Schroders

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Schroder ISF* EURO Credit Absolute Return

Fund Manager: Patrick Vogel & European Credit team | Fund update: October 2021

Performance overview

- Government bond yields broadly rose as central banks indicated readiness to withdraw monetary policy accommodation as inflationary pressures continued.
- Yield curves flattened as shorter-dated yields were markedly higher.
- Euro investment grade saw negative returns, in line with government bonds. Euro high yield (HY) declined.

Drivers of fund performance

- The fund made a negative return. Holdings in longer-dated bonds were a positive as yield curves flattened, including in US-based healthcare companies, and a German transportation company. HY hedges helped.
- Real estate had a negative impact overall. We saw positive performance from a German residential real estate company, but another holding detracted due to negative reaction to an announced acquisition.

Portfolio activity

- We bought selective new issues and sought to add some higher quality exposure where opportunity arose. We added in A-rated senior financials, as the sector has underperformed, and should benefit from higher rates and rising merger and acquisition fees.
- Other selective additions included a manufacturer of piping, which has resilient characteristics, and a Russian energy major, which has no government ownership and an attractive yield for its BBB rating.
- The largest sector exposure is now senior financials. Real estate remains significant, with holdings mostly in residential and logistics, focused on stable markets like Germany. We have key sector exposures in more defensive areas, like utilities, as well as Covid recovery sectors like transportation.
- We maintain a substantial allocation to HY given positive fundamentals and potential for upgrades.
- We also retain some portfolio hedges, both in IG and HY, given the strength of market performance.

Outlook/Positioning

- Overall valuations remain at fairly full levels, but well supported by healthy fundamentals. Opportunities remain mostly selective. We are starting to see better relative value in non-cyclical sectors given the strong recovery in cyclicals. We see room for further upgrades potentially driving total returns going forward.
- Economic activity is still robust, but moderating. Companies have seen a strong recovery in earnings supporting balance sheet strength with high yield defaults at notably low levels.
- The key uncertainties remain inflation and the impact of monetary tapering, which can lead to volatility and sudden moves higher in bond yields.
- We tread carefully, focusing on identifying the pockets of value, balancing cyclical and non-cyclical, and areas with further recovery potential.
- We look for long-term themes and shifts, and companies which can benefit. Security selection remains paramount and sustainability ever more important.

Calendar year performance (%)

%	A Acc	I Acc	Comparator^
2020	2.8	4.3	-0.4
2019	6.5	8.0	-0.4
2018	-4.2	-2.8	-0.3
2017	3.7	5.2	-0.3
2016	3.0	4.5	-0.3

Source: Schroders, net of fees (where applicable), bid-bid, EUR as at 31 December 2020. ^The fund's aims to provide a positive return over a 12-month period. It may be compared against 3 Month EURIBOR (or alternative).

- 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.

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

- 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.
- **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.
- **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