Schroders

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Schroder ISF* EURO High Yield

Fund Manager: Hugo Squire | Fund update: December 2022

Performance overview

- Bond yields were rising in December, reflecting a hawkish tone from the central banks.
- The Federal Reserve (Fed) and Bank of England both enacted rate hikes, while the Bank of Japan announced a modification to its yield curve control policy. The ECB maintained its hawkish position.
- The US 10-year yields rose from 3.61% to 3.88%, with the two-year rising from 4.34% to 4.42%. Germany's 10-year yield increased from 1.93% to 2.57%. The UK 10-year yield increased from 3.16% to 3.67% and 2-year went up from 3.26% to 3.56%.
- High yield and investment grade delivered positive excess returns vs. government bonds, as euro spreads tightened in the month.
- However, as yield rose total returns for European investment grade US and euro High Yield, and US investment grade were negative.
- The US dollar rally continued to slow with the dollar index finishing the year higher than 2021.

Drivers of fund performance

- The fund ended the month with a negative return and beat the ICE BofA Euro High Yield Constrained index.
- Security selection in Senior Banking, Services and Telecommunications has contributed to the outperformance as well as the underweight to automotives
- Overweights to real estate detracted from performance together with security selection in Capital Goods and Media.

Portfolio activity

- After the very strong returns in November, the global credit market gave back some of those gains in December, driven by rising yields.
- We decreased our exposure to defensives, while increasing exposure to cyclicals and financial institutions.
- We reduced the portfolio's BB-rated holdings through the sale of names in energy, senior financial services and telecommunication.
- The portfolio expanded its B-rated names through the purchase of names in services, technology and telecommunications.
- We also expanded BBB-rated names, largely through the purchase of holdings in energy, tier two financial services and media.

Outlook/Positioning

- Credit spreads were largely tighter with the exception of US high yield, but government bond yields were higher, reflecting some market disappointment at the hawkish tone from some central banks, despite mounting evidence of slowing economic growth.
- The new year begins with the global credit markets in much better shape, with overall yields having been re-charged during a very painful correction in 2022.
- Volatility is likely to persist, but we see much better opportunities from allocating investment capital globally, more potential from sector and issuer selection, such as in banking and real estate, improving coupons, and we are much closer to the end of central bank tightening than the beginning.
- In all, we think that bonds, and credit in particular now offers a very good deal for investors in 2023.

Calendar year performance (%)

	A Acc	I Acc	Target
2022	-13.9	-12.9	-11.5
2021	4.5	5.8	3.3
2020	4.2	5.6	2.7
2019	9.8	11.1	11.2
2018	-5.5	-4.4	-3.6
2017	6.7	8.0	6.7
2016	10.0	11.4	9.1
2015	3.5	4.8	0.7
2014	5.0	6.3	5.4

*Schroder International Selection Fund is referred to as Schroder ISF throughout the document.

2013	8.5	9.8	10.0
2012	-	-	-

Source: Schroders, as at 31/12/2022. All performance net of fees (where applicable), NAV to NAV (bid to bid), EUR. Target : ICE BofA Euro High Yield Constrained Index.

– Past performance is not a reliable indicator of future results. The value of investments and the income from them may fall as well as rise and investors may not get back 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.

Risk considerations

– **Capital risk / distribution policy**: As the fund intends to pay dividends regardless of its performance, a dividend may represent a return of part of the amount you invested.
– **Contingent convertible bonds**: The fund may invest in contingent convertible bonds. If the financial strength of the issuer of a contingent convertible bond falls in a prescribed way, the value of the bond may fall significantly and, in the worst case, may result in losses to the fund.
– **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.
– **Credit risk**: A decline in the financial health of an issuer could cause the value of its bonds to fall or become worthless.
– **Currency risk**: The fund may lose value as a result of movements in foreign exchange rates.
– **Currency risk / hedged share class:** The hedging of the share class may not be fully effective and residual currency exposure may remain. The cost associated with hedging may impact performance and potential gains may be more limited than for unhedged share classes.
– **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. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. When the value of an asset changes, the value of a derivative based on that asset may change to a much greater extent. This may result in greater losses than investing in the underlying asset.
– **Event risk**: The fund will take significant positions on companies involved in mergers, acquisitions, reorganisations and other corporate events. These may not turn out as expected and may result in losses to the fund.
– **High yield bond risk**: High yield bonds (normally lower rated or unrated) generally carry greater market, credit and liquidity risk.
– **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.
– **Interest rate risk**: The fund may lose value as a direct result of interest rate changes.
– **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.
– **Market risk**: The value of investments can go up and down and an investor may not get back the amount initially invested.
– **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.
– **Sustainability risk**: The fund has environmental and/or social characteristics. This means it may have limited exposure to some companies, industries or sectors and may forego certain investment opportunities, or dispose of certain holdings, that do not align with its sustainability criteria. Therefore, the fund may underperform other funds that do not apply similar criteria. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

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