Marketing material

Schroder Investment Solutions

Monthly update – December 2022

Market commentary

Overall stock markets finished the year with gains in Q4. Asian shares were boosted by China's relaxation of its zero-Covid policy, while European equities also advanced strongly. Government bond yields continued to increase meaning that prices fell. This reflected some market disappointment as major central banks reiterated plans to tighten monetary policy, even as inflation showed signs of peaking.

US Equities made robust gains in Q4, with much of the progress made in November. Investors balanced ongoing caution from the US Federal Reserve (Fed) with indications that the pace of policy tightening would slow, and signs that elevated inflation could be cooling. Inflation remains elevated however, at 7.1% year-on-year. The Fed's final rate hike of the year was indeed a pared back 0.50% rise after four consecutive 0.75% tightening moves. Most sectors rose over the quarter, a number climbing significantly. Energy stocks posted especially strong gains, with sector heavyweights Exxon and Chevron posting record profits in the quarter. Consumer discretionary was a notable exception, with Tesla's decline an outsized influence.

Eurozone Equities notched up a strong advance in Q4, outperforming other regions. Gains came from a variety of sectors, notably economically-sensitive areas like energy, financials, industrials and consumer discretionary. More defensive parts of the market such as consumer staples lagged the wider market's advance. Equity gains were supported by hopes that inflation may be peaking in Europe as well as in the US. Data showed that the eurozone economy grew by 0.3% quarter-on-quarter in Q3, slowing from 0.8% growth in Q2. Forward-looking indicators continued to point towards contraction although the rate of decline moderated. Falling gas prices, amid unusually mild weather for much of the period, helped to alleviate some cost pressures.

UK Equities rose over the quarter, helped in part by the country emerging from its September crisis. Many of the policies announced in that September 'mini-budget' were reversed and the new chancellor Jeremy Hunt used the Autumn Statement in November to promise the country would tighten its belt in the future. The decision by the Bank of England to reduce the pace of interest rate hikes also helped these areas recover well from their mid autumn lows.

Emerging Market Equities posted strong returns over Q4, helped by a weaker US dollar. Most of the MSCI EM Index's returns were generated in November on optimism that as policy tightening from The Fed slowed, any recession would be shallow and markets would begin to discount the recovery. Optimism faded somewhat in December, however, when The Fed re-iterated its commitment to fighting inflation. Investors welcomed the relaxation of Covid regulations in China, which helped boost optimism regarding an earlier-than-expected re-opening of the economy. Support for the housing sector also added to the positive sentiment.

Government Bonds ended the year on a mixed note in the final quarter. Government bond yields continued to rise, reflecting some market disappointment at the commitment from some central banks to continue increasing interest rates, despite mounting evidence of slowing economic growth. The Fed raised rates twice during the quarter, ending at 4.5%. The Bank of England also announced two rate hikes, bringing the UK interest rate to 3.5% at the end of Q4, while the Bank of Japan announced a modification to its policy for controlling long-term interest rates.

Commodities, represented by the S&P GSCI Index, recorded a positive performance in the fourth quarter, with higher prices in industrial and precious metals offsetting weaker prices in agriculture. Industrial metals was the best-performing component of the index and within precious metals, silver also achieved strong price gains, while the rise in the price of gold was more muted. In agriculture, coffee and wheat prices fell, while prices for sugar, cocoa, corn and soybeans gained. Within energy, strong price gains for unleaded gasoline and heating oil helped to offset a sharp decline in the price of natural gas.

Past performance is not a guide to future performance. The value of investments and the income received from them can fall as well as rise. Investors may not get back the amount invested. Exchange rate changes may cause the value of investments to fall as well as rise.

Portfolio update

Active Model Portfolios
The Active Model Portfolio range had negative returns for December and underperformed relative to their respective Investment Association (IA) peer groups.

European Equities was the only asset class with positive performance over the month, although several funds had positive performance. The JO Hambro Continental European Fund was a top performer and benefited from holdings in the financial services, industrial and healthcare sectors. We also saw positive returns from Neuberger Berman Uncorrelated Strategies Fund as well as one of our Corporate Bond managers, MI TwentyFour AM Dynamic Bond, and our Emerging Market Debt manager, M&G Emerging Markets Bond Fund.

The Global, US and UK Equity asset classes detracted from performance. Negative returns came from the Lazard Global Thematic Focus Fund where stocks in the technology and communication services sectors struggled over December. The Neuberger Berman US Large Cap Value Fund and the Royal London International Government Bond Fund also had negative returns. The effects of higher interest rates continues to negatively impact global government bonds.

Sustainable Model Portfolios
The Sustainable Model Portfolio range had negative returns for December and underperformed relative to their respective Investment Association (IA) peer groups.

European Equities positively contributed to performance of the portfolios. Both the EdenTree Responsible and Sustainable European Equities Fund and the Liontrust Sustainable Future European Growth Fund were top contributors. We also saw positive return from Neuberger Berman Uncorrelated Strategies Fund as well as our Emerging Market Debt manager, Schroder Blue Orchard Emerging Markets Climate Bond Fund.

US, Global and Emerging Market Equities had negative returns over December. The Rockefeller US Equity ESG Improvers Fund and the Legg Mason US Equity Sustainable Leaders Fund detracted from performance with stocks in the technology, financial services and industrial sectors posting negative returns.

Strategic Index Model Portfolios
The Strategic Index Model Portfolio range had negative returns for December and underperformed relative to their respective Investment Association (IA) peer groups.

Positive performance came from the Fidelity Index Europe and this was the only asset class to generate positive returns over the period. Returns have been supported by the hopes that inflation may be reaching its highest level in the region. This could allow for central banks to pause their current interest rate increasing cycle.

The effects of rising interest rates continues to detract from the returns in the Global Government and Corporate Bond markets. Both the HSBC Global Government Bond Index and the Vanguard Global Corporate Bond Index had negative returns over December. We also saw negative returns from the HSBC America Index where stocks in the technology, consumer cyclical and financial services sectors detracted from performance.

Blended Portfolios
The Schroder Blended Portfolio range had negative returns for December and underperformed relative to their respective Investment Association (IA) peer groups.

Performance contributors in December came from European Equities as well as our Corporate Bond funds. The Neuberger Berman Uncorrelated Strategies Fund also contributed to performance. Their equity market neutral strategy performed better in comparison to a very volatile October and November.

December had negative performance from several asset classes including US and Global Equity. Global Government Bonds also detracted over the month with our holding in the HSBC Global Government Bond Index posting negative returns. The Lazard Global Thematic Focus Fund underperformed with stocks in the technology and communication services sectors struggling over December.

Tactical Portfolios and Managed Defensive Fund
The Schroder Tactical Portfolios saw negative returns across the range for December and underperformed relative to their respective Investment Association (IA) peer groups. The Schroder Managed Defensive Fund also saw a negative return for December.

In equities, from an asset allocation perspective we returned to a negative stance in December which was beneficial to performance. With regions outside of the US offering more compelling valuations, we established an overweight position in European equities relative to the US. We think diverging macro stories and continued headwinds faced by the US's tech-heavy equity market should lead to European equity outperformance.

Within fixed income, our preference shifted from high yield to investment grade credit over recessionary fears. Consequently we took profits on the global high yield debt position and implemented a new overweight European investment grade credit position.

In currencies, an overweight Australian dollar versus sterling position was added, in part based on our view that market pricing on Australian interest rate hikes appeared to have softened excessively (providing an attractive entry point), and also reflecting our continued view of a structurally weaker sterling. Elsewhere, overweight US dollar and euro versus sterling positions were closed. Softening global inflation data prints created a market environment that was supportive of risk more generally, which was detrimental to these positions.

The overweight commodities position was closed to offset some of the cyclical (growth sensitive) exposure in the portfolios.

Income Portfolio
The Schroder Income Portfolio had a negative return for December and performed similarly relative to its Investment Association (IA) peer group (IA Mixed Investment 20-60% Shares).

Positive contributions were driven by European, Japanese and Emerging Market Equities. The BlackRock Continental European Income Fund was a top contributor with stocks in the financial services, industrials and energy sectors performing well. The Baillie Gifford Japanese Income Fund also had positive performance which predominantly came from their holdings in the consumer defensive and financial service sectors.

US, Global and UK Equities detracted from performance over December. The iShares USA Quality Dividend Fund had negative returns as did the Schroder US Equity Income Maximiser Fund. After contributing to performance for October and November, the City of London Investment Trust also detracted from performance. Positive performance in the industrial, healthcare and financial service sectors wasn't sufficient to offset the negative returns in consumer defensive and energy stocks.

Investment objectives

Schroder Blended Portfolios

The funds aim to provide capital growth and income by investing in a diversified range of assets and markets worldwide with a target average annual volatility (a measure of how much each fund's returns may vary over a year) over a rolling five year period. This target volatility is fund specific and varies between 30% to 100%* of that of global stock markets (represented by the MSCI All Country World index), depending on the investment objective of each fund.

The Funds are part of the SISCo Schroder Blended Portfolio range, which offers six funds with different expected combinations of investment risk and return.

* Please refer to the Prospectus for the individual risk profile volatility target.

Schroder Tactical Portfolios

The funds aim to provide capital growth and income by investing in a diversified range of assets and markets worldwide with a target average annual volatility (a measure of how much each fund's returns may vary over a year) over a rolling five year period. This target volatility is fund specific and varies between 30% to 90%* of that of global stock markets (represented by the MSCI All Country World index), depending on the investment objective of each fund.

The funds are part of the SISCo Schroder Tactical Portfolio range, which offers five funds with different expected combinations of investment risk and return.

* Please refer to the Prospectus for the individual risk profile volatility target.

Schroder Managed Defensive Fund

The Fund aims to provide capital growth and income in excess of the ICE BofA Sterling 3-Month Government Bill Index plus 2% per annum (after fees have been deducted) over a three to five year period, whilst also seeking to mitigate the risk of incurring a loss greater than 10% over any investment period, by investing in a diversified range of assets and markets worldwide. The Fund will seek to achieve a target average volatility (a measure of how much the Fund's returns may vary over a year) over a rolling five year period of 4% per annum. This cannot be guaranteed and your capital is at risk.

Schroder Income Portfolio

The Fund aims to provide an income of 3% to 5% per year and capital growth by investing in a diversified range of assets and markets worldwide with a target average annual volatility (a measure of how much the Fund's returns may vary over a year) over a rolling five year period of between 50% to 65% of that of global stock markets (represented by the MSCI All Country World index). This is not guaranteed and could change depending on market conditions.

What are the risks?

Prior to making an investment decision, please consider the following risks:
Capital risk: All capital invested is at risk. You may not get back some or all of your investment. **Counterparty risk:** The portfolios may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the portfolios may be lost in part or in whole. **Credit risk:** A decline in the financial health of an issuer could cause the value of the instruments it issues, such as equities or bonds, to fall or become worthless. **Currency risk:** The portfolios may lose value as a result of movements in foreign exchange rates. **Derivatives risk:** A derivative may not perform as expected, and may create losses greater than the cost of the derivative. **Derivatives risk – efficient portfolio management and investment purposes:** Derivatives may be used to manage the portfolios efficiently. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the portfolios. The portfolios may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. When the value of an asset changes, the value of a derivative based on that asset may change to a much greater extent. This may result in greater losses than investing in the underlying asset. **Equity risk:** Equity prices fluctuate daily, based on many factors including general, economic, industry or company news. **High yield bond risk:** High yield bonds (normally lower rated or unrated) generally carry greater market, credit and liquidity risk. **IBOR risk:** The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the portfolios. **Interest rate risk:** The portfolios may lose value as a direct result of interest rate changes. **Investments in other collective investment schemes risk:** The portfolios will invest mainly in other collective investment schemes. **Leverage risk:** The portfolios use derivatives for leverage, which makes them more sensitive to certain market or interest rate movements and may cause above-average volatility and risk of loss. **Liquidity risk:** In difficult market conditions, the portfolios may not be able to sell a security for full value or at all. **Market risk:** The value of investments can go up and down and an investor may not get back the amount initially invested. **Money market & deposit risk:** A failure of a deposit institution or an issuer of a money market instrument could have a negative impact on the performance of the portfolios. **Negative yields risk:** If interest rates are very low or negative, this may have a negative impact on the performance of the portfolios. **Operational risk:** Failures at service providers could lead to disruptions of fund operations or losses. **Performance risk:** Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve.