Schroders

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Schroder ISF* Global Conservative Convertible Bond
Monthly Fund Update
Covering December 2020

Market overview

Performance %		Dec 2020	1 Year	3 Years (p.a.)	5 Years (p.a.)
USD	I class	1.5%	9.0%	4.4%	4.1%
	A class	1.4%	7.5%	2.9%	2.7%
	BM**	1.5%	7.0%	3.4%	2.8%
EUR	I class	1.3%	7.3%	1.9%	2.0%
	A class	1.2%	5.7%	0.4%	0.5%
	BM	1.4%	5.9%	1.3%	1.0%
CHF	I class	1.3%	7.0%	1.6%	1.6%
	A class	1.2%	5.4%	0.1%	0.2%
	BM	1.4%	5.8%	1.0%	0.7%

**Benchmark: Thomson Reuters Global Focus Convertible Bond Investment Grade Index (hedged for USD/EUR/CHF). Performance shown bid to bid, net of fees (where applicable) as at 31 December 2020, Source: Schroders, Bloomberg.

Historical Performance

	Fund (A Acc)	Fund (I Acc)	BM**
2020	7.5%	9.0%	7.0%
2019	7.6%	9.1%	7.1%
2018	-5.8%	-4.4%	-3.5%
2017	3.9%	5.4%	1.6%
2016	4.8%	6.3%	6.2%

Performance data bid to bid, net of fees. Source: Bloomberg, Schroders as at 31 December 2020.

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.

Global stock markets finished the Corona year 2020 on a record high. Around the world, markets noted positive performance for the month of December.

Markets were driven by strong hopes of first vaccines being approved and administered. At the same time, stimulus discussions in the US resulted in an almost permanent positive sentiment. Doubts that the number of vaccine doses available is still too low at present, while mutations of the virus caused an exponential growth in Covid case numbers, were simply shrugged off by market participants. The bulls were clearly in control. Around the world, stock markets continued their bullish run in December.

Despite the vicious market reaction to the lockdown measures in spring, 2020 turned out to be a record year for investors. Global equity markets as measured by the MSCI were up a full 16.8%, mainly driven by stocks benefitting from the new way we all work, live, communicate, shop, and trade in Corona times. It's no surprise that the IT heavy Nasdaq was one of the best markets to be invested in with a plus of 45%, while the 2020 S&P performance gain of 16.7% was 70% driven by IT alone.

For the month of December, US equity markets noted advances of 3.7% for the S&P, 3.2% for the Dow Jones and Nasdaq finished the year with another plus of 5.7%.

Over to Europe where the overall Eurostoxx stated a plus of 1.7% for December. Germany's Dax was up 3.2%, but in France and Italy stock markets lagged a bit with gains of 0.6% and 0.8%, respectively. In the UK, FTSE benefitted from a last minute Brexit deal and advanced 3.1%.

A similar positive picture emerges from Asia. In Japan, Nikkei advanced 3.8%. China's CSI was up 5.6% and Hang Seng moved 3.4%. Other Asian markets stated gains as well. Koreas KOSPI was up 10.9%, in Singapore the stock exchange was up 1.4%. The Taiwanese stock market finished the month of December with a plus of 7.4%.

The MSCI World ended December with a plus of 4.5%. Convertibles benefited significantly from this tailwind. The Refinitiv Global Focus Investment Grade index, which measures balanced convertible bonds gained 1.5% in USD terms.

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

Portfolio overview

In the last few months, we steadily rebalanced our portfolio and sold high delta names into the rising market, thus locking in profits and moving capital to balanced and more protected converts mainly on the primary market.

In December, markets continued to move upwards and convertibles once more profited from the stock market tailwind. Again, we reacted to the impact that rising stocks had on the risk characteristics of our convertible bonds and we have trimmed positions. This, we locked in gains and rebalanced. Overall, we remain underweight in risk terms against our benchmark.

Similar to recent months, we remain underweight to both, the US and to Europe in the fund in favour of the smaller and more discounted convertible bond regions, Asia and Japan,

Since the start of the bull market after the Corona setback in March, the primary market for convertibles has reached record highs not seen for the last ten years. All in all, USD 166bn of new convertible bonds were issued and easily absorbed in 2020. In December, we saw another USD 11.4bn of new paper.

The fund's running yield stands at 0.2%. The portfolio's bond floor now stands at 82%, while the overall credit rating of the fund remains at a BBB+ average.

Outlook and strategy

We have not changed our mid-term outlook over the last few months. Convertibles are clear beneficiaries of the central bank induced market rally.

Now at the beginning of 2021, equity markets have priced in each and every piece of good news: advances in vaccine, significant new fiscal stimulus around the globe, last minute Brexit deal and further excessive quantitative easing. Rational markets would at least question some of these drivers: what percentage of the population can get vaccine fast enough, how can Covid case numbers be stopped and what is the economic impact of yet another lockdown.

Clearly, there is a degree of irrational exuberance. On the other hand, this makes it easy to forecast at least one variable for this year: volatility will remain high as we will see set-back(s) on the equity markets.

Another easy forecast is the liquidity-driven behaviour of assets in a crisis. We believe that similar to the spring 2020 Corona crash, correlations will jump to 1. That means that all assets will be sold, and prices will drop throughout the spectrum of stocks, bonds, converts, gold, and other risk assets. Simply put, there will be no place to hide. As diversification between asset classes may not work, investors need to find convex asset classes that have a built-in safety net and absorb some part of the shock on their own.

With the typical wave like dynamic, the convertible issuance market has once more found the ideal spot in 2020. Convertibles point investors to "where the music plays". However, it is important to constantly rebalance risk, sell into rising markets and lock in gains as eventually, the music will stop playing.

When the Corona dust eventually settles, we will see two major regime shifts. In the US; bond investors have finally given up on another Fed rate cycle and accepted the death of interest rates. Of course Japanese investors have lived in this environment for decades and Europeans are used to this for more than 10 years now, but it is something new for the US. And for the last die-hard bond investor the Fed spelled it out very clearly: with the averaging of inflation numbers, rates will not rise even if inflation eventually does.

At the same time, the European Union developed into what politicians had always refused to admit and were contractually barred from introducing, a debt and transfer union.

Both shifts will be inflationary in the long run. However, market volatility will remain – this is an ideal environment for convertible bonds.

On top of that, we remain confident that convertibles will give some downside protection even in an accelerated sell-off. As a caveat, the overall market equity exposure has moved upwards with the stock market rally. This also holds for the valuation of US convertibles. On the positive side, other global convertible regions remain cheap and the asset class overall is trading below its fair value. In the event of a set-back, diversification will not help much. Investors should look out for an asset class that automatically offers resilience. Convertible bonds have proven time and time again that effective protection against stock market losses does work.

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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 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.

Emerging markets & frontier risk: Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets.

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.

Fund Data 31 December 2020***

Team	
Portfolio managers	Dr. Peter Reinmuth Dominique Braeuninger, CFA

Size & Holdings	
Fund size in base currency (USDm)	17
Number of issues	61

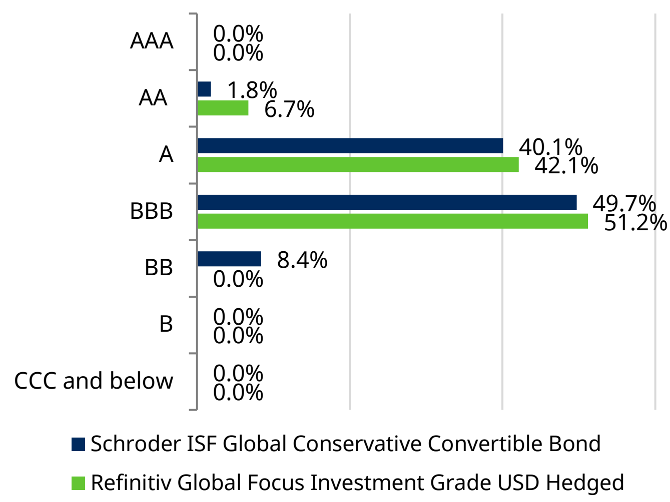
Portfolio Statistics****	
Equity Exposure	36.03%
Delta	0.46
Bond Floor	82.35%
Average Rating	BBB+
Credit Spread (bp)	109
Running yield	0.21%
Effective Duration (years)	2.11

***Source: Schroders. Please note that the sector and country split follows the underlying equity rather than the issuer.
****Average credit quality is based on official ratings where available and implied ratings. Yield is estimated on a running yield basis.

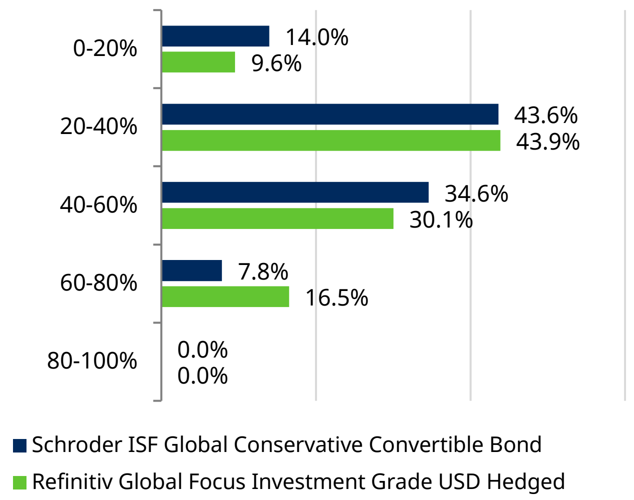
Region Allocation	Portfolio	Index
Europe	56.3%	73.6%
Asia	14.9%	10.0%
Japan	10.5%	1.1%
Americas	11.7%	14.6%
Others	1.6%	0.7%
Cash	5.1%	0.0%

Sector Allocation	Portfolio	Index
Consumer Discretionary	7.7%	14.6%
Consumer Staples	1.4%	1.8%
Energy	4.2%	8.0%
Financials	5.5%	2.2%
Health Care	4.0%	1.9%
Industrials	18.8%	19.0%
Information Technology	21.1%	17.9%
Materials	5.4%	7.8%
Real Estate	13.8%	12.7%
Telecommunication Services	0.0%	1.1%
Utilities	13.1%	13.0%
Cash	5.1%	0.0%

Credit Rating



Equity Exposure



Source: Schroders as at 31 December 2020.

	Top 10 Holdings	Portfolio	Sector
1	ELECTRICITE DE FRANCE SA CONS 14/09/2024	7.25%	Utilities
2	DEUTSCHE WOHNEN AG 0.3250 CONV 26/07/2024 REGS	4.24%	Real Estate
3	SIKA AG 0.1500 CONV 05/06/2025 REGS	3.83%	Materials
4	VEOLIA ENVIRONNEMENT SA CONV 01/01/2025 - REGS	3.52%	Utilities
5	PIONEER NATURAL RESOURCES COMPANY 0.2500 CONV 15/05/2025	3.33%	Energy
6	CHINA RAILWAY CONSTRUCTION CORPORATION LIMITED 0.0000 CONV 29/01/2021 REGS	3.11%	Industrials
7	Park24 Co Ltd 0 29/Oct/2025 0.0000 CONV 29/10/2025	2.85%	Industrials
8	ILLUMINA INC 0.0000 CONV 15/08/2023 SERIES	2.82%	Health Care
9	DEUTSCHE POST AG 0.0500 CONV 30/06/2025 REGS	2.48%	Industrials
10	POSEIDON FINANCE 1 LIMITED CONV 01/02/2025 REGS	2.43%	Financials

Source: Schroders as at 31 December 2020.