Schroders

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Schroder ISF* Global Convertible Bond
Monthly Fund Update
Covering December 2022

Market Overview

Performance %		Dec. 2022	1 year	3 years (p.a.)	5 years (p.a.)
USD	I Class	-0.7%	-17.6%	0.6%	2.3%
	A Class	-0.8%	-18.9%	-0.9%	0.8%
	BM	-1.7%	-16.0%	0.7%	2.3%
EUR	I Class	-1.1%	-19.7%	-1.2%	0.0%
	A Class	-1.2%	-21.0%	-2.7%	-1.5%
	BM	-1.9%	-17.8%	-0.7%	0.4%
CHF	I Class	-1.2%	-20.0%	-1.4%	-0.2%
	A Class	-1.3%	-21.2%	-2.9%	-1.8%
	BM	-2.1%	-18.1%	-0.8%	0.2%

Source: Schroders as at 31 December 2022. All performance data shown bid to bid, net of fees (where applicable).

Historical Performance USD

	Fund (A Acc)	Fund (I Acc)	BM
2022	-18.9%	-17.6%	-16.0%
2021	-3.3%	-1.8%	-1.1%
2020	24.0%	25.0%	22.8%
2019	12.4%	14.1%	13.1%
2018	-5.1%	-3.6%	-3.0%
2017	7.4%	9.0%	6.0%
2016	1.6%	3.2%	1.6%
2015	3.1%	4.8%	3.8%
2014	4.0%	5.7%	4.7%
2013	15.8%	17.7%	13.0%

Benchmark: Thomson Reuters Global Focus Convertible Bond Index (hedged for USD/EUR/CHF). All performance data shown bid to bid, net of fees (where applicable). Source: Schroders as at 31 December 2022.

Past performance is not a reliable indicator of future results, prices of financial securities 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 ended a miserable year on yet another bleak note.

The Bank of Japan joined the chorus of more hawkish central banks widening their curve control and allowing higher rates for longer dated government bonds.

In the US, the S&P 500 shed -5.9%. The Dow Jones stated a loss of -4.1%. The tech and growth heavy Nasdaq suffered a loss of -8.7% in December. For the overall investment year 2022, the performance difference between the Dow Jones with a loss of -6.9% and the Nasdaq with a loss of -32.5% is striking. Higher interest rates have had a significant re-valuation effect on growth stocks.

European bourses also showed downside moves, albeit on a generally lower scale. The overall Eurostoxx stated a loss of -4% for December.

The Dax and CAC40 shed -3.3% and -3.8%, respectively. Italy's and Spain's stock markets retreated by -3.7% and -1.4% . The Swiss Market Index also shed -3.6%. In the UK, the FTSE posted a December loss of -1.5%.

Stock markets in Asia showed a very heterogeneous picture with gains in Hong Kong (Hang Seng +6.4%) and China (CSI +0.6%) driven by China's Covid 19 opening policy, which in hindsight seems rather dangerous.

Elsewhere in Asia, the KOSPI fell -9.5%, Taiwan's bourse closed the month on a loss of -4.8% while Singapore's Strait Times index shed -1.1%.

Japan's Nikkei stated a loss of -6.6%.

The global MSCI equity index finished the month of December with a loss of -3.9%. The Refinitiv Global Focus shed -1.7%. At least the last month of the investment year brought a good level of convexity and downside protection from converts.

Our fund strongly outperformed its benchmark in December.

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

Portfolio Overview

December was yet another negative month for global stocks bringing a truly bad year for investors to a negative end. However, the last few months showed a long awaited return for upside participation and downside protection for convertibles.

Despite another weak December, the final quarter of 2022 saw positive stock markets. The MSCI advanced 9.4% in Q4 mainly driven by strong gains in November. Growth stocks, however, could not escape their downward trend and the Nasdaq suffered a loss of -0.8%. Our convertible bond benchmark, the Refinitiv Global Focus, stated a gain of 4.0% for the quarter.

The universe of convertible bonds remains heavily tilted to growth companies. Information technology is the main sector, but communication and most of the consumer names lean towards disruptive and dynamic platform businesses. This universe reacts more to moves in the Nasdaq than the overall MSCI.

The fund strongly outperformed against its benchmark. Our underweight positions in **Royal Caribbean** and **Norwegian Cruises** added to relative performance, as did our overweight in **Anta Sports.**

In terms of regional positioning, we remain underweight in the convertible bonds of most convertible bond regions. Similar to the last few months, we retain our biggest risk overweight in the US.

At the sector level, information technology names remain dominant with around 34% of the portfolio. This reflects an overweight compared to the benchmark in terms of weight as well as equity exposure. As in previous months, we remain underweight to industrials and are also underweight to materials.

Towards the end of the year, the primary market for convertible bonds developed its usual seasonality with only a few new convertibles coming to the market. We participated in **Axon Enterprise** which launched a USD 500m five-year convert.

The year 2022 marks a record low in terms of new issuance volume. We only saw USD 45bn of new paper coming to the market and estimate the overall market volume now at USD 470bn.

Despite the general lack of supply, valuations continue to be cheap, reflecting a 'risk off' mood within the convertible bond market.

Outlook and Strategy

In 2022, one of the most significant statements in our newsletters was: "The US Federal Reserve has clearly triggered an economic climate change."

For 2023, we are changing that to: "All signs indicate a recession with a significant earnings reduction."

With little difference in market reaction, it is important to see that the first part of the correction was based on higher rates. Rates are high now, and especially our growth universe of stocks has suffered significantly. The second part of the correction will most likely be based on lower company earnings. This down move could affect a much broader equity market spectrum.

Traditionally, equity markets find a bottom after two thirds of a recession is over. Central banks need the first third to accept that the economy is indeed in a recession. Central banks then need to find the right supportive measures – in the case of the US market that could be a pause in interest hikes and a termination of QT. In the last third of the recession, stock markets then price in a bright future for the economy.

We are not there yet. In fact, we are not anywhere close to that point. In the last hundred years, equity markets have not turned before a recession has even begun or before the Fed has stopped hiking rates.

2022 has seen the sharpest interest hikes by the Federal Reserve in history. The quadruple 75bp moves in as many meetings have been unprecedented. Including December's 50bp hike, when the Fed moved interest rates from 0% to 4.25%. In addition, quantitative tightening measures mean that the Fed is taking USD 95bn of liquidity from the market to reduce its balance sheet.

This gives rise to the proposition that the Fed is already too restrictive. The Fed will not pivot (yet) but reduce further hikes all the way to a pause in early 2023.

Markets have reacted and destroyed a significant amount of investments in equities, bonds, and real estate. In nominal terms, that loss is already bigger than in the 2008 global financial crisis. The financial conditions in the US have seen the biggest change downwards since 2008, while the global credit impulse is weaker than in the 2008 doldrums. In the US housing market, both the Case Shiller home price index and the Zillow rent index, have come

*Schroder International Selection Fund is referred to as Schroder ISF throughout this document down already and convertible bonds have suffered peak to trough losses that very much remind us of 2008.

With all these parallels, one crucial part is missing: illiquidity. Credit spreads have not exploded, neither in the investment grade paper, nor on the junk bond market. We think there could be a credit crunch somewhere in the global highly leveraged economy. In this case, and probably only in this case, will central banks be forced to do a U-turn and flood markets with liquidity. This would be bad news for the market.

We clearly have not seen a complete wash out. It's always good to remember old stock market idioms. The economy and the stock market resemble a man walking his dog. With a US stock market cap at 150% GDP, the dog is still very much ahead of its master. However, the December Fed meeting presented a strong case to remain vigilant. Asked whether the current lax financial conditions (equity markets up in November, US rates down from their highs) presented a problem for the Fed, Jerome Powell answered: "Overall financial conditions continue to reflect the policy restraint that we are putting in place to bring inflation down to 2% [...] Policy actions work through financial conditions."

It is quite clear that the Fed does not support strong equity and bond market rallies right now and will continue to reduce M1 money supply and force tighter financial conditions.

Hence, the overall picture looks like a car crash in slow motion. Too fast and on the accelerator too long, inflation took the central bank drivers by surprise, and they slammed on the breaks too hard. Moreover, the Fed steers by looking into the rear-view mirror. Both the strong labour market and the housing and owner equivalent rent as part of the inflation calculations are delayed data. The outcome clearly is an economic crash into a recession.

Finally, it is important to point out the limited power that the ECB actually has to mirror the Fed. With every new print of inflation data – the recent inflation data from Germany remained above 11% in November – the ECB has to decide to really fight inflation or to break the Euro. Lagarde's hawkish press conference and the announcement to hike rates several times in the future looks like a bluff. The weakest link in the European chain remains of course Italy. Apart from the ECB, there is not a single buyer of Italian government bonds at an interest rate level that Italy can afford. A simultaneous quantitative tightening in German Bunds while buying Italian and French government is not a sustainable solution.

Overall, and given that a significant part of our convertible universe is US and growth driven, we remain constructive on markets and see three strong arguments for an investment in convertible bonds:

We need to see a stable and sustainable return to traditional convexity features with good upside participation and efficient downside protection. This overall litmus test for convertibles has improved since the first half of 2022. In November, converts participated 75% of the positive Nasdaq performance (though not as much compared to the broader MSCI once again). That is only a start. Hopefully, we need to see more efficient downside protection in the next equity correction.

The sell-off in converts started earlier than broad markets and the underlying equities suffered strongly. The overall effects remind us of the tech bubble burst in 2001. From a fundamental view, most of the companies are non-cash burning, but delivering revenue. Additionally, our universe is biased towards US names. Compared to the dire situation in Europe, this looks like the preferable market.

In addition, convertibles remain cheap and are trading around 1% under their fair value. That is in line with a sell off of risk assets in general, but again the situation is a bit overdone, and the asset class is oversold.

And finally, the consensus opinion trends towards recession and investors are keeping cash reserves on the side line. There certainly is a chance for another short and sharp rally. Fingers crossed for 2023!

Risk Considerations

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.

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.

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.

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.

IBOR: 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.

Derivatives risk: 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.

Fund Data as at 31 December 2022 ***

Team	
Portfolio managers	Dr. Peter Reinmuth Chris Richards, CFA

Size & Holdings	
Fund size in base currency (USDm)	1'442
Number of issues	135

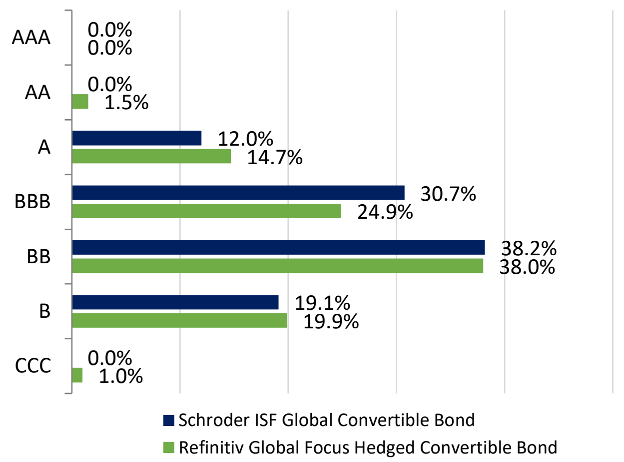
Portfolio Statistics****	
Equity Exposure	40.66%
Delta	51.62%
Bond Floor	80.82
Average Rating	BB+
Credit Spread	271
running yield	0.59%
Effective Duration	1.54
Rho Exposure	1.56%

***Source: Schroders as at 31 December 2022. Please note that the sector and country split follow 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.

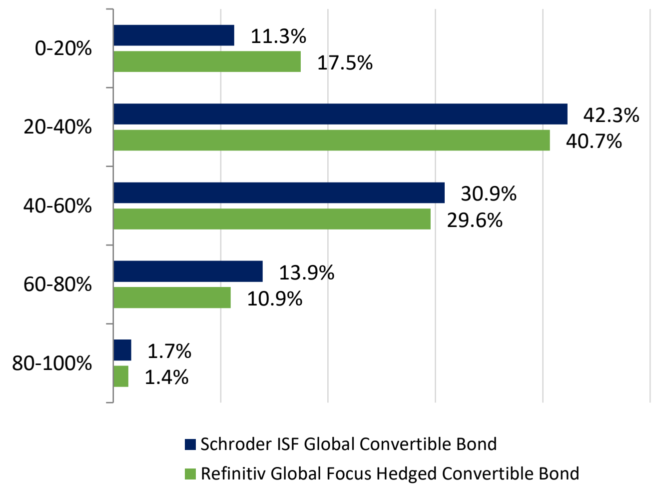
Region Allocation	Portfolio	Index
Europe	20.25%	23.90%
Asia	12.47%	13.50%
Japan	10.95%	7.88%
Americas	54.66%	52.45%
Others	0.00%	2.29%
Cash	1.67%	0.00%

Sector Allocation	Portfolio	Index
Communication Services	12.71%	12.16%
Consumer Discretionary	12.24%	16.87%
Consumer Staples	1.24%	2.30%
Energy	0.00%	0.82%
Financials	1.25%	2.88%
Health Care	12.36%	13.06%
Industrials	13.06%	14.13%
Information Technology	33.75%	22.55%
Materials	7.21%	9.47%
Real Estate	1.09%	2.84%
Utilities	3.42%	2.94%
Cash	1.67%	0.00%

Credit Rating



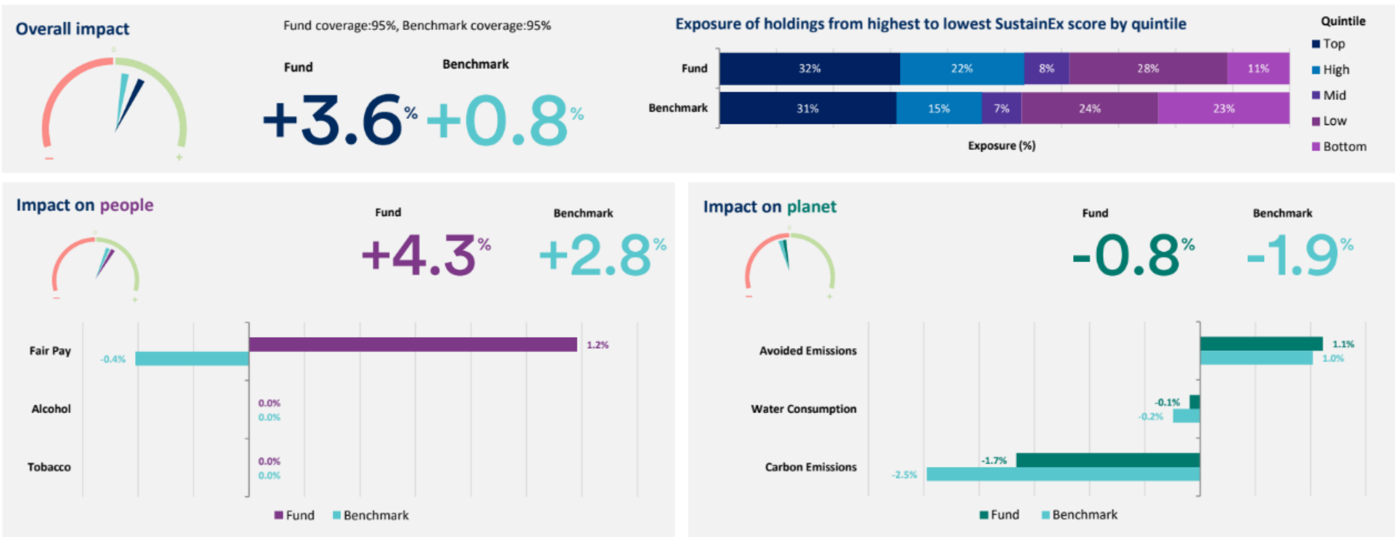
Equity Exposure



Top Ten Issues

Holdings		Portfolio	Sector
1	AMERICA MOVIL BV RegS 0.00% 02 Mar 2024	2.35%	Communication
2	FORD MOTOR COMPANY 0.00% 15 Mar 2026	2.25%	Consumer Discretionary
3	SIKA AG RegS 0.15% 05 Jun 2025	1.96%	Materials
4	CELLNEX TELECOM SA MTN RegS 0.5% 05 Jul 2028	1.95%	Communication
5	ANTA SPORTS PRODUCTS LTD RegS 0.00% 05 Feb 2025	1.87%	Consumer Discretionary
6	DEXCOM INC 0.25% 15 Nov 2025	1.87%	Health Care
7	NIPPON STEEL CORPORATION 0.00% 05 Oct 2026	1.68%	Materials
8	BILL.COM HOLDINGS INC 0.00% 01 Dec 2025	1.61%	Info Tech
9	RAG-STIFTUNG RegS 1.88% 16 Nov 2029	1.46%	Materials
10	MONGODB INC 0.25% 15 Jan 2026	1.43%	Info Tech

Source: Schroders as at 31 December 2022.



Source: Schroders as at 30 November 2022. The Schroders Impact score is based on Schroders' proprietary tool, SustainEx. Overall impact is an indication of the fund's impact compared to its benchmark. All holdings exclude cash and currency holdings. Impact on People and Impact on Planet indicate the fund's underlying benefits and harms compared to its benchmark. Metrics shown are a sample of the total underlying metrics. See definitions slide for more details. Benchmark data Refinitiv Global Focus Hedged (USD) Next Day.

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