate environment and from valuations which remain attractive. Moreover, their balance sheets are sufficiently robust to navigate a recession in Europe, the associated increase in losses and subsequent provisions to cover them.
- **AMC Networks** was the main individual detractor. There are some worries over prospects for advertising spending in the near term. Telecoms firm **BT Group** was another detractor. The business has been contending with strike action by staff.

Portfolio activity

- A new position in the portfolio is **Verizon Communications**. This US telecoms business has a manageable 7% yield, and the company has grown the dividend for the past 20 years. Moreover, having recently invested c.$50 billion on spectrum assets, it is plausible that lower levels of capex should be needed in future; however, we are cautious of basing an investment case on this expectation. With a strong free cashflow yield and a stable profit base, we believe the shares are attractively valued.
- We have done a significant amount of work on the memory sub-sector in the technology sector, looking at a number of the major global players given a fall in shares prices owing to a sudden fall in memory demand and the change in cost structure of the various memory mediums. After this, we bought a new position in **Western Digital** which has a strong market position in HDD, the type of memory used in data centres. Data centres continues to be a growing end market, one battle against deflation in pricing.
- We also initiated a position in **Samsung Electronics**. Samsung's shares have almost halved since 2021, for a number of reasons including not being able to escape the market's concerns of the slowdown in the memory market despite its solid balance sheet and well diversified business. Samsung's DRAM and NAND market position remains very strong and its scale results in a superior position in the cost curve. Given the fall in valuation and the very strong balance sheet (a third of the market cap is in cash and investments, and very little debt) we believe the risk reward trade off is attractive.
- Another new semiconductor addition is **Micron Technology**. While Micron suffers from significant cyclicality and will face near-term profit pressure,

*Schroder International Selection Fund is referred to as Schroder ISF throughout the balance sheet is strong and we think the shares are attractively valued on a five year view.

– Elsewhere, another new holding is Japanese medical supplies firm **Medipal**. We see it as a structurally growing business with a strong cash position. We see increased scope for returns to shareholders after pressure from an existing shareholder for Medipal to improve its capital management.
– Another new holding in the quarter is online marketplace **eBay**. With a cyclical slowdown coming, we must be mindful that eBay is an economically-sensitive business that is highly exposed to discretionary spending. That said, eBay has been re-focusing on core areas where it has a competitive advantage. We'd also highlight that the "take rate" (net transaction revenues/gross merchandise volumes) has been improving in recent years but remains lower than some competitors. We see it as a high quality business with a capital light model and strong profit margins.
– We have exited the positions in **Omnicom**, **Imperial Brands** and **Bristol-Myers Squibb** as the shares have reached our estimate of fair value.
– Within oil & gas services, **Drilling Company of 1972** merged with **Noble Corporation** so our holding is now in the latter. We see the merged group as attractively valued.

Calendar year performance (%)

Year	Fund	Target**	Comp. 1	Comp. 2
2021	21.5	21.8	21.9	14.1
2020	-5.8	12.3	-1.2	16.8
2019	20.3	27.7	21.7	20.6
2018	-14.0	-8.7	-10.8	-15.6
2017	19.5	22.4	17.1	24.6
2016	16.1	7.5	12.3	5.1
2015	-17.1	-0.9	-4.8	-2.5
2014	11.9	4.9	3.7	-1.6
2013				
2012				

Source: Schroders, net of fees, bid to bid, with net income reinvested. A Acc as at 31 December 2021. The target benchmark is MSCI World Net Return USD. The fund's performance should be assessed against its target benchmark being to exceed the MSCI World (TR) index and compared against the MSCI World Value (Net TR) index (comp.1) and the Morningstar Global Flex-Cap Equity sector (comp.2).

The majority of the fund's investments may be components of the target benchmark. The investment manager invests on a discretionary basis and is not limited to investing in accordance with the composition of the target benchmark. The investment manager will invest in companies or sectors not included in the target benchmark in order to take advantage of specific investment opportunities. The target benchmark has been selected because it is representative of the type of investments in which the fund is likely to invest and it is, therefore, an appropriate target in relation to the return that the fund aims to provide. Any comparator benchmark has been selected because the investment manager believes that the benchmark is a suitable comparison for performance purposes given the fund's investment objective and policy.

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

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. 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.

Emerging markets & frontier risk Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.

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.

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.

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.

Stock connect risk The fund may be investing in China "A" shares via the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.

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.