Schroders

Schroder Securitized Credit

Strategy Overview

Summary

Schroder Securitized Credit strategies seek to add value at different points in the credit cycle by capitalizing on cyclical opportunities among sectors with diverse underlying assets. Our approach begins with a top-down examination of the fundamentals and technical factors across sectors using macro-economic, sector and in-depth trend-oriented research of the mortgage and real estate landscape. This is combined with a detailed risk profiling analysis that groups securities across sectors into similar liquidity, volatility and structural leverage profiles. This bottom-up analysis incorporates an in-depth quantitative assessment and modeling of each bond over a wide variety of economic scenarios and is the foundation for our relative value decisions. This assessment is further enhanced with a qualitative analysis of several other key factors such as counterparty and servicer capabilities and risk. We believe this comprehensive approach is the ideal process to capture value in the securitized market.

Schroder Securitized Credit strategies include a range of benchmarked, floating-rate or cash, opportunistic and direct real estate loan strategies. All of the strategies can invest in bonds across a broad spectrum of the securitized sectors and, where permitted, loans tailored to different risk/reward profiles. The Team also manages a number of bespoke portfolios designed to meet a client's specific needs and/or regulatory requirements. Additionally, any strategy can be managed to a risk-free base rate in most currencies.

	Benchmark Oriented	Floating-rate	Opportunistic		Private Credit	Private Debt
Strategy name	**Enhanced Securitized**	**Enhanced Securitized LIBOR/LIBOR Plus**	**Opportunistic Multi-Sector Securitized**	**Securitized Credit Return Opportunities**	**Opportunistic Credit Funds**	**LReal estate/mortgage loan funds**
Key objectives	Benchmark aware, low tracking error	Attractive return, low volatility, low/no duration	Opportunistic income, corporate credit alternative	Opportunistic return, credit alternative* uses leverage	Dislocation/ Inefficient market opportunities fund	Benefit from illiquidity premium in lower leverage loans
Income	✓	✓	✓	✓	✓	✓
Diversification	✓	✓	✓	✓	✓	✓
Capital appreciation	-	-	✓	✓	✓	-
Rate protection	-	✓	✓	✓	✓	✓
ESG	✓	✓	✓	✓	✓	✓
Impact investing	-	-	-	-	-	✓
Benchmarks/alpha	Securitized Index + target	LIBOR+ 150 - 350 bps	LIBOR + 500 bps	10% total return	FOCUS II 15% net return	7%-9% IRR unleveraged
Leverage-Financial	No	No	No	Yes	Funds may use this option	Funds may use this option
Capacity/Scale	Unlimited >25bn	Unlimited >25bn	$10.0bn	$2.5bn	>$10bn	>$10bn
Liquidity	Daily (T+3)	Daily (T+3)	Quarterly	Quarterly	None (income may be distributed)	None (income distributed)

*Includes delegated AUM managed on behalf of Schroders funds globally.
Source: Schroders as of May 2020. There can be no guarantee that any investor objective or outcome will be achieved. For illustrative purposes, intended only to demonstrate the depth and breadth of the Team's investment capabilities. Capital preservation and protection references do not reflect an absolute guarantee against capital loss.
Please refer to the back of this handout for important information. There can be no guarantee that any investment strategy will achieve its objective.

Why Schroders for Securitized Credit?

- Consistent and proven research-oriented, value-driven investment process, practiced for more than 20 years
- Proprietary research, models and risk profile analysis using state of the art technology to develop and evaluate investment ideas
- Specialist culture seated within a global investment team of over 50 portfolio managers and more than 40 analysts/ researchers provides access to experts in the macroeconomic research, interest rate assessment and related credit sectors
- Successful performance track record over full market cycles[1]

Firm highlights

- Founded in 1804, with a strong family presence to this day
- Asset management is our main business
- Over 775 investment professionals worldwide
- Truly global reach: based in London, with offices in 37 countries
- Expertise in Fixed Income, Equities, Multi-Asset, Solutions, and Alternatives

Team highlights

- Long-standing and distinctive expertise in securitized credit with unique MBS history
- 15 investment professionals, with diverse industry backgrounds, an average of 20 years experience and a leadership structure that has been in place for more than 17 years. The team includes dedicated developers and statisticians
- Distinctive real-estate approach in sectors with robust data availability and analysis

Key features

- Industry-leading proprietary analytics and models
- Scale and scope conscious, facilitates alpha-oriented style as demonstrated by strong historical risk-adjusted performance
- Wide latitude to look for long-term benefits in dynamic markets with significant alpha potential
- Sector allocation and security selection help drive return generation
- Key decision makers have been together for a substantial period and an open culture facilitates the ability to generate and execute on ideas

Investment philosophy

We believe in an understanding of collateral cash flow and the impact of structure is the foundation of generating returns in a market where size and complexity leads to exploitable inefficiency.

Collateral cash flow:

- Credit cycle placement helps to determine base case and variance around it
- Quality and amount of data impacts the degree of accuracy
- Historical understanding of / perspective on markets and participants

Structure:

- The right packaging can add protection from or enhance sensitivity to a risk exposure
- Isolates the critical sources of performance and variation

All data and statistics as of June 30, 2020, unless otherwise noted.
1 Past performance is no guarantee of future results.

Investment process

Schroder Securitized Credit strategies use a research oriented, value-driven approach to seek return by investing across the full spectrum of global securitized assets, such as mortgage-backed securities (commercial and residential) and asset-backed securities. Our focus is on data intensive sectors where we believe we possess a competitive advantage in analyzing relative value opportunities.

We identify fundamental and technical factors that drive performance for the overall securitized market and specific sectors, including an assessment of regulation, access to credit, interest rates, prepayment trends and delinquency rates. These factors are incorporated into proprietary models to conduct sensitivity analysis. This identifies risk-profile groupings of securities that are consistent with our view and represent areas of opportunity.

We analyze the option value of each bond and conduct stress testing along a continuum of variables. Each security's cash flow and capital structure are analyzed to determine factors that contribute to strength or weakness. We compile extensive details on loan originators and servicers using data gathered through multiple sources, site visits, and competitor assessments. This is vital as bonds with very similar collateral can experience vastly different performance and cash flow timing due to specific tendencies of the originator and servicer. Portfolio construction ensures combined risks are appropriate across: liquidity, credit, volatility and duration. Portfolios are constructed based on our dynamic assessment of value relative to the expected risk and liquidity requirements.

Portfolio construction aggregates relative value decisions and ensures combined risks are appropriate across four main attributes: liquidity, credit, volatility and duration. Target levels of risks are determined by a combination of research-led conviction on the environment and the level of compensation (pricing). Portfolios are constructed and/or adjusted based on our dynamic assessment of value relative to the expected risk and liquidity requirements. Using this framework, the team identifies preferred asset class and sector exposures, as well as preferred collateral types and counterparty exposures within each targeted risk profile that offer the best value. This integrated approach allows us to efficiently construct as well as execute changes to portfolio positioning should we see changes to potential risks.

Liquidity management is embedded in portfolio construction, with tiers of liquidity including the use of cash/cash equivalents in periods of limited supply or opportunities, such as highly liquid securities (i.e. AAA-rated ABS FRNs, Agency MBS), and larger issue-size bonds with more frequent trading history.

In addition, consideration for environmental, social, and/or governance (ESG) factors are an integrated part of the team's investment process. Furthermore, active engagement with companies is conducted alongside the efforts of the Schroders Sustainable Investment team.

There is no guarantee the investment process will achieve its objective.

Investment research

All members of the investment team are active in the research and investment process. Senior team members and analysts are responsible for specific risk profiles and market technical factors. Research specialists help to identify trends in collateral performance, servicer and issuer performance, as well as ongoing surveillance that drive our model and scenario-based analyses. This integrated approach allows us to develop detailed proprietary asset and risk profile specific analytics to identify and capitalize on diverse opportunities in a cohesive relative value framework.

Risk management

Risk controls are used to ensure portfolios are invested appropriately for each mandate and are consistent with the sector and style discipline. The portfolio management team reviews portfolio holdings and risk characteristics daily.

The team also integrates and augments third party systems with internally developed analytics to measure and evaluate portfolio, sector, and security risk exposures.

At the firm level Schroders believes risk management is a crucial component of the investment process. We have established a three defense approach which provides a rigorous framework to ensure that all of our fund and client mandates are managed in a manner consistent with their performance objective, risk profile, and investment guidelines:

1. First line – Portfolio management and Asset Class Head or Global Head of Product Oversight
2. Second Line – "Independent" Group Risk Oversight
3. Third Line – Internal Audit Assurance and Group Compliance

There is no guarantee the risk management process will achieve its objective.

Risk disclosures

All investments involve risks including the risk of possible loss of principal. Asset allocation and diversification cannot ensure a profit or protect against loss of principal. Duration is a measure of volatility expressed in years. The higher the number, the greater potential for volatility as interest rates change. The market value of a bond portfolio may decline as a result of a number of factors, including interest rate risk, credit risk, inflation/deflation risk, mortgage and asset-backed securities risk, U.S. Government securities risk, foreign investment risk, high yield securities risk and derivatives risk. The use of leverage may magnify gains and losses.

Asset-backed, mortgage-backed or mortgage-related securities are subject to prepayment and extension risks, delinquency and foreclosure. The use of derivatives involves risks different from, or possibly greater than, the risks associated with investing directly in the underlying assets. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Bonds rated BBB/Baa or higher are considered investment grade, while bonds rated BB/Ba or lower are considered speculative as to the timely payment of principal and interest.

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