

# Schroder ISF\* Asian Convertible Bond Monthly Newsletter

Covering October 2019

## Market Overview

Performance %**		Oct. 2019	1 year	3 years (p.a.)	5 years (p.a.)
USD	I class	1.8%	7.7%	4.4%	4.7%
	A class	1.6%	6.1%	2.8%	3.0%
	BM	1.4%	7.1%	3.9%	4.4%
EUR	I class	1.5%	4.2%	1.8%	2.8%
	A class	1.3%	2.6%	0.2%	1.2%
	BM	1.2%	4.1%	1.7%	2.8%
CHF	C class	1.3%	3.0%	0.4%	1.3%
	A class	1.3%	2.4%	-0.2%	0.7%
	BM	1.2%	3.7%	1.3%	2.3%

\*\*Performance net of fees (where applicable), bid to bid.  
Source: Bloomberg, Schroders as at 31 October 2019.  
Benchmark: Thomson Reuters Asia ex Japan Convertible Bond Index (hedged for USD/EUR/CHF).

## Historical performance USD

(%)**	Fund (A Acc)	Fund (I Acc)	Benchmark
2018	-5.7%	-4.2%	-2.3%
2017	9.3%	10.9%	7.9%
2016	0.6%	2.2%	3.1%
2015	6.5%	8.0%	6.8%
2014	1.5%	3.1%	2.9%

Performance shown net of fees (where applicable), bid to bid, USD returns. Source: Bloomberg, Schroders as at 31 December 2018. Benchmark: Thomson Reuters Asia ex Japan Convertible Bond Index (USD hedged).

Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get the amount originally invested.

Some performance differences between the fund and the benchmark may arise because the fund performance is calculated at a different valuation point from the benchmark.

Please see the respective fund factsheets for the performance of other share classes.

Stock markets continued their upward trend in October. Investors' confidence in supportive central bank policies was strengthened with growing central bank balance sheets, dovish statements and low inflation expectations. In Europe, Mario Draghi finished his term as European Central Bank (ECB) president. Clearly, the ECB is not out of ammunition yet and with Christine Lagarde taking over, further supportive measures will remain on the agenda.

Overall, the MSCI world gained 2.6%. In the US, Dow Jones and the S&P 500 were up 0.5% and 2% respectively, while the tech heavy NASDAQ advanced 3.7%, bringing year to date performance on the index to 27.5%.

European bourses performed well with strong gains in Germany, where the Dax advanced 3.5% and in Italy, with the FTSE MIB 2.7% higher. Elsewhere, France's CAC40 was up 0.9% and the key Swiss benchmark gained 1.4%. The UK's FTSE 100 was the odd one out with a negative performance of -2.2%. The Eurostoxx 50 index gained 1%.

Asian markets posted strong gains across the board. In Japan, the Nikkei 225 was up 5.4%. The Hang Seng, in Hong Kong, and China's CSI 300 advanced 3.1% and 1.9% respectively. Taiwan, Korea and Singapore were also in the black, with gains of 4.9%, 1%, and 3.5%. The MSCI Asia ex Japan gained 4.5%.

Despite solid equity gains, high yield credit spreads widened slightly.

Convertible bonds were in demand once more and especially US valuations richened. On the other hand, Asian and to a lesser extent Japanese converts cheapened even further.

Asian convertible bonds as measured by the Thomson Reuters Asia ex Japan convertible index were up 1.4%.

Our fund outperformed its benchmark.

## Portfolio Overview

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We have not changed our overall exposures in the fund over the last few months. On balance, we continue to keep our equity exposure well above benchmark, maintaining an attractive risk/reward through exposure to more “balanced” bonds in the universe. This allocation is not based on a tactical bullish stance but rather driven by the opportunity set in Asian convertibles.

China and Hong Kong based companies continue to make up the vast majority of our holdings. Additionally, in terms of country risk allocation we retain a strong overweight in China. We have remained invested in a number of off benchmark Japanese positions. Also, our positions in New Zealand and Australia are off benchmark positions.

With regard to sector exposure, we remain positive on most sectors such as IT and consumer discretionary. We continue to be underweight in real estate names.

## Outlook and Strategy

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We have not changed our outlook over the last few months, and the current seesaw on global stock markets did not come as a big surprise. Hence, it is fitting to repeat the first paragraphs from previous newsletters:

The overall macro economic picture for Asia remains to be dominated by China – and with regard to China there are two dominating factors: the US China trade war and economic growth in China.

The Yuan exchange rate has helped to offset some of the negative tariff impacts on China. Still, the ongoing trade war with the US has left the Chinese economy in a weak state. While the official growth numbers still quote 6% economic growth for the third quarter of 2018, independent experts have questioned the data once more. Schroders own economist rely on our China Activity indicator. We estimate China's growth at lower than 5% recently. Clearly growth is slowing and especially industrial production is contracting.

Moreover there is the political situation in Hong Kong which dominates the political headlines but also brings back to mind that China is indeed a communist, centrally-managed society.

This is an additional negative effect on top of home-made problems resulting in a lacklustre growth outlook. Lately, China turned to economic measures to boost the economy. The required reserve ratio was cut in August to

increase liquidity to the financial system. The People's Bank of China did not follow rate cuts by central banks in the US and Europa, but stated it would “make flexible use of multiple monetary tools to maintain reasonable ample liquidity”. In terms of communication level, China has clearly joined the level of the Fed and ECB.

Still, there remains quite an arsenal for the government and the central bank to deploy such as tax cuts or the support for increased lending will have effects needs to be seen.

Overall, we remain positive that Asian convertible bonds will provide stability and long term contribution to a global asset allocation.

The fund's running yield sits at 1.2%. The portfolio's bond floor now is on a very high level of just under 90% while the overall credit rating remains on a BBB average with a credit spread of 241 basis points.

The strong gains in the first quarter have had a positive effect on the market structure. More convertibles are now back on the balanced part of convexity. It is important to note that valuations have not increased. Asian convertibles remain cheap and continue to trade below their fair value.

We think that they remain under-researched as many convertible bond specialists concentrate on Europe or US issues only. We continue to be of the opinion that convertible bonds offer a compelling balance of risk and reward for investors looking for Asian equity exposure.

## Risk Considerations

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The capital is not guaranteed.

Non-investment grade securities will generally pay higher yields than more highly rated securities but will be subject to greater market, credit and default risk.

A security issuer may not be able to meet its obligations to make timely payments of interest and principal. This will affect the credit rating of those securities.

Investments denominated in a currency other than that of the share-class may not be hedged. The market movements between those currencies will impact the share-class.

Investment in bonds and other debt instruments including related derivatives is subject to interest rate risk.

The value of the fund may go down if interest rate rise and vice versa.

It may be difficult to sell quickly positions of one or more companies to meet redemption requests upon demand in extreme market conditions.

Emerging markets will generally be subject to greater political, legal, counterparty and operational risk.

Emerging equity markets may be more volatile than equity markets of well established economies.

Investments into foreign currencies entail exchange risks.



## Fund Data\*\*\* 31 October 2019

Team	
Portfolio managers	Dr. Peter Reinmuth Chris Richards, CFA

Size & Holdings	
Fund size in base currency (USDm)	130
Number of issues	49

Portfolio Statistics****	
Equity Exposure	37.23%
Delta	46.75%
Bond Floor	89.82%
Average Rating	BBB
Credit Spread (bp)	241
Yield	1.17%
Effective Duration (years)	1.63

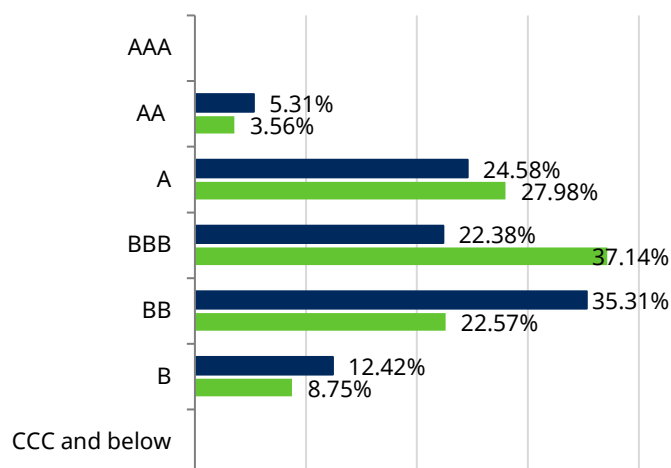
\*\*\*Source: Schroders 31 October 2019. Please note that the sector and country split follows the underlying equity rather than the issuer.

\*\*\*\*Average credit quality is based on official ratings where available and implied ratings. Yield is estimated on a running yield basis.

Region Allocation	Portfolio	Index
Australia	0.55%	0.00%
Chile	0.40%	0.00%
China	64.81%	59.30%
Hong Kong	8.27%	8.85%
India	0.00%	0.00%
Japan	3.51%	0.00%
Malaysia	1.58%	2.55%
New Zealand	0.26%	0.00%
Philippines	0.00%	0.00%
Singapore	1.05%	6.25%
South Korea	7.37%	9.20%
Taiwan	6.74%	10.26%
Thailand	0.00%	0.94%
Vietnam	3.94%	2.66%
	1.52%	
Cash		

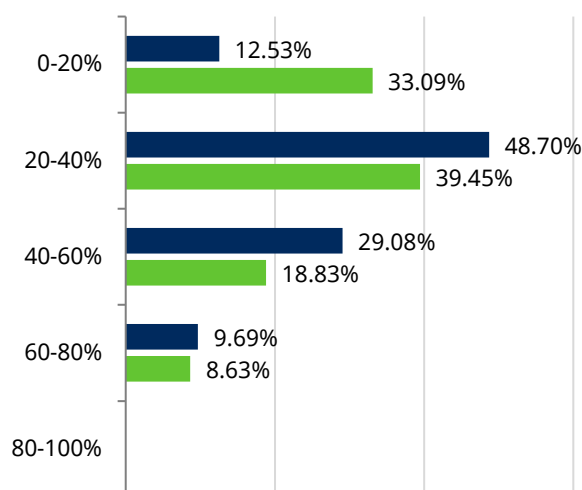
Sector Allocation	Portfolio	Index
Consumer Discretionary	18.73%	11.95%
Consumer Staples	0.00%	1.03%
Energy	0.00%	0.00%
Financials	16.18%	13.75%
Health Care	8.81%	5.65%
Industrials	7.41%	10.80%
Information Technology	23.10%	17.47%
Materials	5.50%	8.01%
Real Estate	18.74%	31.33%
Telecommunication Services	0.00%	0.00%
Utilities	0.00%	0.00%
Cash	1.52%	0.00%

## Credit Rating



■ Schroder ISF Asian Convertible Bond  
 ■ Thomson Reuters Convertible Bond Asia ex Japan

## Equity Sensitivity



■ Schroder ISF Asian Convertible Bond  
 ■ Thomson Reuters Convertible Bond Asia ex Japan

Source: Schroders as at 31 October 2019.

## Top Ten Issues

Rank	Holding	Portfolio	Sector
1	SMART INSIGHT INTERNATIONAL LTD 4.5000 CONV 05/12/2023 REGS	6.14%	Real Estate
2	POSEIDON FINANCE 1 LIMITED CONV 01/02/2025 REGS	5.89%	Financials
3	LENOVO GROUP LTD 3.3750 CONV 24/01/2024 REGS	5.68%	Information Technology
4	CHINA RAILWAY CONSTRUCTION CORPORATION LIMITED 0.0000 CONV 29/01/2021 REGS	5.50%	Industrials
5	HARVEST INTERNATIONAL COMPANY CONV 21/11/2022 REGS	5.37%	Consumer Discretionary
6	CHINA EVERGRANDE GROUP 4.2500 CONV 14/02/2023 - REGS	4.93%	Real Estate
7	Vinpearl JSC 3.500000 14/Jun/2023 3.5000 CONV 14/06/2023	3.94%	Real Estate
8	LG DISPLAY COMPANY LIMITED 1.5 CONV 22/08/2024 REGS	3.91%	Information Technology
9	JP MORGAN CHASE BANK NA 0.0000 CONV 30/12/2020 REGS	3.79%	Financials
10	SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION 0.0000 CONV 07/07/2022 REGS	3.38%	Information Technology

Source: Schroders as at 31 October 2019.

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