Schroders

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Schroder ISF* Emerging Europe Fund Update

A look back on September 2019

At a glance

Fund manager: Rollo Roscow and Mohsin Memon

Performance: The fund returned 2.7% (A Acc Share class) over the month**.

Market overview: The MSCI Emerging Markets Europe 10-40 Index returned 4.5%.

Largest contributors: Stock selection in Greece was positive.

Largest detractors: Stock selection in Russia was negative.

**Source: Schroders, as at 30 September 2019. Net of fees, bid-bid, with net income reinvested.

Calendar year performance (%)

	Fund Net	MSCI EM Europe 10-40 Net TR Index
2018	-6.4	-6.7
2017	11.6	5.7
2016	35.3	29.5
2015	1.5	-5.0
2014	-18.5	-19.7

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

The fund and benchmark have different pricing points (intra-day versus closing price respectively) so there may be a performance timing effect at month-end. In times of elevated market volatility, this timing effect can be larger than usual and may have either a positive or negative impact on the NAV. However, these effects are expected to even out over time.

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.

What happened in the markets

Emerging European equities recorded positive returns in September, led higher by Turkey. The MSCI Emerging Markets Europe 10-40 Index increased by 4.5% in euro terms, outperforming the MSCI World.

Turkey was the best-performing index country as the country's central bank cut interest rates by 325 basis points, more than the market had expected, to 16.5%. Russia outperformed, benefitting from higher crude oil prices. Inflation maintained a downward trend, reaching 4.3% year-on-year in August, and the central bank lowered its headline interest rate by 25bps to 7%; a third consecutive monthly cut.

The Czech Republic recorded a negative return and was the weakest index market, weighed down by weakness from banking stocks. Poland, Hungary and Greece, all posted positive returns but finished behind the index. In Poland, banks were among the weakest index names amid uncertainty linked to an upcoming European Court of Justice (ECJ) ruling on Swiss franc mortgage contracts. In Greece, macroeconomic data continued to hold up, despite wider eurozone weakness.

How the fund performed

The fund returned 2.7% (Acc share class), but underperformed the MSCI Emerging Europe 10-40 Index.

Country allocation was slightly negative, largely attributable to the off-benchmark allocation to Kazakhstan. By contrast, the underweight to Poland was positive.

Stock selection accounted for the majority of negative relative returns. In Russia, the off-benchmark holding in financial holding company **TCS Group** was among the largest detractors. The stock fell amid increased concern over the unsecured consumer lending cycle. A zero-weight to Surgutneftgas, was also negative. The stock rallied sharply amid speculation that the company would buyout minority investors; a move subsequently dismissed by the company's CEO. In Poland, the off-benchmark allocation to debt collector **Kruk** and the overweight to **Bank Millennium** were

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

the key headwinds. Kruk lost value amid deterioration in the macroeconomic outlook and the prospects for cash recovery. Bank Millennium came under pressure ahead of the ECJ ruling in relation to Swiss franc mortgages. Stock selection in Turkey also weighed on excess returns, notably the off-benchmark position in **Pegasus Airlines** which fell back following a sharp rally last month. Conversely, stock selection in Greece was positive, in particular the overweight to **Alpha Bank** which gained ahead of a strategy update which is expected to set out plans for dealing with non-performing assets.

Looking ahead

Schroders' economics team forecasts economic growth in the eurozone to slow to 1.1% this year with an expansion of 0.9% anticipated in 2020. These estimates reflect the impact of the US-China trade dispute on European exporters. After cutting the deposit rate by 10bps to -0.5% in September, the European Central Bank will restart QE from 1 November, with asset purchases of $20 billion per month. The economics team expects one further 10bps cut in the deposit rate in December and for QE to continue for the foreseeable future.

We made a small change to our country allocation targets in October. The off-benchmark allocation to Kazakhstan was marginally increased. This was funded by increasing the size of the Poland underweight. The fund is positioned as follows:

Hungary and Turkey are held overweight. In Hungary, the macroeconomic environment is supportive and valuations are reasonable. In Turkey, the macroeconomic outlook remains weak and policy concerns are ongoing. However, valuations are cheap and we have identified a number of mid cap stock opportunities. The fund maintains off-benchmark positions in Kazakhstan, Georgia and Slovenia, owing to strong bottom-up ideas.

We are underweight to the Czech Republic where valuations are reasonable but stock opportunities are limited. The fund is underweight to Greece due to limited stock opportunities. In Russia, valuations are attractive but we see fewer bottom up opportunities. Poland remains the fund's largest underweight as we have significant concerns over policy and governance at a number of index companies.

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 large positions in a particular investment and if market declines or the issuer defaults, then the fund will be adversely affected.