Schroders

Schroder US Large Cap Equity

Strategy Overview

Summary

The Schroder US Large Cap Equity Strategy is designed to offer investors diversified exposure to US equities. Our approach is driven by a fundamental research process in which our analysts play a key role in stock selection. The strategy has a growth bias, and we look to add value by investing in companies with unrecognized or under-appreciated earnings potential. The portfolio invests in 50 to 70 stocks which are greater than $3 billion in market capitalization.

Firm highlights

- Founded in 1804, with a strong family presence to this day
- Asset management is our main business
- Over 700 investment professionals worldwide
- Truly global reach: based in London, with offices in 27 countries
- Expertise in Fixed Income, Equities, Multi-Asset, Solutions, and Alternatives

Team highlights

- The strategy is co-managed by Matthew Ward and Alan Straus
- Dedicated team of 7 analysts with an average of 16 years investment experience
- Analyst research and grading process is the primary driver of stock selection

Key features

- Markets are inefficient – we can exploit a 'Growth Gap'
- Quality stocks with a sustainable competitive advantage
- A focus on long-term earnings potential
- Consistently apply a robust investment process
- Well resourced and experience team drives stock selection

Investment objective

Our aim is to outperform the S&P 500 Index by 1-2% p.a. (gross of fees) over a market cycle (typically 3-5 years).*

* There can be no guarantee that any investor objectives or outcomes will be achieved.

Investment philosophy

We believe that high quality, reasonably priced companies with strong growth prospects and a sustainable competitive advantage will produce superior long-term investment returns. We consider markets to be inefficient and through intensive bottom-up research that focuses on longer-term fundamentals, we believe we gain an information advantage versus Wall Street. In analyzing individual companies we focus on exploiting what we call an earnings 'Growth Gap', the difference between our estimates of longer-term earnings growth potential versus consensus. Most of the Street tends to be short-term oriented; focusing on a company's prospects over the next 3 to 6 months. Our approach focuses on a longer time period, looking out over the next 3 to 5 years.

Investment process

The universe – generating investment ideas

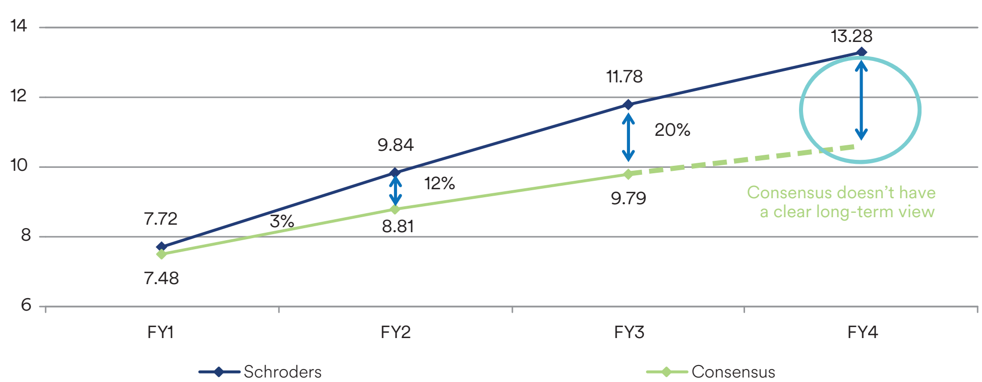
Our investment universe consists of over 1000 stocks, greater than $3 billion in market capitalization. Each sector analyst is responsible for using his or her expertise to come up with a working list of stocks within his or her respective area. Investment ideas stem from internal fundamental research of both companies and the industries in which they operate and compete. While our analysts utilize brokerage research as a source of company and industry information, all portfolio recommendations are based on our own in-house research. We also work closely with the Global Equity team, leveraging each other's sector expertise to bring greater insights into our idea generation. At a strategy level this 'workable list' typically totals between 200 and 250 stocks.

From working list to purchase candidates

When looking for investment ideas, the analysts consider stocks for one of two 'Growth Gap' categories; secular and opportunistic. The analysts use their sector expertise and industry knowledge to select stocks that they believe can benefit from the respective story. On a company specific level, the analysts are expected to evaluate a company's prospects for growing top-line revenues, improving operating margins, and potentially redeploying cash.

Having identified a number of stocks of interest within a sector, the analyst then carries out rigorous analysis of the company and the industry in which the company operates and competes, building up a comprehensive picture of a company's strategy, competitive positioning and industry dynamics. This is achieved through a mixture of one-to-one meetings with management, industry conferences and site visits with senior company representatives, their competitors and other industry participants.

It is during this stage of the process that we construct our earnings 'Growth Gap' model.



Source: Schroders, for illustrative purposes only.

Investment process (continued)

Once we have determined that a potential exploitable earnings 'Growth Gap' exists, we then try to determine if it is sustainable. This determination is underpinned by intensive bottom-up research where we evaluate a company's business prospects as well as quality, which include management track record and corporate governance. We view valuation as complementary to our investment thesis and lastly evaluate price, looking at fair market value, and value in comparison to the sector and universe.

The result of this extensive research process is a stock 'grade'. Our analysts grade stocks from 1 to 4. Grades 1 and 2 indicate a buy recommendation and grades 3 and 4 indicate a sell recommendation. There is no hold recommendation, which ensures analyst conviction in grading stocks. The list of purchase candidates typically consists of 100 to 125 stocks across the strategy.

Investment process — portfolio construction

Constructing a diversified portfolio

Source: Schroders

Portfolios are constructed in the same way that a company deploys capital – the opportunities with the best return potential will be chosen to ensure the best long term returns for the product. Once the analysts' assign grades to their respective stocks, an investment discussion occurs between the analyst and the fund manager, where the analyst discusses the idea and the degree of conviction they have. The fund manager then determines whether or not the stock will be purchased for the portfolio and in what size. The size of position taken in a stock will be dependent on a combination of the analyst grade and portfolio construction considerations made by the fund manager. Portfolios will generally only contain stocks graded a '1' or a '2'. Stocks graded '3' are only held for risk management and portfolio construction reasons in rare circumstances.

When constructing the portfolio we size our sector bets with +/- 5% of the benchmark which tends to generate a tracking error of 2% to 4%. The final portfolio consists of 50 – 70 stocks with typically allocation among 'Growth Gap' categories as follows: secular growth (60%-75%) and opportunistic ideas (25%-40%).

The discipline to sell a stock from the portfolio is seen as equally important as the mechanism through which it is bought. There are several factors which will trigger a review of a stock and which may result in a negative change in analyst grade:

- If the fundamentals of the business or the industry deteriorate
- If the 'Growth Gap' forecast has changed
- If there is a change in strategy or an acquisition or divestiture that may compromise a stock's potential return
- If a stock price materially exceeds its fair value as assessed by the analyst

Investment process — portfolio construction (continued)

These events will be captured in the analyst grading system, with a stock becoming graded 3 or 4. A '4' grade automatically triggers removal from the portfolio.

Stocks may also be reduced in the portfolio or removed when the opportunity cost of not owning another stock arises, and that stock has better appreciation potential and superior returns. This is tied to the concept of constructing the portfolio in the same way that a company deploys capital – the opportunities with the best return potential will be chosen to ensure the best long-term returns for the portfolio. In addition, a stock may be reduced or sold completely in an attempt to control risk in the portfolio.

Risk management

State of the art risk monitoring system:

- Proficient detailed decomposition of each element of risk
- Seeks to build the most effective portfolio
- Aims to ensure overall risk remains whithin acceptable boundries

Why Schroder US Large Cap Equities Strategy?

- Highly experienced, specialized team based in New York
- Unique and patient investment process
- Diversified sources of alpha
- Investing locally with a global perspective

Risk disclosures

All investments involve risks including the risk of possible loss of principal. The market value of a 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.

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