Schroders

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Schroder ISF* Strategic Bond

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Performance overview

- Global bond yields moved broadly higher as central banks indicated they were prepared to withdraw emergency monetary policy accommodation in light of rising inflationary pressures. Curves continued to flatten, as short-dated yields rose markedly.
- Global investment grade credit was flat, in line with government bonds. High yield saw negative returns.
- Emerging market sovereign debt (hard currency) was little changed, while local currency bonds weakened. EM currency performance varied against the US dollar, which was broadly modestly weaker on the month.

Drivers of fund performance

- The fund saw a negative return. Currency positioning detracted, mainly our long in the US dollar, notably against sterling and the Swedish krona. The US dollar weakened despite Treasuries pricing in higher rates.
- In rates, our overall long duration and long to Italy versus Germany detracted. Our US 10 to 30-year curve flattener and long UK versus Australia were effective. Our short to US and UK inflation detracted.

Portfolio activity

- We reduced duration at the headline level, mainly in the US, but we retained a flattening bias, holding an overweight to the 30-year and corresponding underweight to the 10-year sector of the curve. We see longer-dated US Treasuries remaining well supported given the risk of slower consumption growth. We closed our short to inflation but retained our US real yield flattener.
- We reduced our overall long to UK duration given the risks from shifting monetary policy expectations, but our strategic view remains that the Bank of England will be constrained by challenges to domestic growth next year. We added a long UK versus US, closing the longs versus Germany and Australia. Australian yields rose and we opened a long position against the US.
- In Europe, ECB President Lagarde's refusal to push back on market pricing of rate hikes was seen as hawkish. Italian yields rose and we added to the long position versus Germany. We bought a NextGenerationEU green bond issue in anticipation of tighter spreads versus swaps, also positioning for steepening at the front end of the yield curve, all reflective of our positive outlook for the European economy.
- We reduced the fund's sensitivity to the global cycle, adding a short to the Swedish krona versus US dollar and extending our short Czech koruna versus euro.
- We initiated a short to the Australian dollar against the euro and the Japanese yen, expressing our longer-term view on China's slowdown and downside risks for its closest trading partners. We prefer to express our view on China's slowdown in currency and closed our overweight to Korea.
- Given our more pessimistic view on the UK outlook, we used attractive levels to add to our short sterling versus the US dollar.
- We have become less constructive on EM currencies given the significant rise in commodity prices, with oil importers in particular facing deteriorating terms of trade and potentially weaker currencies. We closed overweights to the Brazilian real, the Indian rupee, the Korean won and the South African rand, as a result closing our underweight to Canadian dollar.

Outlook/positioning

- Our dominant view at present is that consumption growth faces headwinds from a number of factors, including reduced monetary and fiscal policy support and higher inflation squeezing real incomes. So far, data has remained fairly resilient and we acknowledge that this idea may take longer to play out.
- We are also starting to see central banks pushing back on the market's hawkish rate expectations. Expectations that monetary policy accommodation in Europe remains in place forms part of our relatively positive view on the economic outlook.
- Our outlook for emerging markets has become more mixed. Having been positive, as EM economies rebounded following the impact of Covid, we now think that the higher oil price will lead to deteriorating terms of trade for importers, with the prospect of weaker currencies.

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

Calendar year performance (%)*

Year	Fund (A Acc)	Fund (I Acc)
2020	-1.3	-0.1
2019	7.7	9.0
2018	-2.9	-1.7
2017	1.2	2.5
2016	2.9	4.2

Source: Schroders, Bloomberg, as at 31/12/2020. Performance net of fees (where applicable), NAV to NAV (bid to bid), USD. Fund performance should be assessed against its objective of providing a positive return over a 12-month period in all market conditions.

- 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 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

- **ABS and MBS risk**: The fund may invest in mortgage or asset-backed securities. The underlying borrowers of these securities may not be able to pay back the full amount that they owe, which may result in losses to the fund.
- **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 shareclass**: 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 – efficient portfolio management and investment purposes**: 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.
- **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.
- **Issuer risk**: The fund is permitted to invest more than 35% of its scheme property in transferable securities and money market instruments issued or guaranteed by an EEA State / governments of the following country: United States of America.
- **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.
- **No capital guarantee risk**: Positive returns are not guaranteed and no form of capital protection applies
- **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.

Important information