Fund performance

The fund posted a return of 7.82% for December. This compared to the FTSE Gold Mines Index benchmark return of 10.33%. Year-to-date 2018 the fund returned -13.90% compared to the FTSE Gold Mines Index benchmark return of -10.04%.

I shares gross

<table>
<thead>
<tr>
<th>US$ %</th>
<th>Dec 2018</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>Since Inception¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund</td>
<td>7.82</td>
<td>-13.90</td>
<td>11.28</td>
<td>-17.21</td>
<td>-20.67</td>
</tr>
<tr>
<td>Benchmark²</td>
<td>10.33</td>
<td>-10.04</td>
<td>10.23</td>
<td>-23.13</td>
<td>24.39</td>
</tr>
</tbody>
</table>

Calendar year performance

<table>
<thead>
<tr>
<th>US%</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund</td>
<td>11.28</td>
<td>-13.90</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benchmark²</td>
<td>10.23</td>
<td>-10.40</td>
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</tbody>
</table>

Source for performance: Bloomberg I shares gross USD. Performance is on a NAV to NAV basis. ¹Inception 29 June 2016. ²FTSE Gold Mines Index. Typical ongoing charges for I shares are 1.07%.

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.

Risk Considerations:
The counterparty to a derivative or other contractual agreement or synthetic financial product could become unable to honour its commitments to the fund, potentially creating a partial or total loss for the fund. A failure of a deposit institution or an issuer of a money market instrument could create losses. The fund can be exposed to different currencies. Changes in foreign exchange rates could create losses. A derivative may not perform as expected, and may create losses greater than the cost of the derivative. Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty and operational risk. Equity prices fluctuate daily, based on many factors including general, economic, industry or company news. A rise in interest rates generally causes bond prices to fall. 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. Failures at service providers could lead to disruptions of fund operations or losses.

Gold and broader market commentary

Broader market volatility picked up further in December, as did wider interest in gold and gold equities. This has prompted us to write a separate detailed report on the outlook for gold and gold equities (Gold and Gold Equities – Unloved, undervalued, increasingly relevant – January 2019).

The report is very informative, but the key messages for investors are summarised as follows;

Cyclically, now appears to be a reasonable time to be adding gold exposure

US economic outperformance, which brought with it a strong dollar and until recently, record high US equity markets, challenged gold performance for much of 2018 (indeed arguably since 2012). With clear signs of late cycle economic weakness, 2019 will likely see the end of “US exceptionalism”, bringing a weaker dollar and a fading belief in the illusion of Federal Reserve “normalisation”. Add to this backdrop a macro landscape littered with risks – from Brexit to US political dynamics to Chinese property markets – and the cyclical case for adding gold exposure appears strong.

Structurally, the argument for gold allocations continues to grow

We can break this into “commodity” arguments and “money” arguments. The commodity case for gold is still reasonable. However, the money case for gold is arguably stronger now than at any point in living memory. There are three main points here. The first is that equity market returns may be weaker in coming years than in the past decade and gold tends to do well when equities do less well. The second, is that the case for the U.S. dollar is structurally quite weak because the likelihood of much larger US deficits is quite high. The third argues that the case for gold is strong in direct proportion to the sheer abnormality of the current global monetary situation. Global financial markets have become overly reliant on Central Bank liquidity injections, while the global economy is arguably stuck in an

¹Schroder International Selection Fund is referred to as Schroder ISF throughout this document.
unprecedented debt trap. Extrication from this trap will test Central Bank credibility to the limit, and we see gold as the ultimate hedge against a potential loss of Central Bank credibility.

**What unconventional policy responses might meet a new global downturn?**

Against a backdrop of rising populist pressures, and QE policies losing credibility for driving wealth inequality, investors should be turning their thoughts to what unconventional policy responses might meet a new global downturn. A return to QE is probable, but additional measures to visibly and more directly help the man in the street are likely. These could well be fiscal, or even involve some form of “helicopter money”.

Either way the inflationary potential should be clear. In a world grappling with de-globalisation and rising geo-political stress, the potential for stagflationary outcomes, accompanied by deeply negative real interest rates, is real. None of this is certain, and of course there are downside scenarios for gold, but the sense we are entering an era where wealth preservation will play a more dominant role in portfolio construction decisions, is building. Gold investment could surge from depressed levels relative to global US$ financial assets (Chart 1).

**The equities offer a clear valuation opportunity**

- Global gold equities are set to generate strong free cash flow yields and trade on depressed P/B multiples (see chart 1), while NPV valuations are attractive (without needing to assume much higher gold prices).
- The sector is absolutely ripe for consolidation and the Randgold / Barrick combination may mark the start of a major trend.
- Management attitudes to cash generation and balance sheet discipline have fundamentally changed (honestly), and will take a long time to get back to the hubris of the late boom years.
- The industry as a whole is now much more conservative from a balance sheet perspective.

**Chart I – NYSE Arca gold bugs FCF yield plotted against price / book ratio**

Source: Bloomberg, Schroders Estimates – January 2019

The above chart summarises very well how cheap the gold equities are right now. If these management teams deliver on their free cash targets, 2019 and 2020 could be their highest free cash yield for the last 18 years. If these management teams deliver on their free cash yields then a Price / Book valuation of just over 1x is completely unjustified and we expect an upward rerating! There is much more detail in the full report (Gold and Gold Equities – Unloved, undervalued, increasingly relevant – January 2019)

**Equity subsector performance and positioning – 31 December 2018**

The Australian gold equities (ASX Gold Mining Index) increased by 6.4% in USD terms during December. At month end, the fund had around 17.9% exposure to Australian listed gold equities. This compared to the benchmark weight of 20.8%.

The South African gold equities (JSE Gold Mining Index) increased by 21.2% in USD terms in December in USD terms. At month end, the fund had around 10.7% exposure to South African gold equities. This compared to the benchmark weight of 8.3%.

The North American gold equities (S&P/TSX Gold Index) increased by 11.0% in December USD terms. At month end, the fund had around 60% exposure to North American gold and precious metals producers. This compared to the benchmark weight of 65%.

**Performance attribution and portfolio activity**

December performance was positive. Strong outperformance of our holdings in Endeavour and Oceana, resulted in 65bps of positive attribution. Oceana continues to expand its resource base through positive exploration and despite the company adding 175bps of full year 2018 attribution, we continue to see significant upside on its NAV and remain a core holding going into 2019.
Monthly chart pack

Chart 1: Spot gold prices expressed in various currencies

Chart 2: Consumer price index (CPI) for major economies

Chart 3: US core personal consumption expenditures (PCE) vs civilian worker wage costs

Chart 4: Total ETF gold holdings vs spot gold price

Chart 5: US Five-Year TIPS plotted against spot gold

Chart 6: CBOE SPX volatility Index (VIX)
**Chart 7: Total Shanghai gold exchange volume plotted against spot gold price**


**Chart 8: Gold vs US dollar**

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