

# Schroder ISF\* Emerging Market Multi-Asset

Fund Managers: Dorian Carrell, Remi Olu-Pitan | Fund update: February 2023

## Performance overview

- Emerging market (EM) equities posted negative returns in February and underperformed global equities. A re-escalation in US-China tensions weighed on sentiment while more resilient-than-expected macro data out of the US raised the prospect of further rate hikes. Against this backdrop the dollar strengthened, an additional headwind for EM.
- Colombia was the weakest index market amid widespread protests against the government's reforms. China also lagged the index by some margin. In part this was due to profit-taking after strong returns recently and as enthusiasm about its re-opening faded somewhat. The underperformance was also driven by geopolitical tensions between itself and the US following the shooting down of a Chinese high-altitude balloon in US airspace.
- Thailand and Brazil both underperformed too. The former saw Q4 GDP growth come in lower than expected while exports contracted given weak global demand. In Brazil, uncertainty about China's recovery weighed on returns.
- South Africa was behind the index as the country was 'grey-listed' by the Financial Action Task Force given deficiencies in its processes to combat money laundering and terrorist financing.
- South Korea posted negative returns that were worse than the index as the combination of the prospect of 'higher-for-longer' rates and uncertainty about China's recovery weighed on the outlook for global trade. India outperformed, despite Q4 GDP data that came in below consensus.

## Drivers of fund performance

- The Fund gave back much of January's gain, as euphoria around China's reopening was overshadowed by rising tensions with the US.
- Equities, understandably, were the largest detractor as sentiment was tested by a resurgence in geopolitical tension.
- The commodity sensitive equity markets of Latin America were also weaker over the month as investors tilted more towards the likely consumption beneficiaries of China's reopening.
- Hard and local currency bonds did provide a useful level of diversification.

## Portfolio activity

- Asset allocation was broadly stable over the month.
- For now, we retain our strategic exposure to Chinese equities and EM Local currency debt, where valuations remain compelling.
- Elsewhere, we retain a preference for sovereign and convertible bonds over corporates.

## Outlook/positioning

- While February has been uncomfortable, we believe there are reasons for optimism. A key driver of market volatility over recent months has been interest rate uncertainty, and for the first time, both the Federal Reserve and the market are now projecting rates in the region of 5% for the end of 2023. This convergence is encouraging as it reduces the scope for significant repricing going forwards. Allowing for short-term noise, and indeed the market has a long wait until the Fed meets again on 21 March, we believe that interest rate volatility has the potential to subside over the coming months as the market begins to accept that interest rates are likely to be higher for longer. Interest rates aside, rising tensions between the US and China remain a key concern for EM.
- Against this backdrop we maintain our cautious approach. EM local currency bonds continue to offer very enticing yields and a number of central banks are further down the path of rate hiking than in the developed world. However we are less positive on the hard currency universe: the high quality names are historically very expensive, while the valuations in the high yield section of the universe are driven by one or two names we continue to avoid.
- Overall, we believe many of the concerns from 2022 have now peaked, but we are not out of the woods yet. Much of what has worked in the past decade will need to be reappraised for a new environment; one of higher interest rates, higher inflation and higher geopolitical tensions. We believe our flexible, multi-asset approach should stand us in good stead to navigate the risks and opportunities in this environment.

## Calendar year performance (%)

Year	Fund Net A acc	Fund Net C acc	Comparator
2022	-19.2	-18.7	-16.9
2021	-3.1	-2.6	-2.8
2020	15.6	16.3	11.8
2019	11.1	11.8	16.1
2018	-13.7	-13.2	-9.4
2017	18.8	19.6	23.1
2016	11.0	11.6	10.5
2015	-	-	-
2014	-	-	-
2013	-	-	-
2012	-	-	-

Source: Schroders, Thomson Reuters, 31 December 2022, A Acc & C Acc share class, net of fees. Please see factsheet for other share classes.

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The fund does not have a target benchmark. The Fund's performance and volatility should be compared against 50% MSCI Emerging Market Index (USD), 16.7% JPM EMBI Index EM Hard Currency (USD), 16.7% JPM GBI Emerging Market Index - EM Local (USD), 16.7% JPM CEMB Index (USD). The comparator benchmark is only included for performance and risk comparison purposes and does not have any bearing on how the Investment Manager invests the Fund's assets.

## Investment Objective

The Fund aims to deliver capital growth and income over a three to five year period after fees have been deducted by investing in a diversified range of assets in emerging markets worldwide.

## 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.

**Bond Connect risk:** The fund may be investing in the China Interbank Bond Market via the Bond Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.

**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.

**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:** 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.

**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.

**Stock connect risk:** The fund may be investing in China "A" shares via the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.

**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.

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