Schroders

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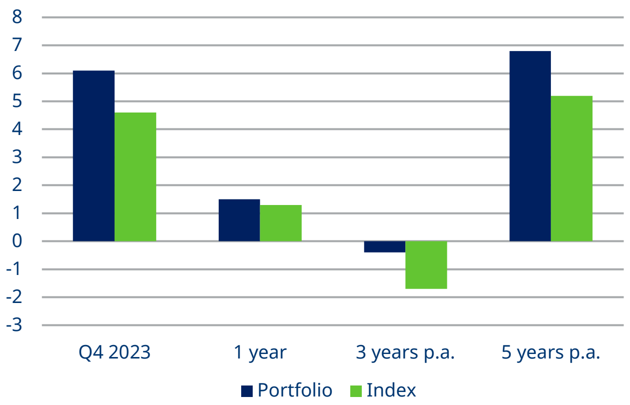
Schroder (CH) Swiss Small & Mid Cap Fund

Quarterly Fund Update

First quarter 2024

Returns to 31 March 2024 (%)

I accumulation shares CHF returns



Source: Schroders, Bloomberg, as at 31 March 2024.

	Q1 2024	1 year	3 years p.a.	5 years p.a.
Schroder (CH) Swiss Small & Mid Cap Fund I Acc	+6.1	+1.5	-0.4	6.8
Swiss Performance Index Extra SPIEX	+4.6	+1.3	-1.7	5.2

Source: Schroders, Bloomberg, as at 31 March 2023.

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. Performance data does not take into account any commissions and costs, if any, charged when units or shares of the fund are issued and redeemed.

Summary

The Schroder (CH) Swiss Small & Mid Cap Fund was up +6.1% in the first quarter of 2024, outperforming the benchmark by +1.5%. Over the past 12 months rolling, the fund advanced +1.5%, +0.2% ahead of the benchmark. Over three years, the annualized performance stands at -0.4%, outperforming the index by +1.3% per annum and over five years, the fund returned +6.8% per annum which equals an annualized outperformance of +1.6%.

It was a strong quarter for global shares. Measured in CHF, the MSCI World advanced 17.0%, the S&P 500 18.7% and the MSCI Europe 13.0%. In Switzerland small & mid caps (SPI Extra) returned +4.6%, lagging the large caps segment (SMI TR +6.8%).

During the first quarter of 2024, we participated in the IPO of Galderma. In addition, we increased our holdings in ams-Osram, Sandoz, SFS, and SIG Combibloc. On the other hand, we took profits in Accelleron, BKW, Bucher, Comet, Georg Fischer, Julius Baer, Schindler, TX Group and Valiant. In addition, we sold our small position in Idorsia.

Portfolio characteristics

Fund manager	Daniel Lenz / Philipp Bruderer
Managed fund since	30 June 2017
Fund launch date	30 June 2017
Fund benchmark	SPI Extra Total Return
Fund size	CHF 194.6 mn
Annual management fee	n/a
Ongoing charge (latest available)	0.03 % p.a.
Number of stocks in fund	48
Fund base currency	CHF
ISIN	CH0368676380
Bloomberg Ticker	SCHSMCI SW
Swiss security number	36867638

Source: Schroders, as at 31 December 2023.

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.

In Switzerland, the State Secretariat of Economic Affairs (SECO) expects the Swiss economy to grow at a below-average growth of 1.1% in 2024 followed by 1.7% in 2025. The Swiss National Bank (SNB) cut interest rates by 25bps to 1.5% in March 2023. A low inflation close to 1% as well as a strong Swiss franc allowed the SNB to make this step to the surprise of most economists. As described in the outlook section of this report in more details, this step will have a positive impact on earnings of Swiss companies due to a weaking of the Swiss franc.

Measured in CHF, the MSCI World advanced 17.0%, the S&P 500 18.7% and the MSCI Europe 13.0%. In Switzerland small & mid caps (SPI Extra) returned +4.6%, lagging the large caps segment (SMI TR +6.8%).

Within Swiss small & mid caps, communication services (+19.1%), industrials (+9.3%), financials (+7.3%) and healthcare stocks (+5.4%) performed best. On the negative side, technology (-11.6%), utilities (-6.7%) and cyclical consumer goods (-0.9%) suffered negative returns.

Performance review

The Schroder (CH) Swiss Small & Mid Cap Fund was up +6.1% in the first quarter of 2024, outperforming the benchmark by +1.5%. Over the past 12 months rolling, the fund advanced +1.5%, +0.2% ahead of the benchmark. Over three years, the annualized performance stands at -0.4%, outperforming the index by +1.3% per annum and over five years, the fund returned +6.8% per annum which equals an annualized outperformance of +1.6%.

In the quarter under review, our stock selection was clearly positive. The biggest positive effects came from our positions in Comet, Accelleron, Bachem, VZ Holding and SFS as well as from underweights in Adecco and Roche. In addition, our participation in the IPO of Galderma had a positive effect of +0.4% to relative performance.

Negative effects were smaller than positive effects. We suffered from our underweights in SGS, VAT Group, Swissquote and Zurich Airport as well as from positions in ams-Osram, BKW, Orior, Daetwyler and Also Holding.

On a sector level, a negative performance of the technology sector within the Swiss small & mid cap segment of -11.6% is contrary to the global trend. The reason is stock specific with the poor performance of Meyer Burger (failure of their business model), ams-Osram (stopped their Micro-LED project) and Temenos (allegations of accounting fraud by a short seller). The portfolio was only little affected by this development: We are not invested in Meyer Burger, we were slightly underweight in Temenos, and we only hold a small position in ams-Osram. The largest positive effect within the technology sector came from our overweight position in Comet. Overall, our positioning in the technology sector contributed +0.4% to the fund's relative performance.

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.

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

Portfolio positioning as at 31 März 2024 *

Sector	Relative weights
Technology	2.7%
Financials	2.3%
Utilities	1.5%
Industrials	1.3%
Cash	0.9%
Cons. Staples	0.4%
Communication	-0.1%
Cons. Disc	-1.2%
Healthcare	-1.3%
Basic Materials	-1.6%
Real Estate	-4.8%

Top 10 overweights	Relative weight (%)
Comet	2.9
VZ Holding	2.7
Tecan	2.7
Forbo	2.3
SFS	2.2
Daetwyler	2.1
St.Galler KB	1.9
Accelleron	1.9
Zehnder	1.8
Baloise	1.8

Top 10 underweights	Relative weight (%)
VAT	-4.0
Lindt & Sprüngli	-2.9
SGS	-2.5
Roche	-2.3
Sandoz	-2.2
Swiss Prime Site	-2.1
Adecco	-1.9
PSP Swiss Property	-1.7
Ems-Chemie	-1.5
Straumann	-1.4

Source: Schroders, as at 31 March 2024

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

Key portfolio activity and positioning

In the first quarter 2024, we participated in the IPO of Galderma. We have been analysing the dermatology company for over a year and have met with the management multiple times. The business model of Galderma is convincing, and the end markets promise good growth. Normally, one must be cautious with IPOs of private equity-held companies. However, after the announcement of the transaction details, it became clear that the transaction would take place at an attractive price according to our valuation model. Additionally, the fact that the private equity firm EQT only placed a very small portion of its stake provided clear confirmation of our assessment.

We increased our holdings in SFS and SIG Combibloc. The prospects for these companies are good, and we expanded our overweight position. We also increased our holdings in Sandoz, but we are still underweight compared to the benchmark. In addition, we increased our holdings in ams-Osram after what we perceived as an exaggerated price reaction. The stock came under pressure after the company had to announce that it would stop its Micro-LED project and write off a significant portion of the activated investments due to a withdrawal by its main customer.

On the other side, we realized profits in Accelleron, BKW, Bucher, Comet, Georg Fischer, Julius Baer, Schindler, TX Group and Valiant. Due to the very precarious financial situation, we divested our small position in Idorsia.

As of 31 December 2023, the fund consists of 48 holdings. Biggest overweight positions are Comet, VZ Holding, Tecan, Forbo and SFS. On a sector level, we are overweight in technology, financials, utilities, industrials and consumer staples. The biggest underweight sectors are real estate, materials and healthcare. Cash was at 0.9%.

Outlook

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.

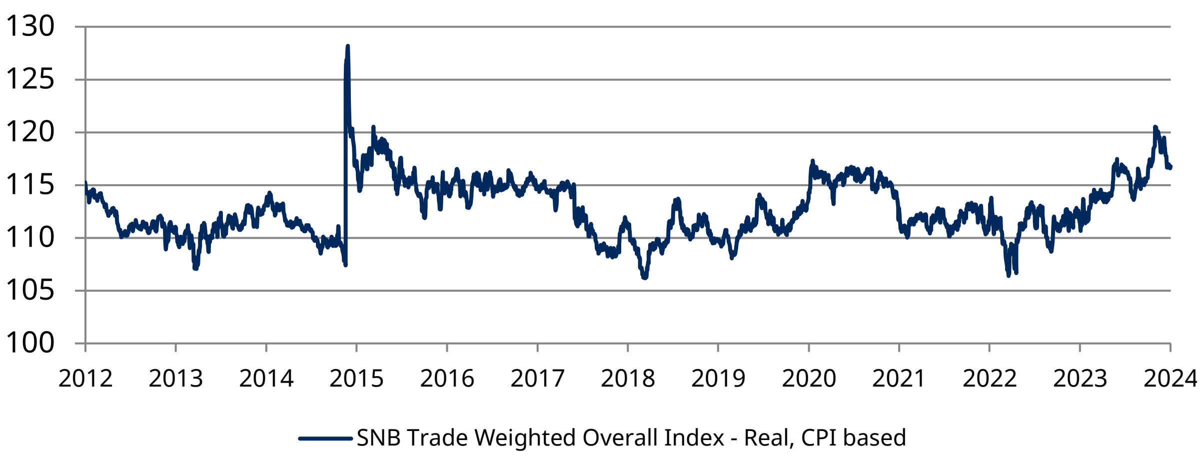
The eurozone has managed to avoid a technical recession, but manufacturing heavy countries such as Germany are struggling. Growth has been revised marginally higher, mostly on the back of a better external outlook, although domestic demand is also expected to recover through 2024. Falling inflation,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

Switzerland has maintained a robust position amidst the global challenges brought up by the Covid-19 pandemic. Switzerland successfully avoided a recession and experienced lower inflation rates throughout the post-Covid period. In February 2024, inflation in Switzerland reached a level of 1.2%. This favorable inflation rate as well as the appreciation of the Swiss franc over the past year allowed the Swiss National Bank (SNB) to make the decision to lower interest rates by 0.25% in March to 1.5%. The SNB's proactive approach demonstrates their commitment to supporting the Swiss economy and ensuring its stability.

The overall outlook for equities has improved in expectation of a more positive GDP growth environment. Swiss equities, in particular, which generate on average between 80-90% of their revenue abroad, benefit from the more positive growth environment. Additionally, when measured in Swiss francs, the earnings of Swiss equities experience a benefit due to the weakening Swiss franc following the interest rate cut by the Swiss National Bank (SNB).

Important to highlight is the long-term performance of the Swiss franc in real terms, i.e. adjusted for different inflation levels. Contrary to popular perception, the Swiss franc has not appreciated in real terms, as illustrated in the chart below. This is a significant factor that has contributed to the robust earnings growth of Swiss companies over the past two decades, compared to other regions.

Trade weighted real Swiss franc has not appreciated over the last 10 years



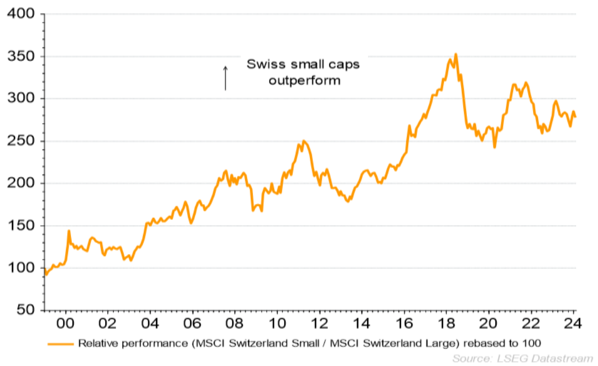
For Swiss small & mid caps, two additional aspects should be beneficial. Firstly, they over-proportionally benefit from global GDP growth due to their higher exposure to cyclical sectors compared to large caps. Secondly, they trade at a valuation premium that has come back considerably since 2021.

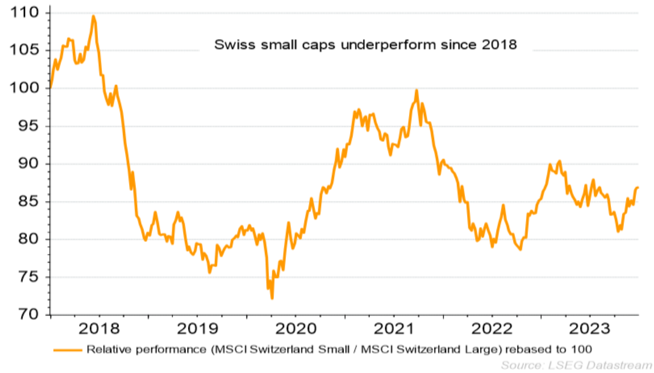
Therefore, we expect small & mid cap to perform well after underperforming since 2018.

<u>Swiss small & mid cap forward price/earnings premium is below historical average</u>

Forward Price / Earnings premium between SPIEX and SMI

<u>Swiss small caps outperform large caps in the long-term, but underperformed since 2018</u>





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.

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