

Schroder Sustainable Global Core PIE Fund

Q2 2024

Investment Report

Q2/2024

Schroders

Schroder Sustainable Global Core PIE Fund

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The Team

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Fund Overview

Investment Approach

An index-relative strategy designed to produce consistent and repeatable performance with low index-relative risk. Stocks are evaluated using a diverse range of Value and Quality criteria to build a highly diversified portfolio, typically holding in excess of 400 stocks.

Fund Performance

Periods 30 June 2024

Total returns NZD	1 month %	3 months %	6 months %	Inception % pa*
Fund at closing prices (gross)	4.03	1.75	18.75	20.96
Fund at closing prices (net)	4.02	1.68	18.55	20.70
Benchmark [^]	3.17	0.99	16.43	19.19
<i>Difference (gross)</i>	+0.86	+0.76	+2.32	+1.77
<i>Difference (net)</i>	+0.85	+0.69	+2.12	+1.51

Fund inception date November 30, 2023.

Source: Schroders, FundRock as of June 27, 2024. End of period adjusted to reflect New Zealand holiday on June 28, 2024. Performance shown reflects past performance, which is no guarantee of future results. Current performance may be higher or lower than the performance shown. Principal value and investment returns will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Performance for periods less than one year is not annualized. NAV performance may differ from performance calculated at closing market prices. The difference between the portfolio and benchmark returns may not equal stated excess returns due to rounding. *Since inception from 30 November 2023. ^Benchmark is the MSCI World ex Tobacco NR NZD. Index is net dividend reinvested (NDR).

Fund Performance (Hedged)

Total returns NZD	1 month %	3 months %	6 months %	Inception % pa*
Fund at closing prices (gross)	3.49	4.21	16.06	20.40
Fund at closing prices (net)	3.50	4.15	15.87	20.14
Benchmark [^]	2.69	3.40	14.17	18.90
<i>Difference (gross)</i>	+0.80	+0.81	+1.89	+1.50
<i>Difference (net)</i>	+0.81	+0.75	+1.70	+1.24

Fund inception date November 30, 2023.

Source: Schroders, FundRock as of June 27, 2024. End of period adjusted to reflect New Zealand holiday on June 28, 2024. Performance shown reflects past performance, which is no guarantee of future results. Current performance may be higher or lower than the performance shown. Principal value and investment returns will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Performance for periods less than one year is not annualized. NAV performance may differ from performance calculated at closing market prices. The difference between the portfolio and benchmark returns may not equal stated excess returns due to rounding. *Since inception from 30 November 2023. ^Benchmark is the MSCI World ex Tobacco NR NZD. Index is net dividend reinvested (NDR).

Summary

Risk assets remained in favour during the second quarter as markets continued their march upwards to round out a solid first half overall. Initial concerns around sticky inflation and dissipating hopes of US rate cuts abated over the course of the quarter, with equity markets regaining their confidence thanks to another solid reporting season.

Whilst the economic data blew hot and cold, the expectation is increasingly that the US economy will achieve a soft landing, but the dominant theme was the ongoing dominance of the big US index stocks which are all regarded as AI beneficiaries. Market breadth was extremely narrow globally, but particularly in the US where almost three quarters of the universe lagged the index, the highest proportion since at least the late 1990s. Nvidia, Apple and Alphabet all posted gains in excess of 20% with Nvidia once again leading the pack, rising by almost 37% during the quarter and is now up 150% over the year (all figures in USD terms).

Elsewhere, equities were a mixed bag. Eurozone shares weakened amid uncertainty caused by the announcement of parliamentary elections in France and dwindling expectations for steep interest rate cuts. Notably, the technology sector gained with semiconductor-related stocks performing particularly well, while the consumer discretionary sector saw declines amid weakness in automotive and luxury goods stocks. UK equities rose with the FTSE 100 achieving fresh all-time highs driven by financials, health care and resources. Performance of small and mid-sized companies was also helped by a flurry of new bids as underperformance has seen many of these areas floundering on low valuations, making them ideal targets for overseas or private equity bids. Japan also gained in local currency terms but returns were negative in USD terms due to the continued depreciation of the Japanese yen.

Market Summary and Performance Review

The fund outperformed during the second quarter, adding to gains posted earlier in the year. Over this period, markets exhibited extremely narrow leadership, especially in those areas that demonstrated the highest earnings potential. Against this backdrop large cap US stocks performed strongly whilst market breadth narrowed considerably.

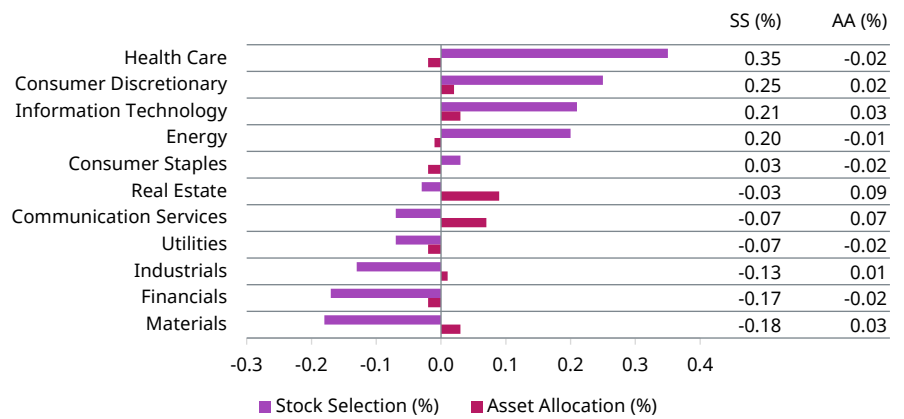
Despite the lack of broad stock participation, the Core strategy's balanced approach, which focuses on better value and higher quality, was robust over the period as avoiding weaker areas alongside a focus on affordable quality, contributed to positive relative performance. In particular, positioning across health care and consumer discretionary was supportive. In healthcare, avoiding weakness in health equipment along with holdings in higher quality pharmaceuticals was beneficial. Similarly, sidestepping weaker apparel names was a boon to relative performance whilst holdings in online retail also contributed positively. Positioning across US technology also aided as the sector enjoyed broad based gains.

Partially offsetting this, stock selection within financials and industrials detracted. Our preferred names in insurers and payments lagged, as did our holdings in US manufacturers and construction related industries.

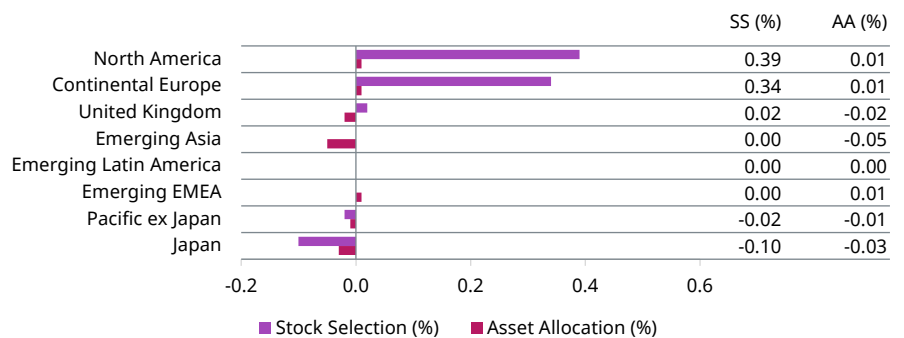
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Relative Fund Performance vs MSCI World ex Tobacco

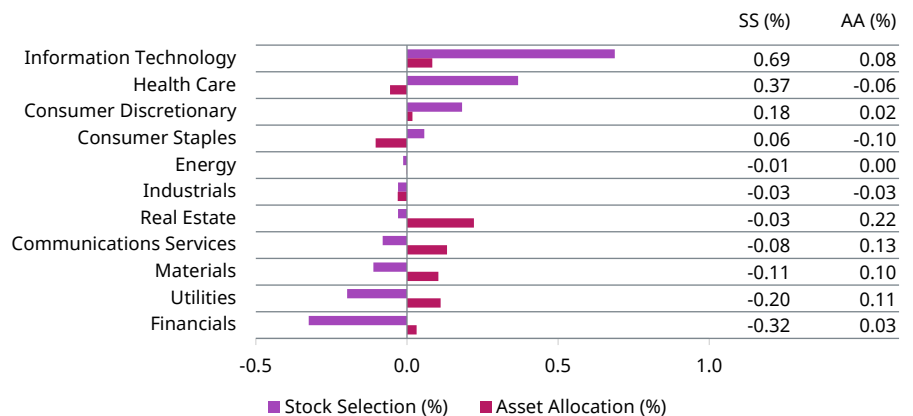
Sector
3 months to 30 Jun 2024



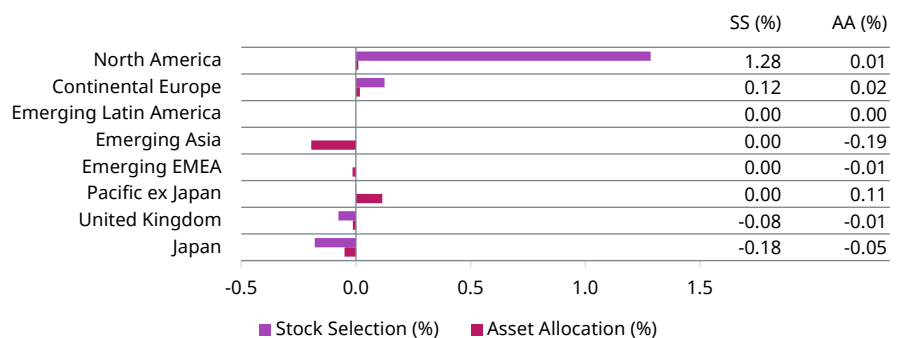
Region
3 months to 30 Jun 2024



Sector
*Since inception to 30 Jun 2024



Region
*Since inception to 30 Jun 2024



Source: Schroders & Investment Team Classifications. The above attribution is shown based on the unhedged portfolio and in USD terms. *Fund inception date November 30, 2023.

Portfolio Activity and Policy

The portfolio maintains its balanced exposure across both affordable quality and better value areas. While positioning across sectors and regions is broadly similar to how we started the quarter, we have remained disciplined in our approach to profit taking at the stock level as markets continued to move higher. We have recycled capital to opportunities which have presented, rotating into compelling options within higher quality cyclicals, whilst maintaining our exposure across structural growth and defensive areas.

Within technology, while we continue to maintain a modest overweight, we have taken some profits where valuations have moved higher. We have prioritised stocks demonstrating stronger growth characteristics with still affordable valuations, particularly within semis and application software. Similarly, within communications, our focus remains on higher quality businesses, where we hold a diversified exposure to integrated telcos alongside online services in media, which exhibit improving earnings.

Within the more defensive parts of the market, our preference has broadly remained similar over the quarter. Our exposure to affordable staples (e.g. home products and drinks) alongside our longstanding overweight to pharmaceuticals persists to provide a hedge against potential downside risks. These companies continue to boast some of the highest quality profiles in the market.

Considering better value areas, we hold exposure to more cyclical segments, namely consumer discretionary and industrials while continuing to review our exposure to financials. Here we focus on the highest financial strength names, with an overweight allocation to both payments and complex banks. Our preferred industry allocation remains within insurers, where we have gradually increased positioning over the year. In consumer discretionary, we retain a preference for online retail, driven by higher quality fundamentals, while in industrials, we are highly selective with a modest overweight in business and environmental services alongside construction supplies.

Regional allocations have not changed materially, although we have reduced our exposure to Japan on profit taking as the market continued to perform strongly in local currency terms. Elsewhere, we continue to hold a higher than index allocation to the US while maintaining an underweight to the UK and Continental Europe where we find some deeper value opportunities.

Outlook

As we enter the second half of 2024, many investors are finding it hard to jump off the momentum bandwagon. In truth, there have been few reasons to change course. The current extended market rally which began in late October 2023 was initially fuelled by the expectation that falling inflation would allow the Fed to cut rates aggressively this year and flawlessly engineer a soft landing. Instead, inflation has proved sticky and economic growth has been uneven, limiting the space for policy easing. Nevertheless, equities have firmly shrugged this off, thanks to a disconnect between the lacklustre macro cycle and buoyant corporate earnings. Historically, this has been a supportive environment for stocks, but the gains posted since last October have been extremely narrow, which increasingly belies the health of the rally.

This “higher for longer” backdrop has rewarded quality stocks but particularly those linked to AI themes to a point where momentum crowding and stock concentration have reached multi decade highs. According to the latest Bank of America global fund manager survey, being long the Magnificent 7 remains the most crowded trade for the 15th consecutive month and there have only been a handful of times when a single trade was more crowded in the history of the survey.

One way to quantify the dispersion between the average stock and the chosen few is to compare the performance of the equally weighted S&P500 and the standard index. Over several decades, the ratio of the two has trended firmly upwards, highlighting the impact of creative destruction at the top of the index. Simply put, it's rare for the biggest stocks to sustain their dominance. However, the recent sharp underperformance of the equally weighted index relative to this longer-term trend is on a par with the depths of the TMT bubble and the Nifty-fifty boom in the early 1970s. Both periods were followed by exceptionally strong performance for the average stock and the onus on those expecting the momentum trade to continue is that this time things are different.

There are certainly reasons to believe this may be the case as all the big stocks share a common trait of strong business franchises in fast growing areas, particularly now that Broadcom has replaced Tesla in the Magnificent-7 cohort. Their valuations look elevated but not particularly egregious and, in the case of the posterchild of the group Nvidia, whilst earnings continue to roll in, there seems little reason to take the career risk of calling the top.

The outsized return of the big index stocks is however masking weakness in other areas of the market. Just as the average stock has trod water for the past 2 ½ years, their earnings have also been unspectacular over the same period. This may be about to

change as current analyst forecasts for next year and 2026 suggest a broadening out of the contribution to market earnings growth beyond the Ultra Mega Caps, which would be a healthy development if it is matched by broader participation.

The second quarter earnings season will most likely be key to deciding the next phase of this market, particularly in the US. Even with earnings support, it may be increasingly hard for the Mag-7 to sustain their recent performance with expectations so elevated and both valuation and investor positioning either at or near the highs of this cycle.

Outside of the US, the case for Value is more compelling. The performance gap between the standard MSCI ACWI ex US Growth and Value indices year to date is narrow with Value outperforming during the second quarter, albeit thanks to the bounce in energy stocks during the period. On a relative basis (i.e. vs the US market), valuations are more attractive and central banks are responding more quickly than the Fed in easing. European political risk is unlikely to be promptly resolved but, following the strong outperformance of European cyclicals between mid-2022 and April which has only partly unwound since, there remain plenty of attractively priced quality defensives within the region.

Elsewhere, it is difficult to get overly bullish about emerging markets, particularly given the likelihood of a strong USD due to its ongoing yield advantage, but robust EM earnings growth and cheap relative valuations are supportive. Lastly, Japan could easily perform well in the second half of the year but this outcome most likely requires a stabilisation in its currency which currently remains elusive. More generally, with investor sentiment buoyant and cash levels low, the most diversifying trade away from momentum tail risk is to allocate more to defensive value (e.g. staples such as home products and pharmaceuticals) as well as cheap insurers. These stocks are also attractive as a potential hedge in the event of a market setback.

Meanwhile, the US election continues to edge closer. The polls are still close but the Trump camp appears to marginally have the upper hand which could also lead to investor uncertainty given the potential for significant changes to trade policy, foreign relations and regulation, not to mention a looser fiscal stance. The long end of the US yield curve is already responding accordingly.

From our perspective, the risks would seem modestly skewed to disappointment, but our key observation is that the wide dispersion of valuations across the market at present, caused by the extremely narrow breadth of recent years, continues to set the stage for bottom-up rather than top-down calls. It seems less likely

that beta will drive returns, meaning that alpha generation will be even more important. Given our diversified approach, we are very comfortable with a more range bound environment and our focus remains on identifying attractively valued high quality stocks that are well suited to navigate a multi themed market.

Active Ownership

The QEP Investment Team works in close collaboration with Schroders' Sustainable Investment team to facilitate our engagement activity. Company engagements play an important role in our process, with the information gained key in helping us understand the sustainability issues corporations face and the specific strategies in place to address them. It also allows us to promote change and make clear our transition expectations for the companies in which we invest. The central store of engagement information available to us, covering all Schroders firmwide engagements, also provides useful qualitative information on issues that are otherwise difficult to capture from traditional ESG data sources. Schroders' engagement blueprint includes six priority engagement themes capturing issues relating to environmental (climate change, natural capital & biodiversity), social (human rights, human capital management, diversity & inclusion) and corporate governance.

Climate change and biodiversity continue to be key subjects of engagement, with several engagements focused on environmental topics conducted during the second quarter. Banks JP Morgan Chase & Toronto-Dominion Bank were both engaged with on their climate alignment practices. The engagement with JP Morgan Chase centred on the bank's green bond framework to understand how the proceeds from green bond issuance were being used. We also sought further information around their financed emissions framework, asking for more robust financed emissions disclosures and the methodology employed to set their new energy targets.

With regards to Toronto-Dominion Bank our focus was on their climate strategy and transition readiness. The bank openly discussed their approach to assessing their transition readiness, communicating how they employ several tools to help in their assessment, such as their Transition Plan Assessment Framework. The bank's focus remains on delivering on the targets that they have already set versus extending these further. Toronto-Dominion Bank also confirmed that climate risk is integrated within their credit assessment processes to identify potential transition risks in their lending book. Finally, the company has increased their focus on utilising sustainability metrics in the remuneration policies for senior-level executives, including financed emissions targets which is a step we welcome to help drive improvements moving forward.

Our stewardship process extends to a proactive voting programme, a mechanism we leverage using the weight of Schroders' asset base and associated voting rights to drive our engagement priorities. We make considered use of our voting rights, acting in line with our fiduciary responsibilities in what we deem to be the best interests of our clients. As a firm, Schroders votes on all resolutions unless we are specifically restricted from doing so with all voting carried out by Schroders' corporate governance specialists. We voted at over 800 meetings on almost 12,000 resolutions for companies held across the QEP desk in the second quarter of 2024. Within these votes, around 15% were not with management. Votes against management were focussed on compensation plans, the election of directors or auditor related. We voted against ASML's remuneration proposal as the metrics used to set targets within the long-term incentive proposal were below expectations. We also voted against AstraZeneca's proposed new director given the overboarding of the company's board presently. The nominee already sits on a number of external boards which could also impact their ability to appropriately carry out the role if elected.

**Portfolio Characteristics
at 30 Jun 2024**

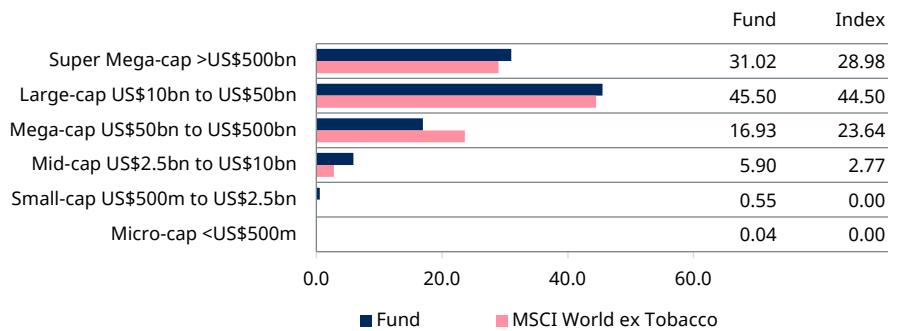
Characteristics	Fund	Index
Active Share	36.6%	-
Weight in non-index stocks	6.4%	-
Ex ante Tracking Error	1.2%	-
Beta	1.00	-
Number of stocks	422	1,425
Company Market Cap	771,499	729,936
Dividend Yield (Gross)	1.6%	1.8%
Carbon Intensity (CO2 t/M\$ Sales)	56.4	94.5

Source: Schroders & MSCI. Tracking Error is sourced from Aladdin.

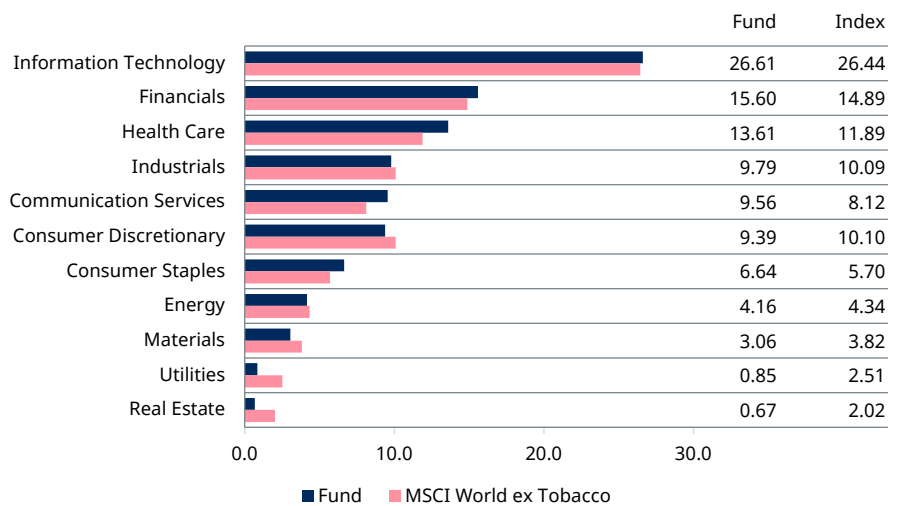
Index: MSCI World ex Tobacco

Portfolio Analysis

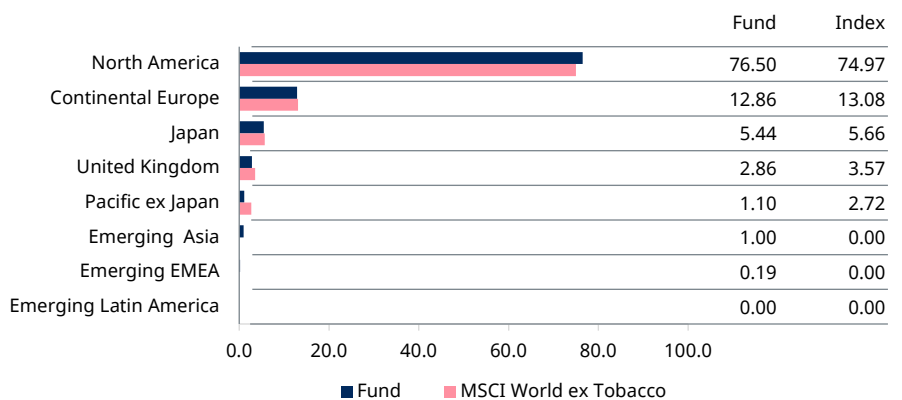
Portfolio Weightings Market Capitalisation (%) at 30 Jun 2024



Sector (%) at 30 Jun 2024



Region (%) at 30 Jun 2024



Source: Schroders & Investment Team Classifications

Notes

Responsible Investment: Schroders Socially Responsible Investment and Corporate Governance policies can be found on our website <http://www.schroders.com/global/about-schroders/corporate-responsibility/responsible-investment/>. We also publish regular articles on Socially Responsible Investing, which can be found on Schroders Talking Point www.schroders.com/talkingpoint.

Important Information

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