Schroders

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Schroder ISF* Greater China
Fund Update
October 2019

At a glance

Fund manager: Louisa Lo

Performance: The fund rose 4.7% (A Acc share class) over the month**, underperforming the benchmark MSCI Golden Dragon Index, which increased 5.1%.

Largest contributors: Stock selection in communication services and overweight exposure to healthcare added value.

Largest detractors: Stock selection in industrials was a drag.

**Source: Schroders, as at 31 October 2019. Net of fees, NAV to NAV, with net income reinvested. Index source: MSCI, as at 31 October 2019.

Calendar year performance (%)

	Fund net	MSCI Golden Dragon
2018	-11.8	-14.8
2017	45.8	43.8
2016	6.5	5.4
2015	-3.2	-7.4
2014	8.3	7.7

Source: Schroders, net of fees, NAV to NAV, with net income reinvested. A Acc share class, as at 31 December 2018.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back 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 fact sheets for the performance of other share classes.

Market review

The Chinese market rose over the month alongside most other Asian equity markets. The improvement in the US-China trade outlook, softer monetary policy from global central banks and stronger-than-expected corporate earnings results boosted sentiment. The MSCI China Index outperformed the MSCI World Index.

In China, the proposed mini-trade deal with the US was positive for sentiment, although an agreement is yet to be ratified. The proposal is expected to require China to significantly raise US agricultural product purchases and to commit to providing further access to its financial sector. The US has suspended tariff increases scheduled for 15 October.

Taiwan was the best-performing market, on gains from technology companies as earnings expectations for the sector were revised upwards. The Hong Kong market also outperformed.

Portfolio overview

The fund rose 4.7% (A Acc share class) over the quarter, outperforming the reference benchmark MSCI Golden Dragon Index, which increased 5.1%.

Stock selection was a negative factor in the fund over the month. Selection was weaker in the industrial and information technology sectors. This was partly offset by better selection in communication services and consumer staples.

Sector allocation was positive, with the overweight exposure to healthcare a notable factor.

On a regional basis, the underweighting of Taiwan detracted from returns. Stronger selection in Hong Kong-listed shares largely offset weaker selection in Chinese mainland-listed shares.

In terms of the major stock contributors, the fund's overweight position in **Chacha Food** was a positive factor as the share price rallied on strong quarterly results. **Sino Biopharmaceutical** performed well due to rising market expectations that medical insurance in China will cover 3-5 company products in the

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

future. **CSPC Pharmaceutical**'s shares rose as investors became attracted to the stock's lagging valuation relative to other major peers. Favourable feedback on the company's recent investor day also drove the price higher.

On the negative side was our position in **Canadian Solar**, which suffered from weak industry solar equipment prices in October, owing to delayed solar installation demand in China. **Sungrow Power Supply** detracted from returns as a result of similar trends in the solar industry. Shares in **Zhaojin Mining** retreated as gold prices slipped owing to a moderation in US-China trade tensions.

Outlook

After a difficult second half last year, China equity markets recovered to register one of their best starts to a year in 2019. Key to this major reversal in sentiment was the shift in policy stance from the US Federal Reserve (Fed) and the Chinese authorities. Both have moved towards a more accommodative position, which is more supportive of medium-term growth and liquidity.

The various stimulus measures introduced by the Chinese government since last year appear to have helped the economy find a bottom. These measures included the delayed implementation of regulations on wealth management products, reserve requirement ratio (RRR) cuts, the acceleration of issuance of local government bonds, encouraging banks to increase lending to small- and medium-sized enterprises, and the State Council's guideline to support domestic consumption, as well as changes to tax regimes. Fiscal spending also picked up, with an acceleration of infrastructure spending coming through. Key to highlight, however, is that these policies were, in our view, largely aimed at cushioning any downside to the economy rather than providing large-scale stimulus.

Moving forward, we think China still has a bit of room to stimulate on both the monetary and fiscal policy fronts, with scope for more RRR and interest rate cuts, and the acceleration of local government bond issuance and tax cuts, respectively. However, continued currency weakness, along with sizeable debt burdens, limit the number of counter-cyclical policy tools the government has.

Elsewhere, US-China trade tensions remain a major overhang for markets. While the direct impact of higher tariffs on earnings for the companies under our coverage varies, our broader concerns are on the impact of trade tensions on both corporate and consumer confidence in China, as well as across the region and globally. Higher tariffs will raise many end-product prices for consumers, which will likely dampen demand, reduce trade volumes and disrupt the global supply chain. Heightened uncertainty will also likely deter corporate investment.

Markets are likely to remain very sensitive to daily headlines. A trade deal between the two sides may still be possible in coming months, as there would still appear to be clear incentives for both sides to show progress. However, over the long term, we expect to see tensions between China and the US persist; this is because of China's longer-term ambitions around economic development, with its industrial blueprint designed to challenge both the US's technology leadership position and its leading role in the global economy.

Looking ahead, we expect earnings growth in the second half of 2019 to be supported by a relatively low base effect, especially since the final quarter of 2018, and the potential bottoming out of business sentiment should the trade negotiations continue to progress. With valuations for Chinese equities already back to their long-term average, markets could remain volatile, albeit range-bound in the near term.

In terms of positioning, we maintain our key exposures in domestically focused names and sectors showing structural growth trends. In the medium term, we continue to favour both domestic Chinese consumption names and Hong Kong consumer goods companies which have strong brand value and pricing power, as they will benefit from upgrade trends. We maintain our overweight in the healthcare space and industrials names in the renewables space, where we believe the outlook for profitability and returns are starting to improve.

In Taiwan, we hold technology companies with solid balance sheets and strong cash flows, spanning a number of sub-sectors including semiconductors, iPhone assembly as well as computer hardware and electronics. We remain focused on companies with strong fundamentals and will be looking for opportunities to re-enter or rotate as value emerges.

Risk considerations

The capital is not guaranteed.

In order to access restricted markets, the fund may invest in structured products. Should the counterparty default, the value of these structured products may be nil.

Investments denominated in a currency other than that of the share class may not be hedged. The market movements between those currencies will impact the share class.

Where the fund (or the manager) holds a significant percentage of the shares of one or more companies,

it may be difficult to sell those shares quickly. It may affect the value of the fund and, in extreme market conditions, its ability to meet redemption requests upon demand.

The fund will not hedge its market risk in a down-cycle. The value of the fund will move similarly to the markets.

Emerging markets will generally be subject to greater political, legal, counterparty and operational risk.

Emerging equity markets may be more volatile than equity markets of well-established economies. Investments into foreign currencies entail exchange risks.

The fund may hold indirect short exposure in anticipation of a decline of prices of these exposures or increase of interest rate.

Changes in China's political, legal, economic or tax policies could cause losses or higher costs for the fund.

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