Schroder ISF¹ Global Gold Fund update
January 2019

Fund performance

The fund posted a return of 9.37% for January. This compared to the FTSE Gold Mines Index benchmark return of 7.77%.

I shares gross

<table>
<thead>
<tr>
<th>US$ %</th>
<th>Jan 2019</th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
<th>Since Inception¹</th>
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<td>Cumulative</td>
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<td>Performance</td>
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<td>Annualised</td>
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<td></td>
<td></td>
<td></td>
<td>Performance</td>
</tr>
<tr>
<td>Benchmark²</td>
<td>7.77</td>
<td>-10.04</td>
<td>10.23</td>
<td>-23.13</td>
<td>-17.86</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>
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<tr>
<td>Benchmark²</td>
<td>10.23</td>
<td>-10.40</td>
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Source for performance: Bloomberg I shares gross USD. Performance is on a NAV to NAV basis. ¹Inception 29 June 2016. ²FTSE Gold Mines Index.

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.

Gold and broader market commentary

Gold ended 2018 brightly and has continued moderately higher in early 2019 despite a very sharp recovery in US equities and increased optimism over a solution to the current US-China trade impasse.

The critical question for gold now is whether it can break the ~US$1,360-65/Oz level which has proved such stubborn resistance over the past three years. Since early 2016 gold has challenged this level four times.

Whether it can is clearly not just a matter of chance. Most importantly it depends on what happens to the US economy. As we recently wrote in our outlook for gold and gold equities in 2019 and beyond (Gold and Gold Equities – Unloved, undervalued, increasingly relevant – January 2019) the two most important cyclical drivers for gold are the US$ and the path of US equities. Underpinning both these factors, more than anything else, is the overall health of the US economy. If recent weak datapoints (in housing, autos, consumer confidence and elsewhere) morph into a deeper slowdown than currently forecast by consensus then we fully expect the recent recovery in US equities to prove a bear market bounce, for the dollar to weaken further and for investor engagement in gold ETFs to accelerate. Datapoints like that expressed in chart 1 below, highlighting that the gap between US consumer future expectations and US consumers perception of current reality have not been so wide since 2001, do not fill us with confidence about the US economic outlook. As such, we view the chance of a breakout as quite high, and the fund remains fully invested.

¹Schroder International Selection Fund is referred to as Schroder ISF throughout this document.
Gold equities: M&A momentum continues to build

Following the Randgold / Barrick merger which completed at the start of January 2019, M&A momentum has continued with the announcement on Newmont's acquisition of Goldcorp.

At 10% of our fund, we recognised the value in the Goldcorp assets, particularly if management executed their 20/20/20 strategic plan of cutting costs by 20%, growing production by 20%, by 2020.

As a result, we think the price paid (a 17% premium to a share price languishing close to five year lows, and just 0.6x price / book) was far too low. But worryingly, the fact that management were so quick to accept Newmonts bid suggests the much vaunted 20/20/20 strategic plan promoted by Goldcorp was in fact highly over-ambitious.

From this point in time, we think the combined entity is an attractive proposition. The best management team in the industry (Newmonts management team) can apply their cost control to the Goldcorp assets. We think the synergies will be significant.

Looking beyond this merger, we think there will be further consolidation in the industry; and to be blunt, it really is needed. There are over 200 listed “precious metal producers” with market capitalisations over US$100m globally, if you include smaller producers the number rises to above 1,100. The mass majority of these are gold miners. We see industry M&A and consolidation as both natural and necessary.

It is true that mining “synergies” from an operational perspective often disappoint. It is quite rare to find genuinely contiguous assets where infrastructure costs and fleets can be shared (Nevada would be one obvious exception where Barrick and Newmont operate substantial combinable assets).

However, the area cost savings can be obviously achieved is in industry G&A. The industry, mainly at the board level and particularly in certain jurisdictions, pays itself very well. In addition replicating head office functions in remote locations can be costly. There are some fairly obvious examples. In the small cap space the combination of Great Panther Silver and Beadell Resources brings together assets in Mexico and Brazil under one management team and one balance sheet. The previous situation, where Beadell was managed from Perth, among other issues, limited the amount of time senior management were able to spend onsite. Another example from the same region is the acquisition of Tahoe by Pan American silver. Recent year Tahoe G&A expenditure has been close to US$50m. We expect that if the Pan American acquisition goes through this can be cut substantially.

On compensation in particular, we expect shareholder activism to increase on this front. The severance pay accorded to David Garofolo upon the change of control resulting from the recent Newmont acquisition is, for example, completely unjustifiable given the destruction of shareholder value through his short tenure (joined April 2016) and the significant underperformance versus peers.

On mining productivity perhaps results from Pogo, the Alaskan based asset bought recently by Northern Star from Sumitomo, will be an acid test of this point. If Northern Star can make substantial improvements, as well as sharpening the spot light on existing management teams in the region, it will further strengthen the logic of inbound M&A transactions into the undervalued North American sub-sector. Certainly at assets such as Stillwater (palladium asset in Montana now run by Sibanye) the introduction of Australian shift patterns and other practices has improved operational results and reduced costs.

More broadly, despite the strong start to 2019, we still see a strong case for the gold equities:
- Global gold equities are set to generate strong free cash flow yields and trade on depressed P/B multiples, while NPV valuations are attractive (without needing to assume much higher gold prices).
- The sector is absolutely ripe for consolidation and we think the Randgold / Barrick and Newmont / Goldcorp combinations mark the start of a major trend.
- Management attitudes to cash generation and balance sheet discipline have fundamentally changed, and will take a long time to get back to the hubris of the late boom years.
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!

Equity subsector performance and positioning – 31 January 2019

The Australian gold equities (ASX Gold Mining Index) increased by 11.4% in USD terms during January. At month end, the fund had around 17.2% exposure to Australian listed gold equities. This compared to the benchmark weight of 21.2%.

The South African gold equities (JSE Gold Mining Index) increased by 14.7% in USD terms in January in USD terms. At month end, the fund had around 10.4% exposure to South African gold equities. This compared to the benchmark weight of 8.5%.

The North American gold equities (S&P/TSX Gold Index) increased by 6.2% in January USD terms. At month end, the fund had around 62% exposure to North American gold and precious metals producers. This compared to the benchmark weight of 64.5%.

Performance attribution and portfolio activity

January performance was positive. Strong outperformance of holdings including Alacer, Centerra and Eldorado resulted in significant outperformance of the benchmark.

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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