Schroders

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Schroder QEP Global Quality

Strategy Overview

What is QEP Global Quality?

The Schroder QEP Global Quality is an index-unconstrained strategy which tends to perform particularly well at times of market uncertainty or heightened risk aversion.

Analyzing a broad universe of 15,000 stocks across around 40 developed and emerging countries, the team constructs highly diversified portfolios without sacrificing conviction (active share 70%+, see below).

Benefits of our approach

- Aims to offer investors a more stable alternative to traditional growth approaches, by investing in higher quality companies
- Exploits a wide opportunity set, tapping into all sectors and regions, including the emerging markets
- Innovative approach to portfolio construction combining high conviction with broad diversification
- Highly experienced and well-resourced team

A more stable growth proposition

Our research has found that Quality companies (as defined by measures of profitability, stability and financial strength) have tended to outperform in the long-run. While the strategy is designed to outperform across a broad range of market environments, it tends to perform particularly well at times of market uncertainty or heightened risk aversion. As such, the strategy seeks to offer investors a more stable form of growth investing and aims to deliver higher returns through time, but with typically a lower level of volatility than the broader market.

Exploiting genuine breadth of opportunity

We maximize the opportunity set by looking beyond the index to an investment universe of more than 15,000 stocks globally. The strategy is highly diversified, typically investing in over 400 stocks, which enables us to gain exposure to many more potential return opportunities in a risk- controlled way. More stocks does not mean compromising on conviction and the strategy's active share[1] is typically higher than 70% - the strategy looks very different to the index.

Intelligent portfolio construction

Our process is focused on delivering returns through stock selection and does not impose any index-based sector or region constraints, enabling us to invest wherever we find the best opportunities. Moreover, by weighting stocks based on their fundamentals and not their size, our portfolios express genuine conviction and are not forced to hold higher weightings in more expensive stocks. Our portfolio construction tools allow us to manage the risk-return trade-off efficiently and we also focus on cost-effective implementation.

[1]Active share is a measure of the proportion of a portfolio's holdings that are different to the benchmark; an indexed portfolio identical to the benchmark would have a 0% active share, and a portfolio with no overlap at all with the benchmark would have an active share of 100%.

About the team

The QEP Investment Team was established in 1996 and has managed assets since 2000. The team, led by Justin Abercrombie, consists of 31 team members based in London, Sydney and New York. It manages around $31 billion in a comprehensive range of global and emerging market equity strategies for clients all over the world, including pension funds, insurance companies and sovereign wealth funds.

Source: Schroders, team as at 30 July 2019, assets as at 30 June 2019

A strategic approach to equity investing

There are three distinct components to the QEP team's investment philosophy:

1. All stock selection is focused on two key fundamental drivers of long-run equity returns: stock valuations and business quality.
2. We then use quantitative models to 'scale up' our process, which allows us to access the best opportunities across a broad global universe. These models enable us to maximise the opportunity set and re-balance portfolios in a disciplined way as opportunities evolve.
3. Finally, experienced investors are responsible for implementing every trade decision, ensuring proper diversification and identifying future risks and return opportunities.

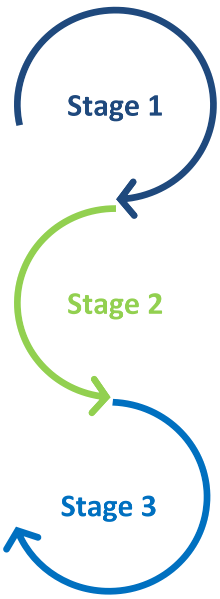
Key features of QEP Global Quality

Active share	70%+
Number of holdings	300+
Stock weights	Maximum 1.0% at the company level at the time of purchase
Sector weights	Unconstrained
Country/region weights	Unconstrained except 20% maximum in emerging markets

Source: Schroders. Guidelines only and subject to change.

Investment process

Our investment process can be summarized in three stages:



Fundamental drivers

– Universe of 15,000 stocks to maximise the opportunity
– Rank stocks by Value (cash flows, dividends, earnings and assets)
– Quality (profitability, stability, financial strength and governance)

Stock selection

– Industry-specific decision tree 'trades off' value and quality
– Prioritise high quality stocks which are attractively valued; avoid over-paying
– Stock weight (target 1.0%[1]) determined by conviction, risk, ESG, liquidity and size

Portfolio construction

– High active share +70%; stocks: 300+[1]; attractive risk/return trade-off
– Diversified across region, country, sector, market cap and style
– Disciplined re-balancing (buy/sell) to take advantage of market volatility

Source: Schroders. [1]Internal guidelines only and are subject to change.

Investment process (continued)

Stage 1 – Fundamental drivers

We analyze an investment universe of 15,000 companies across around 40 developed and emerging countries. Each stock is ranked in terms of its Quality, which involves measuring a company's profitability, stability and financial strength. In terms of profitability we focus upon evaluating company margins and how they are changing, using both a normalized and an industry-relative measure. We also look at return on capital employed, return on equity and cash-based measures of operating performance. Stability tries to capture the cyclicality of a business and measures the volatility of sales, cashflow, earnings and dividends through time. Financial strength is based on company balance sheets and captures leverage, liquidity and the ability to service debt. We also use specialized balance sheet measures for financials. This rank is re-calculated on a daily basis in order to ensure that the latest information is incorporated e.g. price movements and company fundamentals.

Stage 2 – Stock selection

We select stocks from the top third of our Quality Rank. The decision on how much to invest in a stock is then guided by an additional assessment of its fundamentals, including a decision tree model which calculates our assessment of the probability of each stock's value being realized. Weights are further adjusted by a proprietary market impact model, which incorporates information on stock size, liquidity and volatility to reflect the associated trading risks stocks while still allowing us as broad a range of investment opportunities as possible. Position sizes are not influenced by the market cap of the stock - weighting according to a company's fundamentals, rather than its market cap, means that we are not forced to hold higher weightings in more expensive stocks.

Stage 3 – Portfolio construction

We take a disciplined and sophisticated approach to portfolio construction. Stock selection is primarily driven by bottom-up decisions as described in Stage 2. Sector, country and regional allocations are generally allowed to build from our stock selection process - we only invest where we see the best opportunities. Portfolios are exceptionally diversified, accessing a genuinely broad opportunity set while also reducing stock-specific risk.

Awareness of risk management is integrated throughout our investment process and in particular at this final stage. The most critical role of our portfolio managers is to understand when stocks are attractive on a risk-adjusted basis, maximizing return opportunities within a comprehensive risk framework. On a daily basis portfolio managers review trades which have been recommended by our proprietary allocator tool and make the final decision on implementation; no trade is made automatically. The team has built an impressive track record in the implementation of investment decisions: liquidity considerations are built in at every stage of the process and we actively work to minimize the costs of trading.

Risk disclosures

All investments, domestic and foreign, involve risks including the risk of possible loss of principal. The market value of the portfolio may decline as a result of a number of factors, including adverse economic and market conditions, prospects of stocks in the portfolio, changing interest rates, and real or perceived adverse competitive industry conditions.

Investing overseas involves special risks including among others, risks related to political or economic instability, foreign currency (such as exchange, valuation and fluctuation) risk, market entry or exit restrictions, illiquidity and taxation. These risks exist to a greater extent in emerging markets than in developed markets.

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