Schroders

Schroder European Small & Mid Cap Value Fund (ex UK)

Quarterly Report

First quarter 2024

Portfolio Analysis

Market Review

Global stock markets registered **strong gains in Q1** amid a resilient US economy and ongoing enthusiasm around Artificial Intelligence. Expectations of interest rate cuts also boosted shares although the pace of cuts is likely to be slower than the market had hoped for at the turn of the year. Bonds saw negative returns in the quarter.

Eurozone shares posted a strong gain in Q1. Improvements in the economic outlook boosted more economically sensitive stocks while banks were supported by some announcements of improvements to shareholder returns. By contrast, utilities, consumer staples and real estate were the main laggards. Over the quarter there were signs of **improving business activity** in the eurozone. The flash eurozone purchasing managers' index (PMI) rose to 49.9 in March compared to 49.2 in February. This signals that business activity is almost at stable levels. Eurozone **inflation continued to cool** in the quarter. The annual inflation rate (consumer price index) was 2.6% in February, down from 2.8% in January. In February, European Central Bank President Christine Lagarde sought to downplay the chances of an imminent interest rate cut. She told the European Parliament that the central bank does not want to run the risk of reversing any cuts.

During the period under review, the MSCI World gained 11.8%, the S&P 500 +13.3%, the MSCI Europe +7.8% and the Swiss SPI +1.1% (all in EUR). Small and mid-caps in Europe continued to underperform larger companies (MSCI Europe ex UK SMID Cap +4.7%).

From a sector view, within European small & mid-caps, the picture during the quarter under review was heterogenous: energy, financials, industrials, communication services and consumer discretionary posted significant gains, while utilities, real estate, consumer staples, information technology, health care and materials were laggards.

Performance Review

Total returns in € (%)	Q1 2024	2023	3 years p.a.	Since inception p.a.[1]
Schroder European Small & Mid Cap Value Fund (ex UK)	2.3%	11.7	-0.4	9.9
MSCI Europe ex UK SMID Cap Net	4.7%	12.1	2.5	8.4

Source: Schroders, Bloomberg, 31 March 2024; all fund performance data on a NAV to NAV basis, net income reinvested, net of fees.
[1]Fund inception date: 1 November 2003. [2] Index only available from 30.06.2017

In the **first quarter** of 2024, the portfolio advanced by +2.3%, not keeping up with the strong development of the benchmark (+4.7% MSCI Europe ex UK SMID Cap Net). **Since inception of the fund,** performance of the portfolio stands at +9.9% p.a., compared to the benchmark at +8.4% p.a.

Stock selection was the main detractor of performance during the quarter, most prominently in the sectors: information technology, energy and financials. While the q4 reporting season was mostly satisfactory/solid for our portfolio holdings, some stock moves following the results were confounding or lackluster. Two ouf our holdings (Soitec, ams-Osram, see comments below) had to revise or postpone their targets and this had a negative impact on performance in the quarter.

On a single stock view, **Rheinmetall** continued to be a strong contributor to relative performance, as orders continue to ramp and long-term visibility improves. CTS Eventim was another significant **positive contributor**. **CTS Eventim**, the leading European ticketing operator continues to benefit from growing demand for live events and the shift to mobile tickets, improving the margins. **Galderma** contributed positively, as we participated in the IPO which was priced very attractively and the stock surged more than 20% on the first day of trading (and was stable since). **Accelleron** exceeded the high expectations for the full year results due to strong dynamics in both divisions (marine and energy).

Soitec was a main **negative detractor** as the company is hit by a delay in the smartphone market recovery and by destocking issues at clients. While this short-term delay is unfortunate, the growth path once inflection is reached remains highly attractive. **ams-Osram** was impacted as Apple unexpectedly cancelled their MicroLED project, which is triggering signficant impairments on R&D and the production site of ams-Osram. While this removes a mid-term growth driver, it improves current cash flow generation. **Dermapharm** was another detractor, despite solid results as current investor interest seems low, despite the stock being excellent value at these levels.

Fund Activity and Positioning

During the quarter under review, we added **two new positions** and **sold one** position. We added Galderma (IPO) and Swedish Orphan Biovitrium (SOBI) and we sold our remaining position in Agrana.

We participated in the IPO of the Swiss dermatology company **Galderma**. Their product offering covers injectables, skincare and medical treatments. Galderma holds strong global market positions in its focus areas and has been outgrowing the market, which has been growing doube-digit. Additionally, we bought a position in **Swedish Orphan Biovitrium.** We previously held a position in this niche pharma company specializing in orphan drugs, but sold it in 2021 as they received a bid to be bought out (which eventually did not happen). In the meantime their growth outlook has improved significantly with new indications. Valuation is attractive (P/E of 16x for 2025) with one of the highest growth rates in the pharma sector coming from existing/marketed products, within a segment with less competition (orphan drugs).

We sold our remaining small position in **Agrana**, as we are disappointed by the pace of improvements over the past years and we see much more attractive upside in other companies. Additionally, we have governance issues with the CEO being additionally in the position of CFO and division head (Fruit).

As usual, we **decreased** holdings which had outperformed significantly or which needed to be resized like ASM Intl., BE Semicon, CTS Eventim, D'Ieteren, Logitech and Kontron. We opportunistically **increased** our existing positions as we took advantage of outsized moves on a stock level in companies like Aurubis, Bank of Ireland, Duerr, FlatexDegiro, Mayr-Melnhof Karton, LEG Immobilien, Neste and Viscofan.

Key Stock Positions*

Top 10 holdings	Sector	Country	Absolute weight (%)
Rheinmetall	Industrials	Germany	2.6
ASR	Financials	Netherlands	2.5
Euronext	Financials	France	2.3
Galderma	Healthcare	Switzerland	2.3
CTS Eventim	Communication Services	Germany	2.0
Accelleron	Industrials	Switzerland	2.0
Bank of Ireland	Financials	Ireland	2.0
Andritz	Industrials	Austria	2.0
ASM Intl.	Information Technology	Netherlands	1.8
Hannover Rueck	Financials	Germany	1.8

Source: Schroders, 31 March 2024

* Data can differ from our factsheets due to different sources.

Investment View

Investors and economists alike had thought that policy makers needed to engineer mild recessions to reduce inflation pressures. And yet, inflation has fallen sharply over the past year and is almost back to target for the major central banks. This has occurred while economies have outperformed expectations, against a backdrop of interest rates rising by more than had been expected a year ago. An immaculate disinflation, whereby inflation moderates while economic activity continues to grow, and unemployment remains low, appears now to be playing out.

As inflation continues to fall, central banks have started to change the tone of their communication. References to upside risks for interest rates have largely been removed, while discussions of downside risks have remained. Expectations are building that interest rates will be lowered as we progress through this year, but there are still questions over how much easing will follow.

The outlook for the global economy is looking brighter. Global GDP growth in the new Schroders forecast has been revised up from 2.2% to 2.6% for 2024 and from 2.2% to 2.7% for 2025. Meanwhile, global inflation is forecast to slow from 4.4% in 2023 to 2.9% in 2024 (unrevised) and to 2.5% in 2025 (revised down from 3%).

In the US, the economy has proven to be far more resilient, all whilst inflation has continued to moderate. Job creation is easing but is set to remain healthy, supporting consumer spending which is also benefitting from improving real income growth as inflation continues to fade. Falling inflation should allow the Federal Reserve (Fed) to start cutting the fed funds rate this summer.

The eurozone has managed to avoid a technical recession, but manufacturing heavy countries such as Germany are struggling. Growth has been revised marginally higher, mostly on the back of a better external outlook, although domestic demand is also expected to recover through 2024. Falling inflation, and interest rates from the spring should support a recovery in household spending.

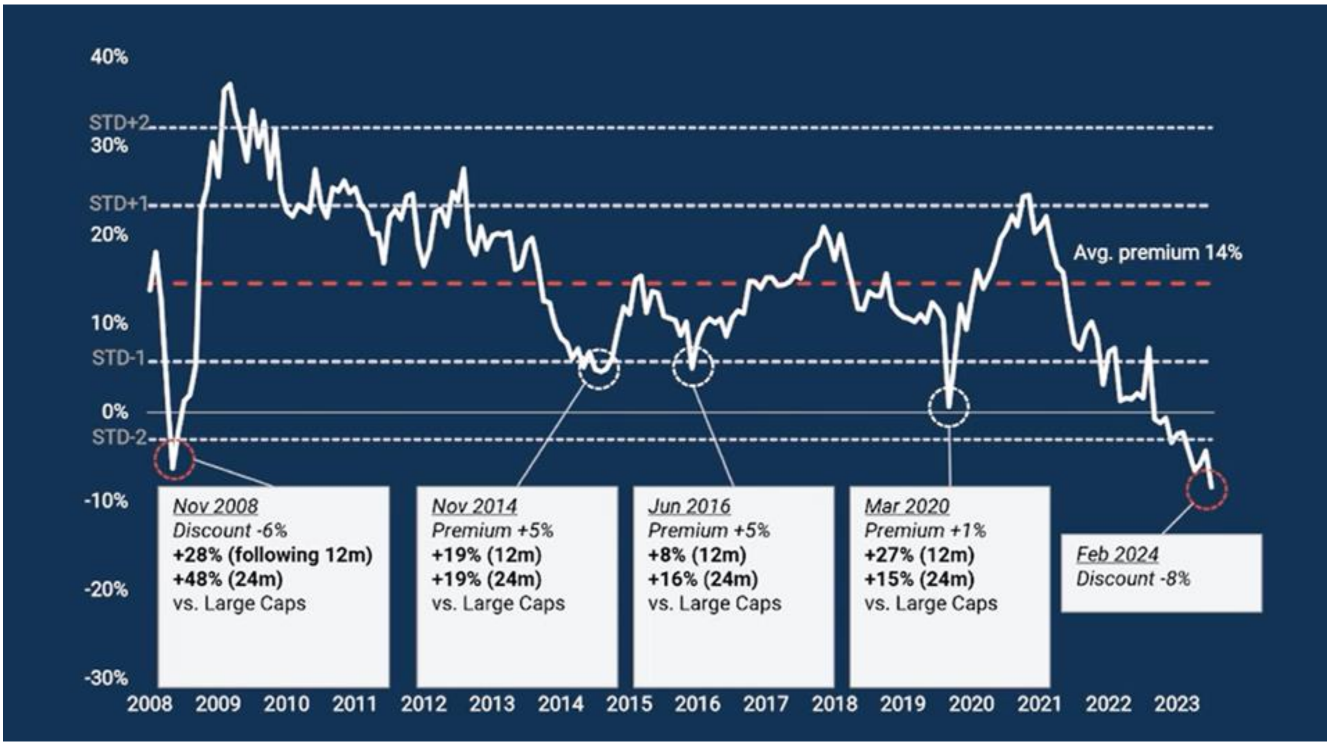
European equities have had a strong start to 2024. March brought signs that the market breadth is increasing and investors are now seeking out lowly valued and unloved areas of the market, rather than sticking with recent winners. If this trend persists, then it should prove positive for Europe relative to the US, value rather than growth, and for smaller companies relative to larger ones. Indeed, flows into European equities are showing signs of improvement, from a low base although. The path of interest rate cuts is increasingly visible and it appears this is a base for investors to take on more risk.

Leading indicators are improving more quickly in the US than in Europe. However, there are some first tentative signs of the upturn coming through in Europe too, for example in the latest German industrial production data. Early cycle stocks in sectors such as industrials, materials and information technology will be the first beneficiaries of improved economic momentum.

European small & mid caps have underperformed European larger companies significantly since 2021 and are currently at a significant discount (see Chart 1 on next page). Given the fundamental back-drop described above, we expect this to be a very attractive point in time for this asset class. While we do not know when relative performance to the large companies inflects, historically this looks like a great place to be looking forward.

Chart 1: European Small & mid caps stand at near-record-low valuations compared to large, last seen during the great financial crisis

Relative P/E NTM – MSCI Europe Small Cap / MSCI Europe



Source: Jefferies Intl. Ltd

In terms of our investment strategy, we stick to our balanced positioning with a clear focus on high-quality firms with healthy balance sheets. As started in the course of the last two quarters, we continue to add stocks that have suffered more during risk-off phases and typically benefit from risk-on phases. We find such stocks in various sectors including the more cyclical segments.

Portfolio characteristics – Schroder European Small & Mid Cap Value Fund (ex UK)

Fund managers	Philipp Bruderer and Daniel Lenz	**Number of stocks in fund**	81
Managed fund since	1 November 2015	**Bloomberg**	SRIFSME SW
Fund launch date	1 November 2003	**ISIN**	CH0016875426
Fund benchmark	MSCI Europe ex UK SMID Cap Net*	**Swiss security number**	1687542
Fund size	EUR 148.4 mn	**Fund base currency**	EUR
Ongoing charge[1]	0.70%		

Source: Schroders, 31 March 2024.
[1]The ongoing charge figure is based on expenses as per audited annual account 31.12.2020 and may vary from year to year.
*Benchmark: since inception until 31.12.2015: DJ Stoxx 200 Mid Cap TR; since 01.01.2016: MSCI Europe ex UK SMID Cap Net.