Schroders

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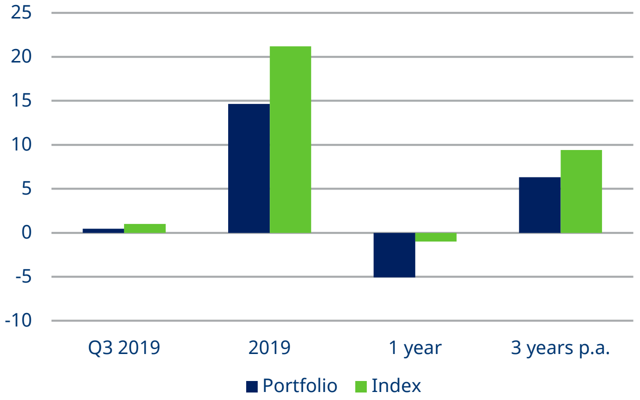
Schroder ISF* Swiss Small & Mid Cap Equity

Quarterly Fund Update

Third quarter 2019

Returns to 30 September 2019 (%)

A accumulation shares
CHF returns



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

	Q3 2019	YTD 2019	1 year	3 years p.a.
Schroder ISF Swiss Small & Mid Cap Equity A Acc	0.5	14.7	-5.1	6.3
Swiss Performance Index Extra SPIEX	1.0	21.2	-1.0	9.4

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

Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get the amount originally invested.

Calendar year returns (%)

	Fund	Index
2018	-17.3	-17.2
2017	23.9	29.7
2016	13.8	8.5
2015	10.0	11.0
2014	8.7	11.4

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

Summary

– Schroder ISF Swiss Small & Mid Cap Equity returned 0.5% in the third quarter of 2019, underperforming the benchmark SPI Extra by -0.5%.

– Worldwide equities were positive in the third quarter of 2019. The MSCI Europe returned +2.6% and outperformed the S&P 500 (+1.7%) and the MSCI World (+0.7%) in local currencies. In Switzerland, large caps outperformed small caps by 0.9%, supported by the strong performance of defensive index heavyweights Nestlé and Roche.

– During the third quarter, we increased our positions in Sulzer, SIG Combibloc and Vifor Pharma. On the other hand we sold our positions in VAT Group and Romande Energie and reduced Belimo, Bucher Clariant, DKSH, Georg Fischer, Flughafen Zurich, Oerlikon as well as Schindler.

– The environment for equity markets is little changed. Risks like trade tensions, Brexit and weakening global growth on the negative side, but ultra-loose monetary policy, lack of investment opportunities due to low interest rates, attractive equity valuation (at least relative to other asset classes) and, likely, increased fiscal stimuli on the positive side are balanced overall.

Portfolio characteristics

Fund manager	Daniel Lenz
Managed fund since	28 June 2002
Fund launch date	28 June 2002
Fund benchmark	SPI Extra
Fund size	CHF 226.6mn
Annual management fee	1.50% p.a.
Ongoing Charges (latest available)	1.85% p.a.
Number of stocks in fund	49
Fund base currency	CHF

Source: Schroders, as at 30 September 2019.

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

Economic environment

After expanding by 3.3% in 2018, global growth is expected to moderate to 2.6% in 2019 and 2.4% in 2020 – the slowest rate of growth since the Global Financial Crisis. US growth is forecast to slow to 2.1% in 2019 and 1.3% in 2020. Following the latest escalation in the US-China trade war, we no longer expect a resolution but a further escalation where the US increases the soon to be applied 10% tariff to 25% by the end of the year. The impact of actions so far will still be felt in 2019 and 2020. We now see an extended period of economic weakness as uncertainty weighs on the willingness of firms and households to make significant spending decisions. Eurozone growth is forecast to moderate from 2% in 2018 to 1.1% in 2019 as the full effects from the US-China trade war and Brexit hit European exporters.

In Switzerland, the State Secretariat for Economic Affairs ("SECO") reduced its 2019 GDP growth expectations to 0.8% from 1.2% but maintained its 2020 forecast at 1.7%. The SECO anticipates weaker exports and investments against the backdrop of a slowing global economy and mounting uncertainties. In our view, given the global slowdown of economic growth rates, expectations for 2020 by the SECO seem ambitious.

Market environment

Worldwide equities were positive in the third quarter 2019. The MSCI Europe returned +2.6% and outperformed the S&P 500 (+1.7%) and the MSCI World (+0.7%) in local currencies.

In Switzerland, Swiss small and mid caps (SPIEX Index) returned 1.0%. The large cap segment (SMI total return +1.9%) outperformed small and mid caps by +0.9%, supported by the strong performance of defensive index heavyweights Nestlé and Roche. Within Swiss small & mid caps, real estate (+11.3%) and utilities (+11.0%) were the best performing sectors. Positive contributions also came from communications, materials, health care, technology and financials. On the negative side, consumer discretionary and industrials declined (-3.6% and -3.4% respectively).

Performance review

Schroder ISF Swiss Small & Mid Cap Equity returned +0.5% in the third quarter of 2019, underperforming the benchmark SPI Extra by –0.5%. Since the beginning of the year, the fund returned 14.7% compared to 21.2% of the benchmark. Over three years, annualised performance stands at +6.3% p.a., compared with +9.4% p.a. for the SPI Extra.

In the third quarter of 2019, positive contributions came from our positions in SIG Combibloc, BKW, Daetwyler, VZ Holding and Implenia as well as from our underweights in Straumann und Temenos. On the other hand, negative contributions came from our underweights in Swiss Prime Site, PSP, ams as well as from our positions in Interroll, Aryzta, Forbo, Tecan, Bucher and Valiant.

The underperformance since the beginning of the year is mostly a result of our investment style. In our fundamental analysis, we focus on value and quality aspects. Our approach has led to an outperformance long-term; however, in 2019, we were not able to catch up with the strong overall market until mid-August. Until then, the environment, which was driven by decreasing interest rates, was highly beneficial for expensively valued growth stocks. Examples of stocks that performed strongly since the beginning of the year which we do not own or which we have underweighted in our fund are Temenos (+42% since the beginning of the year), ams (+88%) or Straumann (+33%). On the other hand, defensive small caps which we own did not follow the overall market or even delivered a negative return; examples are Bell (-9%), Orior (+10%), Valiant (-4%) or BKW (+11%). We also had positive contributors, such as Logitech (+33%), Belimo (+42%), SIG Combibloc (+32%), Interroll (+29%) or Daetwyler (+33%). However, these names could not compensate for the above-mentioned negative effects

Please note that past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get the amount originally invested.

Risk considerations

The capital is not guaranteed.

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.

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

Portfolio positioning as at 30 September 2019*

Sector	Relative weights
Industrials	7.1%
Cons. Disc.	4.5%
Utilities	2.5%
Cash	2.2%
Communication	1.3%
Financials	-0.5%
Materials	-1.5%
Technology	-2.6%
Cons. Staples	-2.8%
Healthcare	-4.7%
Real Estate	-5.5%

Top 10 overweights	Relative weight (%)
Orior	2.8
BKW	2.7
Daetwyler	2.6
Logitech	2.4
Tecan	2.3
Bell	2.2
Forbo	2.2
VZ Holding	1.9
Bucher	1.9
Zug Estates	1.8

Top 10 underweights	Relative weight (%)
Lindt & Sprüngli	-6.0
Straumann	-3.4
Kühne & Nagel	-3.0
Temenos	-2.7
Swiss Prime Site	-2.6
Julius Baer	-1.9
PSP	-1.9
Barry Callebaut	-1.7
Partners Group	-1.7
EMS-Chemie	-1.6

Source: Schroders, as at 30 September 2019.
*Data can differ from our factsheet due to different sources.

Key portfolio activity and positioning

In the quarter under review, we increased Sulzer, Vifor Pharma and SIG Combibloc. On the other hand, we sold our positions in VAT Group and Romande Energie and reduced Belimo, Bucher, Clariant, Georg Fischer, DKSH, Oerlikon, Flughafen Zurich and Schindler.

We increased Sulzer and Vifor Pharma. We expect an improved midterm outlook for Sulzer after a long and difficult period. For Vifor Pharma, we see strong earnings growth in the next years as the company will profit from its investments in the sales infrastructure of the new drug "Veltassa". We added to our position in SIG at the beginning of the quarter. Later in the quarter, we took partial profits after a significant increase of the share price due to strong Q2 numbers.

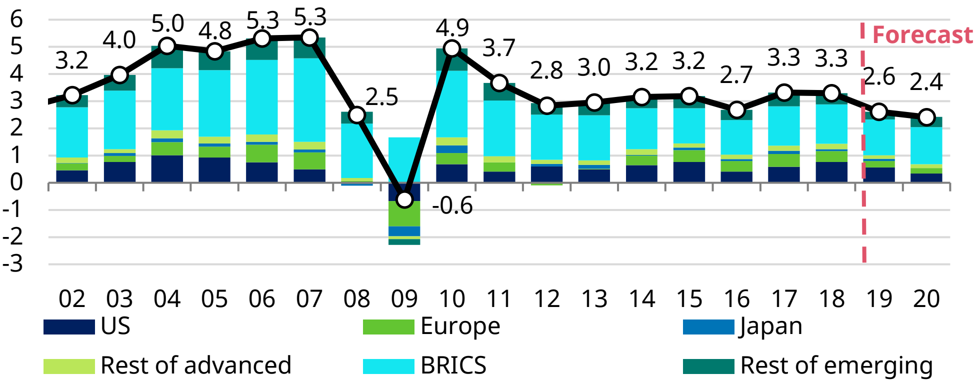
On the other hand, we took profits in quality stocks like Belimo and Flughafen Zurich. We reduced Bucher, Clariant, Georg Fischer, DKSH and Oerlikon as we expect negative earnings developments for these companies due to challenging end markets. Opportunistically, we also reduced Schindler after an unsubstantiated market rumour regarding a potential take-over led to a spike of its share price. Furthermore, we sold our position in VAT Group. The stock has performed well year to date, despite uncertainties in the end-market for semiconductors. We believe that a lot of optimism for 2020 is already priced in. We also sold our residual position in Romande Energie as we see less upside potential compared to our position in BKW.

Outlook

After expanding by 3.3% in 2018, global growth is expected to moderate to 2.6% in 2019 and 2.4% in 2020 – the slowest rate of growth since the Global Financial Crisis. Inflation is forecast to decline to 2.5% this year after 2.7% in 2018 and then rise to 2.6% in 2020. Following the latest escalation in the US-China trade war, we no longer expect a resolution but a further escalation where the US increases the soon to be applied 10% tariff to 25% by the end of the year. The impact of actions so far will still be felt in 2019 and 2020. Rather than expecting a boost to global growth as a trade deal between the US and China is struck at the end of the year, we now see an extended period of economic weakness as uncertainty weighs on the willingness of firms and households to make significant spending decisions. Investment plans are likely to be further delayed or cancelled particularly now that tariffs are more likely to be permanent rather than temporary.

US growth is forecast to slow to 2.1% in 2019 and 1.3% in 2020. Eurozone growth is forecast to moderate from 2% in 2018 to 1.1% in 2019 as the full effects from the US-China trade war and Brexit hit European exporters. Inflation is expected to disappoint, remaining well below target as lower oil prices contribute to lower energy inflation, while core inflation fails to rise due to weaker GDP growth.

Global growth actual and forecast



Source: Schroders Economics Group. 19 August 2019. Please note the forecast warning at the back of the document.

The escalation in trade wars is expected to lead to more rate cuts. Although core CPI inflation is higher, we expect the Federal Reserve (Fed) to look through this, especially as headline inflation will be kept close to 2% as a result of lower oil prices. Consequently, the weaker growth profile we now forecast for the US allows the Fed to cut rates once more this year and bring forward easing in 2020 (to March and June). We have taken out the pause in rates from our previous forecast and now see policy rates at 1.25% at the end of next year (previously 1.5%). What starts as insurance rate cuts morphs into a more conventional easing cycle.

We also see lower interest rates elsewhere: the European Central Bank (ECB) is now expected to cut rates again in December 2019. Switzerland will follow the ECB and we cannot exclude the SNB cutting interest rates toward the end of 2019. The Bank of England is not expected to raise rates until late in 2020 and only then on the contentious assumption that the UK achieves a Brexit deal with a transition period. In China, fiscal policy is eased more than previously expected and next year we have more interest rate cuts.

Overall, the environment for equity markets is little changed. Risks like trade tensions, Brexit and weakening global growth on the negative, but ultra-loose monetary policy, lack of investment opportunities due to low interest rates, attractive equity valuation (at least relative to other asset classes) and, likely, increased fiscal stimuli on the positive side are balanced overall. However, it is also very likely that the remainder of 2019 and the start of 2020 will be characterized by ongoing sentiment changes. Consequently, we also expect equity markets to remain volatile.

After the strong performance of certain market segments since the beginning of 2019, many "quality growth" companies have become expensive while others, mainly in consumer goods, financials and industrials, were clearly lagging and remain attractively priced. We have noticed a partial reversal since mid-August and expect a normalization in the mid-term as outperformance of growth is at extremes, pointing to excessive positioning in these growth stocks versus the value segment. Consequently, as a stock picker, we are evaluating whether an equity asset is priced attractively or expensively compared to its long-term earnings power and dividend capacity. We continue to take profits in stocks that have performed strongly or where the outlook is deteriorating such as Belimo, Bucher, Clariant, and Oerlikon and increased stocks with good upside like SIG Combibloc, Vifor Pharma and Sulzer.

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

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