Schroder ISF* Asian Equity Yield

Fund Update

August 2019

At a glance

Fund manager: King Fuei Lee

Performance: The fund returned -5.0% (A Acc share class, USD) in August, and underperformed the broader regional index MSCI AC Pacific ex Japan's return of -4.5%**.

Largest contributors: Stock selection in Korea and Singapore.

Largest detractors: Overweight and stock selection in Hong Kong.

**Source: Schroders, as at 30 August 2019. Net of fees (where applicable), bid-bid, with net income reinvested. Index source: MSCI, as at 30 August 2019.

Calendar year performance (%)

	Fund	MSCI AC Pacific ex Japan Net TR
2018	-13.1	-14.5
2017	29.5	36.9
2016	7.4	7,5
2015	-9.4	-9.6
2014	7.6	1.5

Source: Schroders, net of fees, NAV to NAV, with net income reinvested. A Acc share class as at 31 December 2018. The fund is not managed with reference to a benchmark but its performance may be measured against one or more.

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 factsheets for the performance of other share classes.

Market review

Pacific ex Japan equities fell in August amidst a difficult backdrop of recession risk fears and a re-escalation in the trade dispute between the US and China.

Hong Kong was the weakest index market given the prolonged unrest and demonstrations. GDP growth for the second quarter of 0.5% year-on-year (y/y) disappointed, and retail sales fell 13% y/y in July. Singapore, where industrials stocks led the market lower, and South Korea also underperformed. In Korea, rising global trade uncertainty continued to weigh on the outlook.

By contrast, Taiwan recorded a negative return but outperformed, supported by performance from utilities, communication services and IT stocks.

China posted a loss amid a deterioration in the trade dispute with the US. The US announced 10% tariffs on $300 billion of Chinese goods with effect from 1 September, albeit around half of these were later delayed to 15 December. The renminbi subsequently depreciated beyond the symbolic 7-per-US-dollar threshold, and in response the US Treasury labelled the country a currency manipulator.

The Chinese authorities retaliated to trade actions with tariffs on $75 billion of imports from the US, and also suspended new US agricultural product purchases. Meanwhile, fresh policy support was announced in response to domestic economic weakness.

The Australian market fell broadly in line with the regional index in a weak month for commodities.

Portfolio overview

The fund returned -5.0% (A Acc share class, USD) in July, and underperformed the broader regional index MSCI AC Pacific ex Japan's return of -4.5% in USD terms.

From a geographic perspective, an overweight exposure to Hong Kong was the main detractor from returns as the market significantly underperformed

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

the regional index. Stock selection in China also detracted. Positive stock selection in Korea and Singapore partially offset this, as did our cash position.

Sector-wise, stock selection in industrials and consumer discretionary detracted the most.

At the stock level, the main detractors included Australian logistics firm **Brambles**. It lagged the market after results disappointed as profitability in the US is under pressure and management downgraded margin targets. **Jardine Strategic** also detracted, reporting weak results for the first half of the year at a time when concerns over the prolonged social unrest in Hong Kong also weighed on the share price.

On the positive side, the main contributors were Australian wagering and gaming group **Tabcorp** and Singapore's **Mapletree Commercial Trust**. Tabcorp reported results in line with market expectations, with lotteries delivering strong growth. Meanwhile, in Singapore there was renewed focus on the redevelopment of the Greater Southern Waterfront area, which is positive for Mapletree's assets.

Outlook

A shift in policy stance from the US Federal Reserve (Fed) and the Chinese authorities towards more accommodative positions have marked a significant reversal in sentiment coming into 2019.

In the US, subdued inflation data and more dovish Fed commentary have significantly altered market expectations for future interest rates. Tapering of the Fed balance sheet is also likely to end sooner than previously thought. In line with this more accommodative stance and concerns over the impact of the trade war on global growth, long bond yields have fallen dramatically from their November highs. In a world where the US dollar remains the key reserve currency and many Asian economies need to adjust their own policy stance (at least loosely) along with the Fed to support their local currencies, this shift in US dollar money markets has positive implications. At the same time, the oil price has corrected from its October highs, which is beneficial for the trade balances of the many oil-importing economies in Asia and improves disposable incomes for consumers around the region. Supporting this view, we have recently seen interest rate cuts in India, Malaysia and the Philippines – reversing hikes put through in 2018 when external conditions were more hostile.

We have also seen an important shift in China's policy stance in the last six months. Reserve requirement ratios have been cut and banks have been encouraged to lend more aggressively to small and medium-sized enterprises (SMEs) and the private sector. The recent acceleration in credit data suggests that local financial institutions are responding to this top-down guidance. Fiscal spending also appears to be picking up to support growth, with lower income taxes for consumers and reduced value-added tax for corporates being announced and an acceleration of some infrastructure spending coming through.

These have been seen as supportive of medium-term growth and should offer favourable liquidity conditions. Until early May this year, there was also greater optimism among investors about the prospects for a trade deal between the US and China, although more recently negotiations have stalled and restarted again, indicating that the threat of a further increase in tariffs remains a major overhang for markets.

Even so, on a medium-term view, structural deflation will mean that bond yields remain lower for longer. The demographic trend of an aging global population will underpin dividend investing in the longer term.

Overall, dividend investing is starting to look attractive again as interest rate expectations moderate and rate cuts are now considered likely in the next 12 months in contrast to the path of steady rate hikes expected six months ago. Its strong bias to quality businesses with sound capital structures and strong cash flow generation remains relevant as the nearer-term growth outlook remains uncertain. In Asia, where payout ratios remain amongst the lowest globally, steeply rising profitability, historically low gearing and burgeoning free cash flows present the best conditions for dividends to surprise on the upside. The propensity for dividends to surprise in Asia is further helped by improving corporate governance and regulatory changes in the region.

In terms of portfolio strategy, we continue to pick up Dividend Surprise opportunities as they present themselves in an environment that we believe is conducive. Dividend Surprise ideas in the portfolio are found in select Australian, Korean, Indian and names. We continue to be well-diversified across our portfolio of Dividend Cows and Growers, and our preferred areas of investment remain in select blue chips in Hong Kong and Australia, as well as in China and Singapore.

Risk considerations

The capital is not guaranteed.

The fund intends to make regular yield payments to investors and, if its income is insufficient to cover these payments, these payments may reduce the fund's capital.

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.

Investments in small companies can be difficult to sell quickly which 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.

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.