

# Scudder Global Bond Fund

**Annual Report to Shareholders**  
October 31, 2005

In the following interview, the portfolio management team (Brett Diment, Annette Fraser, Anthony Fletcher, Nik Hart, Stephen Ilott, Ian Winship and Matthew Cobon) discusses Scudder Global Bond Fund's strategy and the market environment for the 12-month period ended October 31, 2005.

**Q: How did the global bond markets perform during the annual period?**

**A:** Looking across the full 12 months, the global bond markets as a whole produced a slightly positive total return. However, this result obscures the fact that volatility was high and that most markets traded back and forth within a broad range throughout the year. In the United States, for instance, the yield on the 10-year Treasury note moved in a range bounded by a high of 4.62%, hit on March 28, and a low of 3.89%, touched on June 20. The high level of volatility was largely the result of investors' rapidly shifting views regarding inflation, energy prices, and the direction of central bank policy and global economic growth. A key feature of most markets was the "flattening" of the yield curve, or the outperformance of longer-term bonds versus shorter-term issues. Short-term bonds, which are most sensitive to central bank policy, generally rose in yield (and fell in price). Conversely, prices of longer-term bonds generally rose due to strong demand from large buyers such as pension funds and foreign central banks.

In terms of specific regions and asset classes, yields rose in the United States and Japan but declined in the UK and Europe. High-yield and emerging-markets bonds both performed well.

### **Q: How did the fund perform?**

**A:** The total return of the fund's Class A shares for the 12 months ended October 31, 2005, was 0.92%. (Returns are unadjusted for sales charges. If sales charges had been included, returns would have been lower. Past performance is no guarantee of future results. Please see pages 3 through 8 for complete performance information.) The fund's return outperformed the -1.76% return of its benchmark, the Citigroup World Government Bond Index. The fund slightly underperformed the 0.94% average return of the 91 funds in its Lipper peer group, Global Income Funds.<sup>1,2</sup>

### **Q: What were the key factors helping and hurting performance?**

**A:** On the plus side, the fund's positioning in the major markets was positive: we added value through underweights (a weighting less than that of the benchmark) in the United States and Japan and an overweight in Europe.<sup>3</sup> In addition, we positioned the fund with an overweight in longer-term bonds and an underweight in short-term bonds, which means the portfolio was able to benefit from the flattening of the yield curve. A relatively large position in emerging-markets debt was positive, but this was offset by the negative effect of a zero weighting in high-yield issues.

<sup>1</sup> *Lipper Global Income Funds Category: Funds that invest primarily in US dollar and non-US dollar debt securities of issuers located in at least three countries, one which may be the United States. It is not possible to invest directly into a Lipper category.*

<sup>2</sup> *The unmanaged Citigroup World Government Bond Index consists of worldwide fixed-rate government bonds with remaining maturities greater than one year. Index returns assume reinvested dividends and, unlike fund returns, do not reflect any fees or expenses. It is not possible to invest directly into an index.*

<sup>3</sup> *"Overweight" means a position in a security greater than that security's weighting in the benchmark, while an "underweight" refers to a position in a security that is smaller than that of the benchmark.*

The currency area was moderately positive versus the benchmark but a negative versus the peer group. The fund held an average weighting in the US dollar of about 55%–60% throughout the course of the period, while the benchmark weighting is about 27%. This proved beneficial given that the value of the dollar rose during the year. However, it was a slight negative relative to the peer group, which holds about a 60% US dollar weighting.

**Q: Will you discuss your positioning in the United States?**

**A:** We believe the near-term outlook for US growth remains favorable. Strong personal spending and investment growth resulted in an above-consensus third-quarter gross domestic product expansion of 3.8%. The fourth quarter should also be supported by the rebuilding of inventories, the acceleration of government spending due to the Gulf Coast hurricanes, the rise in mortgage refinancing during the third quarter (which frees up cash for consumers) and rising employment. The persistence of above-trend growth in the near term should support the continuation of the Federal Reserve Board's (the Fed) policy of boosting interest rates in a measured fashion. Recent Fed statements indeed have been consistent in saying that rising inflationary expectations and the pass-through effects from increasing energy prices would justify further rate hikes. We therefore remain cautious on the United States and retain the underweight position that proved additive to performance during the past year. However, we will be closely watching for any shifts that could lead the Fed to stop raising rates sooner than is currently anticipated by the market. These include below-trend growth, housing market weakness, and any shifts to Fed policy that result from the retirement of Chairman Alan Greenspan.

**Q: How are you positioned in Europe?**

**A:** Europe represented the fund's largest average overweight position during the past year. This proved beneficial to performance given that yields fell and prices rose during the period. The basis for our positioning was that continued tepid growth on the Continent would enable the European Central Bank (ECB) to keep interest rates steady, and this proved to be the case. This situation has shifted, however, as the market has begun to expect that the rising level of core inflation in Europe will prompt the ECB to start raising rates. Our view is that while the possibility of an early rate hike has in fact increased, subdued core inflation, slow wage growth and uncertainty over the sustainability of the recovery will delay a substantial rate move. Most notably, we believe longer-term bonds will remain in high demand from pension funds. As a result, we intend to maintain an overweight in Europe for the immediate future.

We hold a corresponding underweight in the UK gilt or government bond market. We do not think the central bank will cut interest rates — as some investors had been hoping for throughout the middle of this year. As a result, we believe that gilts do not represent an attractive value versus bonds in either the United States or Europe.

**Q: What is your view on Japan?**

**A:** We believe that the recent progress of Japan's economy is well-underpinned. Both bank lending and domestic demand, which have long been weak, have shown signs of a recovery. In addition, there is evidence that the long, destructive era of deflation — i.e., falling prices — is finally drawing to a close. With this as a backdrop, the message from the Bank of Japan has been clear: a move

away from the zero-interest-rate policy is approaching. Notably, there appears to be a consensus within the Board of Governors of the Bank of Japan that rate increases are necessary. Key officials have been unusually frank in stating that inflation will be positive by year-end and that interest rates will be moved higher in 2006. In light of this, we believe the most likely direction of yields will be up. We therefore have been maintaining a large underweight in the Japanese bond market, which has been helpful to performance, and we intend to continue doing so as long as higher rates appear likely.

**Q: How is the fund positioned in the emerging-markets debt and high-yield corporate bond areas?**

**A:** Emerging-markets bonds have performed well, as the fundamentals of the asset class continue to improve significantly. Emerging nations have strengthened their “balance sheets” and engaged in meaningful reforms. Five years ago, only 15% of the asset class was rated investment grade; today that number stands above 50%. This trend aided performance during the past year, given that we have invested up to 10% of fund assets in emerging-markets debt, compared with a zero weighting in the benchmark. However, our current view is that emerging-markets debt is more fairly priced, and we have begun to take some money off the table by reducing the fund’s positions in higher-risk countries.

In terms of high yield, the fund’s zero weighting in this strong-performing asset class has taken away from relative performance, but our belief is that our avoidance of this group will ultimately pay off. Companies are increasingly focused on maximizing stockholders’ value, sometimes at the expense of bond investors. In this sense, rising merger and acquisitions activity — which has been a

positive for stocks — may lead to increased debt, a negative for bonds. We also view the recent bankruptcies of Delphi Automotive and certain airlines as potential warning signals. Believing high yield does not offer an attractive value given its potentially shaky fundamentals and continued low yields in relation to Treasuries, we continue to avoid the asset class.

**Q: How did the fund's currency positioning affect performance?**

**A:** Our overall view was that the dollar would continue the trend of weakness it experienced in 2004 due to the continued growth in its trade and budget deficits. However, the growing differential between interest rates in the United States and other parts of the world attracted investment into dollar-based assets, supporting the currency. As of the end of the period, an investor could benefit from 4% short-term rates in the United States versus 2% in Europe and 0.1% in Japan. The result was dollar strength: at the beginning of the period, it took \$1.2794 to purchase one euro; by the end of the period, it required only \$1.2063. Similarly, it took more Japanese yen to purchase one US dollar — 115.68 — at the end of the period than it did at the beginning — 105.79.

In the immediate future, we believe interest rate differentials and the positive growth outlook for the United States will continue to support the dollar. While we are respectful of these forces, we do not believe that the longer-term outlook for the dollar is all that positive. Through the end of October, the dollar had already posted a year-to-date gain of nearly 12% versus a narrow index of major currencies. However, we believe there are risks of a sustained dollar fall once the Fed stops raising rates, given the continued growth in the trade and budget deficits. We

believe the supports for the dollar remain temporary, and further dollar weakness remains likely under all but the most favorable scenarios.

**Q: Do you have any closing thoughts for shareholders?**

**A:** The bond and currency markets continue to have a short-term focus, with individual economic data points providing the impetus for rapid shifts in market direction. In such an environment, it is necessary to maintain a longer-term focus. We will continue to use our focus on research and emphasis on value to generate competitive long-term results.

Regardless of the short-term market movements the months ahead may bring, we encourage investors to maintain a long-term view and stay focused on the important diversification benefits provided by an investment in the global bond markets.

*The views expressed in this report reflect those of the portfolio managers only through the end of the period of the report as stated on the cover. The managers' views are subject to change at any time based on market and other conditions and should not be construed as a recommendation.*