Newsletter – February 2010

Schroder ISF Global Corporate Bond

Performance %	Feb 2010	1 year	5Y (p.a.)
Schroder ISF Global Corporate Bond – I Shares*, Acc	0.3	21.9	4.9
Barclays Capital Global Aggregate Credit Component USD hedged**	0.4	17.9	3.9

Source: Schroders, 28/02/10.

*I shares use NAV returns.

** BarCap Global Aggregate Credit in USD to 30/06/2006, USD hedged thereafter

Market Overview

Schroder ISF Global Corporate Bond delivered an eleventh consecutive positive month of returns in February. The level of returns, however, was modest as credit spreads widened – markets were concerned about developments in Greece, the ongoing uncertainty over how banking regulation will change and some weak macro-economic data in the eurozone. A recovery in credit spreads from mid-February, and a generally supportive underlying government bond market, still trading at record steep levels, ensured that returns were at least positive.

The US dollar investment grade credit market is in our view a potential relative safe haven – the US dollar investment grade OAS widened just one basis point (bp) in February. The dispersion of excess returns across the market was easily the lowest in quite some time. Systemic fears over sovereign debt, monetary policy in China, and financial regulatory reform kept volatility well bid during the first half of the month. But as those headlines softened a bit, and as earnings and economic data continued to mostly surpass expectations, risk markets rallied once again.

Primary issuance was much lighter than expected at $47 billion, mainly due to the adverse market conditions during the first half of the month, leading to very low levels of activity amid poor liquidity. The three best performing sectors were sovereigns, finance companies, and energy, while the worst three were banking, communications, and insurance.

Schroder International Selection Fund is referred to as Schroder ISF in this report

The three best performing issuers were Motorola Inc. (MOT), Zurich Finance USA (ZURNVX), and Societe General (SOCGEN). The three worst performing issuers were Westfield Group (WDCAU), Credit Agricole SA (ACAFP), and Finmeccanica (FNCIM).

The European credit market saw much worse liquidity over the month, owing to concerns across the Mediterranean countries. This led the market to return a small negative excess return of -0.24% (+0.21% year to date). A flight to quality into government duration in the first half of the month, led to an underlying interest rate curve rally, resulting in a total return performance of 0.63% on the month (+2.21% year to date).

Many companies saw their individual fundamental situations continue to improve, evidenced by sound fourth quarter earning stats. Henkel is indeed a great example of a top performer this month whilst on an issuer basis, some of the most crowded sectors, in particular, Spanish and Japanese junior bank structures were among the worst performers. The BBB part of the universe as well as the high yield sector were marked down in the first two weeks of the month amid low liquidity market conditions.

The economic backdrop in the eurozone is set to be fairly weak anyway, given the eventual petering out of the inventory led economic bounce, the strong euro and some declines in PMIs. Bond markets have, however, forced a more aggressive pace of fiscal consolidation, which will condemn many economies to negative growth this year (Greece, Spain, Ireland in particular).

The lack of liquidity was also noticeable in the GBP investment grade universe which delivered a negative -0.35% excess return on the month (+1.38% year to date). The UK Gilt market remained volatile, as investors continued to express concern over the rapidly deteriorating fiscal position of the UK as it deals from the fallout of 2008's banking crisis and very high levels of consumer debt. Economic activity in the UK remains very subdued, and the potential for a rise in risk premia on UK assets remains.

Portfolio Overview

Portfolio performance was positive in absolute terms, albeit marginally below the benchmark in February. The portfolio had been positioned very long of credit risk as recently as December 2009

and early January 2010. As readers will recall, beginning in mid-January 2010, we raised significant amounts of cash, top-sliced our high yield positions and took substantial profits on our subordinated financial positions, in order to lock in the outsized gains from December and position the portfolio for higher potential volatility. Holding cash in our view has the benefit of creating flexibility – if the market cheapens or if the primary (new issue) calendar picks up again, then cash creates the headroom to take advantage of opportunities at cheaper spreads. Toward the end of the month (and since month-end), we have actually deployed some of this cash given the spread widening seen over the last six weeks and given some of the relative value opportunities this has created. Nevertheless, we are highly unlikely to run the same higher levels of portfolio risk which we had in December, given the choppier nature of market price action we expect going forward.

The main positive contributors were overweights in consumer non-cyclicals and energy in the US. That outperformance was offset by overweight positions in banking, communications, and REITS; and underweight exposure to non-corporates (particularly sovereigns), technology, and finance companies. Presently, our largest overweights in the US are communications and banking (and smaller overweights to basic industries, consumers, energy, and REITS). Our largest underweight holdings are technology, finance companies, electrics, and non-corporates.

In Europe, we continued to run underweight positions across Spanish, Portuguese and Italian corporates. We believe that despite the spread widening seen in these markets, the country risk remains elevated and the structural imbalances of the eurozone wont disappear overnight. Corporates at only 1.25% above bunds and banks at only 2% above make little sense in economies such as Spain and Portugal. In the UK, as financials suffered further weakness, we continued to hold portfolio positions in strong cash flow generative businesses such as tobacco and consumer products companies.

In high yield, while we continue to like the prospective returns, we have trimmed some of the more cyclical credits (such as FIAT), in order to focus on companies that can withstand any relapse in economic conditions across Europe without any credit deterioration. This may prove too conservative, but we still believe the macroeconomic risks in Europe are very fragile.

Outlook

In the very near-term, we are quite constructive on credit spreads as we believe that markets can recover some of the weakness seen in the six weeks from mid-January to end-February. Investment grade credit spreads are still too wide cyclically on a multi-year basis and this, coupled with low official rates and zero returns on cash will continue to lend support to returns this year. Credit spreads continue to price in mild recession globally. While many countries are indeed back in recession (e.g. Italy) and many risk multi-year recession (eg. Spain, Greece, Ireland), mild recession is unlikely globally (even Roubini expects small positive growth in the second half of 2010 in the US) given growth in Asia and the potential for better growth in the US, versus Europe.

However, we think that while credit spreads are still wider than normal and while credit markets will prove a relative safe haven versus alternative asset choices, the potential for some significant structural changes in world economies and markets remains. As southern European governments race to introduce fiscal retrenchment programs, economies are likely to contract. The structural inflexibilities created by the three main (and increasingly unsustainable) currency pegs of the world (southern Europe to northern Europe, Abu Dhabi to Dubai and of course the United States to China) will not be solved by the introduction of spending cuts and tax rises in a few small beleaguered economies.

These developments have the potential to cause significant volatility in equity markets and other 'risk assets'. If their resolution evolves along a more disorderly path, liquidity will remain weak and the more volatile end of the credit spectrum will be impacted – albeit not to the same degree as equity markets and most other cyclical/riskier assets.

In this environment, government bond markets could quite equally see more *differentiation* as investors continue to factor in macroeconomic fragilities, fiscal contexts and trade balance into the overall yield compensation they demand from different government issuers. In this environment, we continue to hold no interest rate duration in Japan or the UK given our concerns there.

Finally, we think differentiation could also develop into a major theme in FX markets – a theatre we view as the ultimate zero sum game in macroeconomic *country differentiation*. Given the magnitude of imbalances across the world and the size of fragilities one to two years after the biggest banking crisis for over seventy years, the scale of moves in FX markets have the potential to surprise people on the upside and it is highly unlikely that other markets will behave in a calm and isolated fashion in this scenario.

We continue to look at different ways of expressing these *differentiation* themes in portfolios as well as ensuring that if higher volatility arrives, we are prepared and positioned.

Newsletter
Schroder ISF Global Corporate Bond

Fund Data as at 01 March 2010

Team	
Jamie Stuttard	Lead Portfolio Manager
Wes Sparks	Co – Portfolio Manager

Size & Holdings	
Fund Size in Base Currency	USD 1.4bn
Number of Issuers	220

Portfolio Statistics	Fund vs. Index
Effective Duration	4.61 vs. 5.34
Spread Duration	5.27 vs. 5.23
OAS*	230 vs. 151
ASW#	221 vs. 128
Effective Yield	4.40%

*Option Adjusted Spread. #Asset Swap Spread

Credit Quality	%
AAA	3.25
AA	3.51
A	14.93
BBB	41.49
BB	5.09
B	7.36
CCC	0.19
Not Rated	1.18
Cash	14.57
Derivatives	8.42
Average Credit Quality	A-

CDS Summary	%
Total Single Name Shorts	4.37
Total Single Name Longs	0.66
Total Index Shorts	0.00
Total Index Longs	0.00
Total Swaption Shorts	4.86
Total Swaption Longs	0.00
Total Net Synthetic	-3.71
Total Cash Bonds	85.57

Geographic Allocation*	%
USD	67.97
GBP	12.91
EUR	19.15
JPY	-0.04

*Portfolio 100% hedged to base currency

	Contribution to Duration		
Sector Allocation	Portfolio	Index	Active
Industry	3.03	1.70	1.32
Finance – LT2	0.59	0.34	0.25
Finance – T1	0.29	0.14	0.16
Treasuries	0.14	-	0.14
REITS	0.15	0.05	0.11
Sovereign	-	0.07	-0.07
Local Authorities	-	0.16	-0.16
Utility	0.63	0.80	-0.17
EMD Sovereign	-0.02	0.21	-0.22
CDS Basket Main	-0.23	-	-0.23
Agency	0.15	0.39	-0.24
Supranational	0.07	0.35	-0.27
Finance – Senior	0.63	1.06	-0.43
Futures	-1.36	-	-1.36

Note: Fund performance is shown using the fund's NAV. Portfolio data sourced form Schroders, FIA (unaudited) Number of holdings excludes derivative positions.

Sector allocation excludes positions with less than or equal to +/-0.02 active CTD.

Newsletter
Schroder ISF Global Corporate Bond

Important Information:

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.

This document does not constitute an offer to anyone, or a solicitation by anyone, to subscribe for shares of Schroder International Selection Fund (the "Company"). Nothing in this document should be construed as advice and is therefore not a recommendation to buy or sell shares.

Subscriptions for shares of the Company can only be made on the basis of its latest prospectus together with the latest audited annual report (and subsequent unaudited semi-annual report, if published), copies of which can be obtained, free of charge, from Schroder Investment Management (Luxembourg) S.A.

An investment in the Company entails risks, which are fully described in the prospectus.

Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise.

Schroders has expressed its own views and opinions in this document and these may change.

This document is issued by Schroder Investment Management Limited, 31, Gresham Street, EC2V 7QA, who is authorised and regulated by the Financial Services Authority.

For your security, all telephone calls are recorded.

Schroders