Schroder Real Return Fund (Managed Fund) ASX Code: GROW

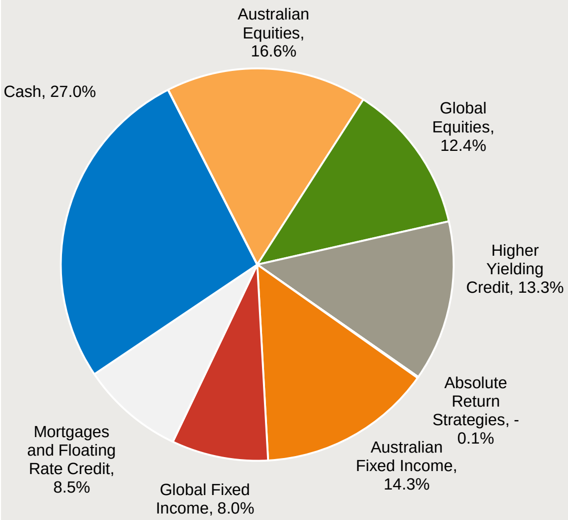
Quarterly Report - September 2016 | **For more information about the Fund visit www.schroders.com.au/grow**

Total return %	1 mth	3 mths	6 mths	1 yr	3 yrs p.a.	Inception p.a.
Schroder Real Return Fund (Managed Fund) (pre-fee)	0.32	-	-	-	-	0.81
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.25	-	-	-	-	0.69

Portfolio inception 09/08/2016, 0 years and 1 months

Past performance is not a reliable indicator of future performance. Returns over 12 months are annualised

Asset allocation



Fund objective

To deliver an investment return of 5.0% p.a. before fees above Australian inflation over rolling 3 year periods. Inflation is defined as the RBA's Trimmed Mean, as published by the Australian Bureau of Statistics.

RBA CPI Trimmed Mean* as at 30 June 2016

3 months	0.51%
6 months	0.75%
1 year	1.66%
3 years. p.a.	2.19%

*The RBA CPI Trimmed mean returns are published quarterly by the ABS. Historical returns may be subject to revisions.

Portfolio refers to investment in the Schroder Real Return Fund (Managed Fund)

Unless otherwise stated figures are as at the end of September 2016

Portfolio review

The Real Return Fund (ASX: GROW) delivered a positive return of 0.3% (post-fee) in September. September was a mixed month in financial markets. While it began poorly for many assets, the second half saw many of these trends reverse. The initial weakness was largely due to sentiment that monetary stimulus is reaching the limits of its effectiveness and the policy mix (at the margin anyway) could change. Such thinking, however, dissipated after softer US data gave the Federal Reserve another reason to balk at raising the US cash rate. While bond yields rose early in the month, much of this was reversed. While the Australian equity market edged higher in aggregate, significantly sectoral divergence emerged. Materials posted solid gains (+5.6%) while REITs, telecoms and utilities recorded declines (-4.3%, -4.0% and -3.6% respectively). The vulnerability of the “bond-sensitive” sectors has been a dominant theme for us for some time (particularly against the relative cheapness of commodity producers). Being positioned for this shift contributed to performance in September.

Outlook and strategy

Notwithstanding the comments above about market performance in September, volatility in financial markets remains low. A naïve assessment would be that risks are also low. After all, relatively narrow credit spreads and moderate prospective returns from equities would seem consistent with this – right?

A more objective assessment, though, would likely conclude that this is not the case. As the recent poor performance of REITs would highlight, if the crutch of central-bank largesse wobbles significant repricing is likely. Owning risky assets because the alternative offers effectively nothing while assuming unwavering central-bank support is not necessarily a sustainable long-term investment strategy. A low return on cash is better than a negative return from bonds. In an environment where risks seem skewed to the downside, it may not take much to cause investors to rethink. Low returns at least imply capital preservation (at a minimum) and the liquidity to take advantage of opportunities. This optionality is not without value even if in the short run there might be an opportunity cost.

The list of reassessment triggers is long; and history suggests that in all likelihood the trigger is not even on the list. European banks (Deutsche Bank is currently prominent), a Trump presidency (not the base case but neither was Brexit), the Chinese debt bubble or a pick-up in US inflation each have the potential to shake investors from their complacency. Focussing on triggers, though, while an interesting exercise, is in many ways pointless. The key issue is whether or not the preconditions exist. On this point asset prices are vulnerable.

A disconnection exists between the pricing of risk and the inherent riskiness of asset classes. At the heart of the issue are sovereign yields, which have been manipulated to satisfy policy goals, not to balance the demand and supply considerations of investors. As this drives the discount rate applied to all financial (and non-financial) assets, prices have risen across the curve, not because the cash flows generated by these assets have improved (either in quantum or stability), but because they are being discounted by a lower number. If yields stay low AND cash flows continue as assumed, then all is good. But if either of these assumptions is tested, watch out.

Secondly, low yields have distorted the behaviour of investors looking to increase income – after all, for most investors their income requirements haven’t fallen with yields. While typical of “late-cycle” investor behaviour, alternative investments have gathered favour. Alternatives are typically characterised by factors such as leverage, the absence of mark-to-market pricing and a lack of transparency in the underlying investments (and performance fees). While their introduction may help smooth returns when markets are kind, they can compound the challenge faced by investors if markets conditions worsen. (The year 2008 is a good case study). Liquidity should not be undervalued.

Post-fee performance of other Real Return products offered by Schroders

	1 mth	3 mths	6 mths	1 yr	3 yrs p.a.	mFund Code
Schroder Real Return CPI Plus 3.5% Fund Wholesale*	0.07	1.90	3.55	4.27	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.23	2.52	4.48	4.86	5.02	SCH11

*Both funds on offer are unlisted. An application into these funds may be made through an application form attached with the PDS, which is available on our website at www.schroders.com.au. The management fee for the Schroder Real Return CPI Plus 3.5 % Fund (Wholesale Class) is 0.60% and for the Schroder Real Return CPI Plus 5% Fund (Wholesale Class) is 0.90%.

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Investment style

Our approach to inflation plus (or real return) investing is to choose the portfolio that has the highest probability of achieving the required return objective over the investment horizon with the least expected variability around this objective. The Fund employs an objective based asset allocation framework in which both asset market risk premium, and consequently, the asset allocation of the portfolio are constantly reviewed. The portfolio will reflect those assets that in combination are most closely aligned to the delivery of the objective.

Fund details

ASX Code	GROW
Fund size (AUD)	$21,263,795
ASX Quoted Price	$3.5240
Fund inception date	August-2016
Management costs	0.90%
Distribution frequency	Normally twice yearly - June and December

Unless otherwise stated figures are as at the end of September 2016

Outlook and strategy continued

We probably sound like a broken record on some of these issues but so be it. Timing, as always, is the difficult bit. Trying too hard to finesse this, though, can be just as problematic as not being positioned in the first place. To this end, we have maintained a consistent position with respect to the growth-defensive split in the portfolio. Our equity exposure is about 28% (but drops to 23% if we adjust for the delta of a put option position should markets slump). The flip side of this is a cash holding of about 26%. Overall, we remain cautious.

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