

# Schroder Core Plus Fixed Income

## Product Overview

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### Strategy overview

Schroders' Core Plus Fixed Income strategy focuses on active sector rotation, utilizing an investment process that relies heavily on identifying undervalued sectors and securities and opportunistically applying sector and security swapping strategies. We are not market timers and, therefore, maintain portfolio duration at +/- 20% of the duration of the index. Our team approach focuses on in-depth research and risk management, emphasizing analytics, which help us analyze individual securities and portfolios as a whole. We apply a combination of top-down and bottom-up fundamental and technical analysis for security selection because we believe that this approach is the way to uncover relative value, which drives security and sector selection, the major sources of our value added.

### Firm highlights

- Schroders manages over \$158 billion in assets worldwide
- Wide range of fixed income strategies across all major markets – developed and emerging
- Global bond team of over 100, including: 32 portfolio managers and 25 credit analysts
- Deep global research database – 85% of research generated in-house

### Team highlights

- \$28 billion of fixed income assets globally
- Specialist portfolio managers in all U.S. market sectors (avg. 15 years investment experience)
- Invest across the full spectrum of asset classes and maturities
- Risk management mentality central to philosophy and process
- Stronger team of career global analysts (avg. 10 years experience)

### Key features

- Research-driven process
- Fundamental credit opinion, backed by state of the art quantitative tools
- Relative-value approach to decision making
- Experienced, specialist portfolio managers and analysts
- Risk budget varies based on expected returns, volatility and confidence
- Opportunistic, nimble approach in changing market conditions

### Investment objective

Schroders' US Core Plus Fixed Income strategy targets outperformance (before fees) over the Barclays Capital U.S. Aggregate Index over an investment cycle.

### Investment philosophy

Schroders is an active fixed income manager, seeking return primarily through sector rotation and security selection. We are research-driven bond investors who believe:

- Risk control is paramount
- Bond markets are global, interrelated and generally efficient, but overreact to events
- Evaluating bonds from the point of view of a lender makes us better investors
- A performance advantage can be gained through in-depth local market research, conducted by a globally integrated team of specialist analysts and portfolio managers

In-depth, fundamental research that helps us identify investment opportunities combined with disciplined risk control is essential in generating consistent successful performance. Further, we believe a robust risk management framework is essential to efficiently integrate a diversified set of investment decisions into a portfolio.

All data and statistics as of December 31, 2008



## Investment process – overview

Our fixed income process consists of four distinct steps:

- Conduct in-depth proprietary market research (fundamental, quantitative and technical) to develop investment themes that aims to dominate markets over the ensuing 3-6 month period
- Based on investment themes, develop and prioritize investment strategies which will determine optimal portfolio positioning in three primary areas of the market: duration, yield curve exposure, and sector allocation
- Implement investment strategies within an actively managed portfolio, using relative value framework to prioritize investment ideas and execute security selection using the resources of our global credit, securitized and quantitative teams
- Continually review portfolio within rigorous risk management framework, emphasizing contribution-to-duration metrics

The cornerstone of our investment process is our weekly Tuesday afternoon Strategy Meeting. Here, portfolio managers combine the macroeconomic outputs from our economic and global investment teams with the bottom-up credit and fixed income sector research to establish investment themes and resulting investment strategies. Rates and sector strategies and overall risk budgeting are determined at this meeting. Portfolio construction, including security selection follows is implemented by portfolio managers. This process is outlined in the following chart

### Core & Core Plus investment process



Source: Schroders

The team aims to maximize risk-adjusted returns across diversified sources of alpha. The contribution to alpha generation from each of these areas will vary with market conditions and between regions. Over an investment cycle, however, approximately:

- 70% of alpha is expected to come from sector weightings and security selection
- 30% of alpha is expected to come from duration and yield curve management

## Investment process – sector allocation

Sector allocation decisions, such as the split between government and non-government bonds, are made by the US Fixed Income team. The primary driver of sector allocation is the forecast for spreads over the next 3-6 months. This process is driven by the dedicated sector specialist portfolio managers with top-down input from the Global Fixed Income Strategy Group and bottom-up input from credit research. The quantitative team is also involved in sector allocation using a range of proprietary models. Hence, the team uses a number of fundamental, technical and valuation driven inputs to help them identify investment opportunities. The key inputs are shown below:

### Sector Weighting Factors

Fundamental	Valuation	Technical
Macro economic trends	Swap spread analysis	Supply and demand
Investment themes	Relative value analysis	Risk appetite indices/Volatility
Credit research	Yield curve analysis	Momentum and direction indicators

The fundamental inputs include both top-down and bottom-up analysis. An important top-down factor is how different sectors react to potential movements in interest rates. Fundamental bottom-up drivers include inputs from the Global Credit Team and other analysis such as trends in default rates.

The valuation aspect of sector selection involves a multitude of different analyses and models. Sectors are valued against a common base such as Treasuries or swaps, but can also be valued relative to each other. Quantitative modeling involves historic movements and correlation analysis. A key valuation driver for determining the relative attractiveness of a sector is the expectation for relative yield spreads, which are made on a duration-adjusted basis.

Sector specialist portfolio managers also analyze technical factors which influence the performance of each sector and the broader market. Although models are valuable for analyzing factors such as historic momentum and volatility, only experience and an understanding of the market can be used to judge other technical influences, such as forecasts for demand, the effects of changes to indices and seasonality.

The US Fixed Income team implements changes to sector allocations consistently across all active portfolios. Depending on relative pricing and sector peculiarities, allocations can be changed either in the cash market or through derivatives.

## Investment process – security selection

Credit research is core to our investment philosophy and we believe constitutes a major contributor to our ability to deliver solid risk-adjusted performance. The Schroders Global Credit Team is one of the most experienced in the market: 25 dedicated credit analysts with assigned industry coverage and geographic responsibility, covering over 1,200 individual bond issuers. The team averages over 10 years experience and six senior members have over 20 years experience analyzing credit markets.

The **corporate bond selection** process begins with a detailed due diligence examination of each issuer and detailed financial modeling to assess creditworthiness – with particular focus on a company’s current and future ability to service debt from cash flows.

Three-facet of credit rating system improve the issue selection process

View	Angle	Scale	Description
Opinion	Credit quality direction	Improving Moderately Improving Moderately Declining Declining	<ul style="list-style-type: none"> <li>Fundamental view on possible direction of credit 6 to 12 month outlook</li> <li>Not a measure of absolute quality</li> <li>All credits force ranked within sector: strongest to weakest</li> </ul>
Recommendation	Credit view versus market expectations	1 Strongest 2 3 4 Weakest	<ul style="list-style-type: none"> <li>Measure of relative strength of Schroders’ view versus the markets –in both magnitude and direction</li> <li>Rating based on potential undervaluation compared to market expectations</li> <li>Cannot be long issuers ranked “4”</li> <li>Cannot be short issuers ranked “1”</li> </ul>
Issuer Concentration Limit	Maximum issuer weightings determined by current ratings and potential volatility	Maximum overweight versus benchmark A Strongest Credits B C D E Weakest Credits	<ul style="list-style-type: none"> <li>Concentration limits based on credit ratings and potential downside price volatility</li> <li>Risk management step applies to total portfolio</li> </ul>

Source: Schroders

**Government bonds** are chosen by specialist government bond portfolio managers within each region in conjunction with the other team members. Issue selection is driven by: duration and yield curve view; technical factors specific to a particular bond or market, such as supply and demand issues.

**ABS and MBS selection** is driven by macro factors as well as assessments of relative value. The macroeconomic view takes account of forecasts for interest rates, volatility and swap spreads. Relative value analysis for ABS and MBS is similar to the process for other securities. The ABS/MBS process uses standard valuation parameters, such as option adjusted spreads (OAS), and to identify relative value the team rigorously models the collateral and cash flows for each security.

**High Yield and Non-Dollar bonds** are selected opportunistically based on our assessment of relative value.

## Investment process – duration & yield curve

The formulation of duration and yield curve positions relies on a balance of qualitative, quantitative and technical approaches. Analysis of the movement and shape of the yield curve underpins this process; therefore the team’s interest rate forecasts relative to the market forms the basis of any market-directional positioning.

The qualitative views of the US fixed income specialists are complemented by Schroders’ economic team, as well as targeted use of third-party research.

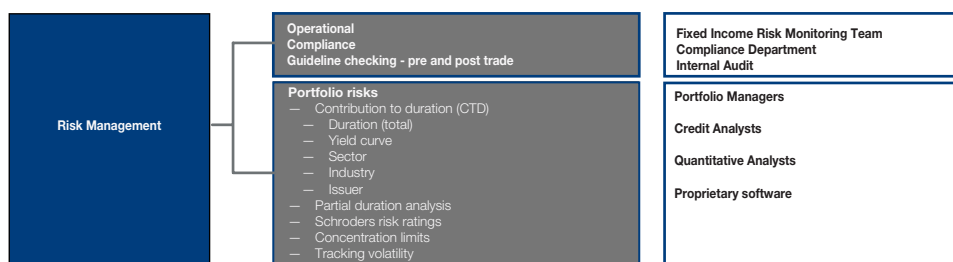
This teams’ qualitative assessment is then combined with a quantitative approach that uses several proprietary models. These models help formulate a view on likely movements in the yield curve. To do this, we ‘create’ a yield curve by deriving short rate and long rate ‘fair value’ estimates based on two-year and 10-year bonds.

## Investment process – risk management

Inherent within the fixed income investment process is a total risk management mentality: a structured approach to risk management and monitoring which utilizes a combination of formal and informal rules and guidelines, as well as proprietary quantitative models and externally supplied software tools.

At a total portfolio level, the team seeks to reduce risk through the diversification of non-correlated investments. For individual issues, position size is determined by an assessment of risk and reward across different strategies, and is rigorously controlled based on the issuer's risk profile. All positions are measured in both percentage and contribution-to-duration (CTD) terms.

The use of structured risk controls is critical in limiting the volatility of returns versus the benchmark while achieving the portfolio performance target. Our process tracks individual exposures and positions, as well as compares positions against their benchmarks, quantifying such exposures as: modified and effective duration, yield to maturity, OAS, yield curve exposure, sector and sub-sector allocation, and credit rating category.



Source: Schroders

## Risks

All investments involve risks including the risk of possible loss of principal. The market value of the portfolio may decline as a result of a number of factors, including interest rate risk, credit risk, inflation/deflation risk, mortgage and asset-backed securities risk, U.S. Government securities risk, foreign investment risk, currency risk, derivatives risk, leverage risk and liquidity risk. Frequent trading of the portfolio may result in relatively high transaction costs and may result in taxable capital gains.

## Why Schroders for Core Plus Fixed Income?

- Experienced global team of fixed income professionals
- Diversified portfolio across the entire spectrum of fixed income opportunity
- Stringent credit standards supported by deep research capability
- Risk management mentality governs every step of the investment process

### Schroders plc

Schroders is a global asset management company with \$158 billion under management as of December 31, 2008. Our clients are major financial institutions including banks and insurance companies, public and private pension funds, endowments and foundations, high net worth individuals, financial intermediaries and retail investors. Our aim is to apply our specialist asset management skills in serving the needs of our clients worldwide and in delivering value to our shareholders. With one of the largest networks of offices of any dedicated asset management company and over 350 portfolio managers and analysts covering the world's investment markets, we offer our clients a comprehensive range of products and services.

Further information about Schroders can be found at [www.schroders.com/us](http://www.schroders.com/us).

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