Schroders

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Schroder ISF* Sustainable Global Multi Credit

Fund Managers: Patrick Vogel | Fund update: Fourth Quarter 2022

Performance overview

- Government bond yields edged up towards the end of Q4, reflecting some market disappointment at the hawkish tone from some central banks, despite mounting evidence of slowing economic growth. The Federal Reserve (Fed) raised rates twice during the quarter, ending at 4.5%. The Bank of England also approved two rate hikes, bringing their interest rate to 3.5% at the end of Q4, while the Bank of Japan announced a modification to its yield curve control policy.
- Credit spreads tightened across the quarter on improved risk sentiment. Although strong performance was tempered slightly into year end, US and European investment grade and high yield credit generated positive returns and outperformed government bonds over the quarter.
- The Eurozone faced its most challenging year for inflation in its history, though signs emerged towards the end of Q4 that there may be some respite as the region's latest indicators signalled slowing headline inflation, helped by falling energy price pressures. Nevertheless, the European Central Bank (ECB) continued to tighten monetary policy conditions, maintaining its hawkish message and indicating future rate hikes.
- The US 10-year yield rose from 3.83% to 3.88%, with the two-year rising from 4.28% to 4.42%. Germany's 10-year yield increased from 2.11% to 2.57%. The UK 10-year yield decreased from 4.15% to 3.67% and 2-year eased from 3.92% to 3.56%.
- The US dollar's rally continued to slow into Q4. Across the quarter, the dollar index lost just under 8%, though ended 2022 higher than a year ago at 7.9%.

Drivers of fund performance

- The fund posted a positive return in the fourth quarter and outperformed its reference index. Security selection in financial services, healthcare and utilities contributed positively together with exposure to subordinated banking. Overweight exposure and security selection in real estate detracted.

Portfolio activity

- The portfolio's largest sector exposure is in banking followed by utilities, financial services and real estate.
- We increased exposure to AAA-rated names across the quarter, particularly US and European sovereigns in order to maintain flexibility to participate in new issues.
- Headline duration was very slightly expanded over the quarter.
- Across the quarter, the portfolio continued to predominantly be composed of investment grade securities, which we increased over the quarter. At the same time, high yield holdings were trimmed down and compose roughly a fifth of the holdings.

Outlook/positioning

- 2022 was a challenging year for global fixed income markets as persistent inflation forced central banks to act aggressively in order to stem broadening price pressures. As we head into 2023, supply chain issues and commodity prices show signs of easing and the lagged impact of monetary policy tightening is beginning to cool both growth and inflation. We expect the US to lead this disinflationary trend in the first half of the year driven by a further softening of goods prices. Although we believe the path to target inflation may ultimately prove difficult due to the stickiness of service inflation, the rapid pace of initial improvements should lead to a more favourable backdrop for global bonds.
- Meanwhile, as global rate hiking cycles mature, we expect to see greater divergence in terms of central banks' reaction functions. While monetary policy will continue to be principally determined by the inflation outlook, we think that those central banks that face downside risks to their economies thanks to overleveraged consumers (through mortgage debt) and are the past the peak in inflation are more likely to turn dovish.
- Developments unfolding in China have the potential to be market moving. The country's rapid re-opening and lifting of many Covid restrictions has the potential to boost growth prospects for the broader Asian region and help support global sentiment.

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

While we hold a relatively pessimistic view on global growth (and especially on growth in the US), an improvement in the outlook for China could also provide significant benefit to Europe.

Calendar year performance (%)*

Year	A Acc	C Acc	Target**
2022	-16.3	-15.7	-14.1
2021	-0.3	0.4	-0.2
2020	7.5	8.3	7.9
2019	13.7	14.5	13.2
2018	-3.4	-2.7	-1.4
2017	7.9	8.7	6.7
2016	-	-	-
2015	-	-	-
2014	-	-	-
2013	-	-	-
2012	-	-	-

Net of fees, NAV to NAV (bid to bid), USD. Source: Schroders, as at 31/12/2022. **Bloomberg Barclays Multiverse ex Treasury A+ to B- USD Hedged. Fund not managed with reference to a benchmark but its performance may be measured against one or more.

– 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: Derivatives may be used to manage the portfolio efficiently. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. 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.

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.

Sustainability risk: The fund has environmental and/or social characteristics. This means it may have limited exposure to some companies, industries or sectors and may forego certain investment opportunities, or dispose of certain holdings, that do not align with its sustainability criteria chosen by the investment manager. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

Important information