Schroders

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

Quarterly Report

Third quarter 2024

Portfolio Analysis

Market Review

Global equities gained in the third quarter despite pronounced volatility on several occasions. **US shares** advanced over the quarter but sector performances were mixed as some previous winners lagged. Changing expectations for the path of US interest rates shaped the quarter and contributed to the divergent sector performances. A weaker jobs report in July sparked fears that the Fed may have left it too late to cut interest rates, and risked damaging the economy. Markets began to price in significant monetary policy easing by the end of the year, this was followed by a 50 basis point (bps) reduction to rates by the Fed in September.

Eurozone shares, as measured by the MSCI EMU index, made gains in Q3. The advance was led by the real estate, utilities and healthcare sectors as the prospect of lower interest rates saw investors reassess some previously out-of-favour parts of the market. Energy and information technology were the main laggards, delivering negative returns for the quarter.

The **European Central Bank** (ECB) kept interest rates on hold at its July meeting but then cut by 25 bps in September. Data indicated a softening of inflation over the period, with annual inflation falling from 2.6% in July to 2.2% in August and 1.8% in September. However, activity indicators pointed to a slowdown in the eurozone economy. The HCOB flash eurozone purchasing managers' index (PMI) for September came in at an eight-month low of 48.9. A deepening downturn in the manufacturing sector was behind the reduction in overall activity. Service sector activity rose slightly, with a reading of 50.5. The weaker PMI data, combined with the softer inflation readings, bolstered expectations of further imminent rate cuts from the ECB.

During the period under review, the **MSCI World** advanced 2.3%, the **S&P 500** +1.8%, the **MSCI Europe** +2.4% and the **Swiss SPI** +4.3% (all in EUR). Small and mid-caps in Europe for once were ahead of larger companies (MSCI Europe ex UK SMID Cap +4.2%).
From a **sector view**, within European small & mid-caps, the picture during the quarter under review was widely spread: real estate (+13%), utilities (+8.7%), consumer staples (+7.6%), healthcare (+7.4%) and industrials (+6.7%) advanced significantly, while energy (-11.9%), information technology (-6.2%) and materials (+0.0%) were significant laggers.

Performance Review

Total returns in € (%)	Q3 2024	YTD	3 years p.a.	Since inception p.a.[1]
Schroder European Small & Mid Cap Value Fund (ex UK)	-0.5%	2.7	-2.4	9.7
MSCI Europe ex UK SMID Cap Net	4.2%	10.0	1.6	8.4

Source: Schroders, Bloomberg, 30 September 2024; all fund performance data on a NAV to NAV basis, net income reinvested, net of fees.
[1]Fund inception date: 1 November 2003.

In the **third quarter** of 2024, the portfolio declined by 0.5%, while the benchmark (MSCI Europe ex UK SMID Cap Net) advanced by 4.2%. **Since the start of the year,** performance of the portfolio stands at +2.7%, lagging the benchmark's advance of 10.0%. Both security selection and sector allocation contributed negatively amid the wide dispersion of sector and individual stocks in the quarter under review. Selection in industrials, healthcare and consumer discretionary detracted performance significantly while our overweights in information technology and energy as well as our underweight in real estate were detractors on sector allocation view.

On a single stock view, **Accelleron** continued to be a strong contributor to relative performance as growth continues to surprise on the upside and good cost control results in attractive operating leverage. As growth trends that continues to support Accelleron remain intact for the coming years, we continue to find the stock attractive. **CTS Eventim** was another significant **positive contributor**. The leading European ticketing company continues to benefit from strong demand for live events and increasing share of online / mobile tickets is driving margins higher. **LEG Immobilien**, a German residential real estate company, contributed positively as residential property prices are bottoming out and interest rates are declining. Furthermore, the structural supply/demand imbalance is causing ongoing rent increases.
Gerresheimer was a main **negative detractor** as the medical packaging company had to cut its outlook due to slower-than-expected market recovery from de-stocking in its vials business. This followed rather reassuring statements by management recently. While we continue to see an attractive growth path over the next years, confidence in management communication and targets has been harmed. Similarly, visibility for **GN Store Nord's** enterprise business remains challenging and the expected recovery is now seen towards the end of the year. Clearly, it is a question of "when" and not "if" the market recovers and the company has defended its high market share. **Ubisoft** was another detractor, as they see the need to delay the launch of a key game. We continue to see strong value in the company's franchise intellectual property, but execution risks around extracting value remain an issue.

Fund Activity and Positioning

During the quarter under review, we added **one new position** and **sold one**. We added AFRY and we sold our position in DFV Deutsche Familienversicherung.

We bought a new position in **AFRY**. AFRY is a Swedish engineering company with leading positions in the Nordic region and is the global leader in energy and process industries. The business is well-diversified, with a high exposure to infrastructure and energy transition, which provide resilience during economic cycles. Valuation is attractive at 10x EV/EBIT for a business with high FCF generation and structural tailwinds from climate change, electrification, digitization and urbanization.

We sold our small position in **DFV** Deutsche Familienversicherung despite that the company has reached its milestones as trading liquidity in the stock prevents us from increasing the position size.

As usual, we **decreased** holdings which had outperformed significantly or which needed to be resized like Accelleron, ASM Intl., Aurubis, Euronext, Galderma and LLB. We opportunistically **increased** our existing positions as we took advantage of outsized moves on a stock level in companies like AMS Osram, BE Semicon, Getinge, Gaztransport & Technigaz and Syensqo.

Key Stock Positions*

Top 10 holdings	Sector	Country	Absolute weight (%)
ASR	Financials		2.4
Euronext	Financials		2.3
Andritz	Industrials		2.3
CTS Eventim	Communication Services		2.2
Bank of Ireland	Financials		2.2
Michelin	Consumer Discretionary		2.0
DSM Firmenich	Materials		1.9
Rheinmetall	Industrials		1.9
Accelleron	Industrials		1.9
Syensqo	Materials		1.9

Source: Schroders, 30 September 2024

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

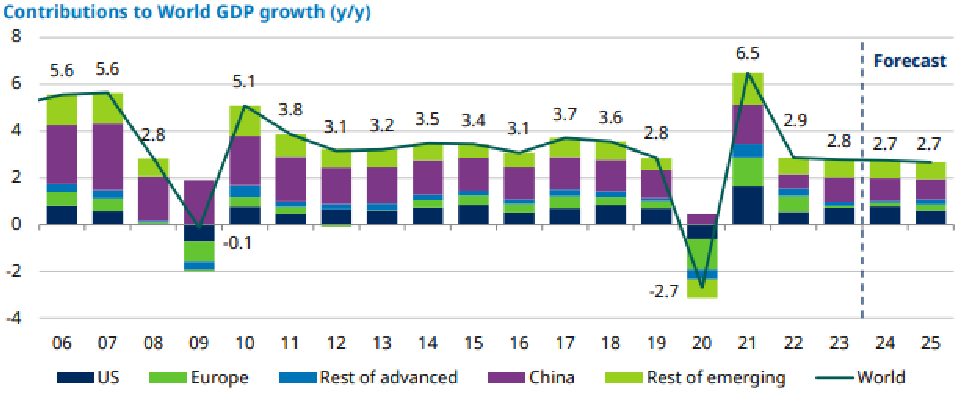
Investment View

We have slightly revised our global GDP growth forecasts to 2.7% for 2024, down from our previous projection of 2.8%. For 2025, we continue to see a growth rate of 2.8%. From our perspective, concerns about an imminent US recession are overblown. Rising unemployment has not been driven by layoffs, but rather elevated inward net migration outpacing the normalisation in job creation. More broadly, labour market conditions have moved into better balance, which ought to see hiring and wage growth revert to a more typical pace. Taken alongside further disinflation and improving credit availability, this should serve to sustain solid household consumption and, by extension, economic activity more generally. The eurozone economy is being held back by the manufacturing malaise. Factory output continues to lag far behind consumer-facing sectors despite the upturn in the global goods cycle. With manufacturers faring better elsewhere, this might point to a structural loss of competitiveness, leading us to scale back our eurozone growth forecast for next year. China now looks set to fall short of its 5% growth target this year. Soft domestic demand has outweighed a solid export performance, with the housing crisis remaining a significant drag on confidence and investment. The recently announced program to support the domestic economy including the real estate sector was well received by market participants.

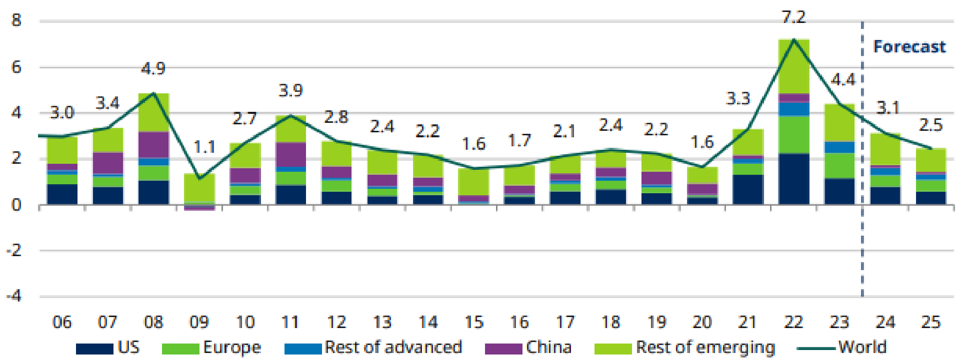
Central banks are unlikely to deliver the easing priced into markets. Policymakers are set to cut rates cautiously to avoid a second wave of inflation. After the first 0.5% cut in September, our forecast sees the Federal Reserve (Fed) lowering rates at a quarterly pace. And tweaks to our rate profiles for the European Central Bank (ECB) and Bank of England (BoE) mean both deliver one fewer rate cut by end-2025 than we previously expected.

In Switzerland the State Secretary of Economic Affairs (SECO) left its estimates for GDP growth unchanged at 1.2% in 2024 and slightly reduced its forecast for 2025 to 1.6% (June forecast as 1.7%). Inflation forecasts have been further reduced to 1.2% for 2024 (previous forecast 1.4%) and 0.7% in 2025 (previous forecast 1.1%). This favorable inflation rate allowed the Swiss National Bank (SNB) to make the decision to lower interest rates by another 0.25% in September to 1.0%. The SNB's proactive approach demonstrates their commitment to supporting the Swiss economy and ensuring its stability.

Contributions to World GDP growth (y/y)



Contributions to World inflation (y/y)



Source: Schroders Economics Group, 27 August 2024.

The overall environment for equities overall stays positive supported by a low but pretty stable GDP growth environment and declining interest rates. Short term however, we expect ongoing market volatility as one cannot exclude that certain companies may disappoint with their H2 2024 earnings as shorter-term visibility on the economic development of the major economic regions North America, Eurozone and China is still limited and market expectations might be too optimistic.

In terms of our investment strategy, we remain focused on the long-term prospects of our holdings and stick to our balanced positioning with a clear focus on high-quality firms with healthy balance sheets. As started during the last few quarters, we continue to add to stocks that have experienced temporary setbacks due to minor negative news, whereas the long-term fundamental prospects remain fully intact. 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 74.8 mn	**Fund base currency**	EUR
Ongoing charge[1]	0.70%		

Source: Schroders, 30 September 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.