Schroders
Fund Update

Schroder International Selection Fund*
Emerging Markets Debt Absolute Return

Fund overview:

The Schroder ISF Emerging Markets Debt Absolute Return team manages global emerging market debt funds using a variety of instruments and techniques in an effort to enhance overall risk-adjusted returns. The funds' aim is to achieve high, long-term absolute returns while keeping volatility to a minimum. Specifically, the team aims to make positive absolute returns in any 12 month period. Schroders benefits from the consolidated experience and proven track-record of the Schroders Emerging Markets Debt team, led by Geoff Blanning since 1998, with a total of 4 professionals based in London and Buenos Aires. The team manages "absolute return" EMD funds of over **US$8.4** billion as at 31 May 2010 on behalf of private clients, institutional and retail investors worldwide.

% *	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
1997									0.82	-6.18	0.86	0.61	-4.01
1998	-2.03	2.08	2.65	0.39	-1.96	-1.61	-1.24	-12.17	6.31	3.31	5.06	0.01	2.01
1999	-0.75	0..50	5.33	8.84	-1.86	1.44	-0.54	0.06	3.52	3.94	2.71	3.18	29.19
2000	-0.44	3.40	2.51	-1.79	-1.41	4.77	3.67	2.46	-1.79	-0.28	1.47	4.08	17.62
2001	3.29	-0.66	-1.48	-2.49	1.34	1.78	0.23	4.42	-3.71	0.47	-0.11	0.36	3.21
2002	0.93	2.32	-0.03	4.48	3.31	3.05	-0.09	2.74	1.04	0.97	2.51	4.02	28.23
2003	1.95	0.38	-0.15	2.62	1.81	1.16	-0.53	0.05	1.57	-0.84	-0.45	2.93	10.91
2004	-0.99	0.77	1.21	-1.04	0.00	-0.39	0.83	0.00	2.31	2.32	4.12	2.75	12.41
2005	-1.57	1.77	-1.33	0.06	-0.24	0.46	0.96	-0.39	-0.20	0.86	0.35	0.05	0.72
2006	2.61	1.12	1.45	2.04	-1.01	-0.65	1.00	1.04	0.52	1.39	2.66	1.52	14.60
2007	-0.73	1.03	0.80	1.23	0.06	-0.07	0.75	-0.97	2.35	2.52	0.97	0.14	8.32
2008	1.49	1.92	1.25	-0.72	-0.65	-0.10	0.54	-2.73	-2.65	-3.27	1.58	3.32	-0.25
2009	-1.69	-2.02	1.18	3.99	6.49	1.14	3.13	1.03	3.75	1.52	1.22	-1.26	19.72
2010	0.41	0.07	0.42	0.49	-0.84								0.54

* Performance is presented on USD C NAV gross basis and does not take into consideration deduction of fees

Review

A broad based and impulsive sell-off was witnessed in May. Global equity markets, commodities, corporates and all types of EM assets have started to break down. This leaves no doubt that what we are witnessing is not just a Greek crisis, nor a problem confined to southern Europe but rather a global market "disciplining event", that is following a clear trajectory: (i) unsustainable government accounts have been exposed; (ii) policy mistakes (e.g. China's credit and investment excesses) are now starting to attract attention; and (iii) countries with a large stock of foreign short-term capital are being challenged as evidenced by the sharp sell-off in all EM currencies during the month of May. As problems are now broadening, investment opportunities are becoming even more scarce.

As a result, Schroder ISF EMD Absolute Return has taken refuge in cash (40% of NAV) and in US Treasury Bonds (9.3% exposure). The remaining positions are also very defensive: external debt (4.4% of NAV) remains at a very low level while local debt (46.2% exposure) is predominantly short dated and mostly currency hedged (*the fund's overall FX position in now only at* 7.6% *of NAV*). As seen in the recent resilience of its performance, Schroder ISF EMD Absolute Return is well insulated against the ongoing dislocations.

* Schroder International Selection Fund is referred to as SISF throughout this document

Investment Outlook

Fundamental Analysis

After the strong economic data publications seen during the past several months, the recent activity numbers are starting to be more mixed. PMI in countries such as China, South Africa, Poland and Hungary have disappointed. Trade and current account balances in many countries are also deteriorating making yet again some of the usual high deficit countries such as Turkey heavily dependant on short-term capital inflows.

It may be true that the apparent turnaround in activity numbers is still in its early stages to be considered as a serious vulnerability. An overwhelming majority of economists view this economic pause as a normal or even a welcome development at this stage of the recovery cycle. This is not our central scenario.

Indeed, we reiterate our view that the second half of this year is likely to bring some bad surprises in terms of economic activity. We believe that the effects of the credit squeeze in China, the ongoing disorder in the Eurozone and the fading fiscal and monetary support in the West have yet to severely propagate to the real economy.

In Emerging Markets, the poor performance of some currencies this quarter (notably in Eastern Europe and in trade or commodity sensitive countries) is an early warning of what's to come in terms of global economic and trade activity. While these exchange rates are discounting to some extent the unfolding slowdown, most EM credit spreads have not yet widened meaningfully.

The exceptions are Venezuela and Argentina where sovereign spreads have widened by 500bps and 280bps respectively from their lows of the quarter. We have always considered these weaker and less liquid credits as a leading indicator for the sector as a whole. In order words, unlike the reassuring comments from a variety of EM investors, we do not view this as a "healthy differentiation". Indeed, during major market downturns, pressures tend to first affect the most vulnerable credits and then spread more meaningfully to the rest of the sector.

Quantitative Analysis

In this area of analysis, the contraction in global monetary aggregates has been a major focus for the investment team. The month of May brought further evidence that monetary dynamics are becoming even more worrisome. More initiatives on regulation and the sharp and broad based rally in the US Dollar all amount to further global liquidity tightening.

US Dollar strength is also creating a dampening effect on the US recovery and will ensure global macro-economic imbalances remain uncorrected. In other words, what the global economy needs to help achieve "re-balancing" is not occurring. Our quant model continues to highlight this as a major risk factor.

Chart Analysis

Chart patterns during the month of May suggest that we are entering the acceleration phase of the recently established downtrend in stock, credit and currency markets. A key characteristic of this phase is that the sell-off has gained in speed and in scope, as a large number of markets have made new 2010 low during the month under review. This has occurred in high volumes, confirming the sharp reversal of the uptrend of the last few months. As an example, EMD average spread (measured by the EMBI+ index) has surged in May to 354bps, erasing in a very short period of time all the tightening achieved in the last 9 months. EM currencies have seen similar sharp moves.

The failure of markets to react to the European bailout initiatives should also be viewed with caution. This is one of the hallmarks of a bear market starting to be in place.

Sentiment Analysis

Linked to the chart dynamics highlighted above, we have probably reached a phase where market participants will be forced to reassess their prevalent bullish positioning. Inflows to some credit and equity markets appear to have come to a halt. However, there is not yet evidence of any major shifts in asset allocations. Revisions to growth forecasts have been limited so far to some European countries but in general the euphoria towards the Emerging Markets growth story is still prevalent. Based on this alone, we are still far from reaching a level where buying opportunities can be safely contemplated.

Asset Allocation as at 31 May 2010

Holdings as at 31 May 2010

	Exposure	Duration
China	0.4	3.9
Hungary	0.9	1.9
India	0.4	3.7
Malaysia	0.6	1.2
Mexico	0.9	1.8
Poland	1.2	2.0
External Debt	**4.4**	
China	5.8	4.1
Czech Republic†	4.0	0.9
Hungary†	0.7	3.1
Indonesia†	5.2	4.6
Korea†	3.4	4.7
Malaysia†	3.1	3.1
Mexico†	7.3	3.2
Poland†	5.3	3.3
Russia	0.2	1.8
Singapore^	8.0	0.6
Taiwan†	0.9	0.1
Turkey†	2.1	0.6
Ukraine	0.1	0.1
Local Debt	**46.2**	
US Treasury Bonds	9.3	16.5
US Treasury Bonds	**9.3**	
Cash	40.0	
Cash	**40.0**	

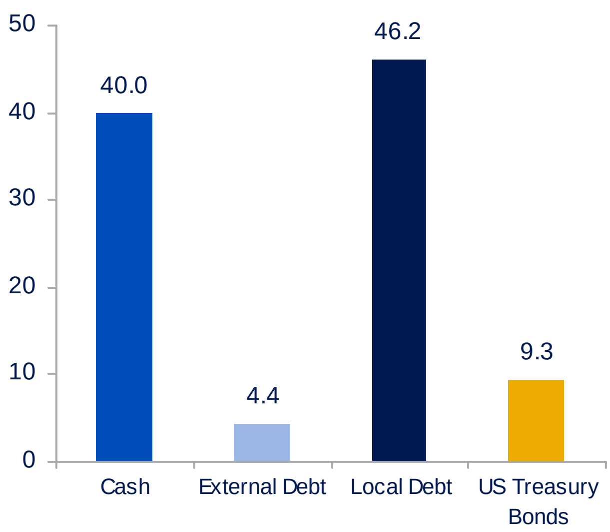
†Hedged
^Partially Hedged
Source: Schroders

Performance Overview

Since Dec 1998*	Fund	EMBI+	ELMI+**
Annual Rate of Return %	12.31	12.04	8.49
Annual Volatility %	6.78	10.98	7.05
Sharpe Ratio	1.39	0.87	0.81
Sortino Ratio	2.88	1.09	0.92
Correlation	1	0.63	0.63
Positive Quarters %	88.89	75.56	73.33
Maximum Drawdown %	-9.26	-19.71	-19.93
Best Month %	8.84	8.52	5.52
Worst Month %	-3.71	-13.79	-8.73
Max 12M Rolling Return %	33.35	40.19	20.29
Min 12M Rolling Return %	-7.19	-18.15	-13.87

* Since inception of current fund manager
** ELMI to 31.01.02 (Index discontinued)

Sector Allocation as at 31 May 2010 %



Fund Summary	%
Yield to Maturity	1.53
USD Exposure	92.4
EM Currency Exposure	7.6
Duration (years)	2.90
Average Credit Rating	AA
Corporate Exposure	1.10

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Investments in emerging markets are subject to market risk and, potentially, liquidity and currency exchange rate risk. Investments in debt securities are primarily subject to interest rate, credit and default risks and, potentially, to currency exchange rate risk.

This fund may use financial derivative instruments as a part of the investment process. This may increase the fund's price volatility by amplifying market events. Investments in absolute return funds are primarily subject to interest rate, market, liquidity, credit and default risks and, potentially, to currency exchange rate risk.

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