

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



Monthly Report - October 2016

For more information about the Fund visit www.schroders.com.au/grow

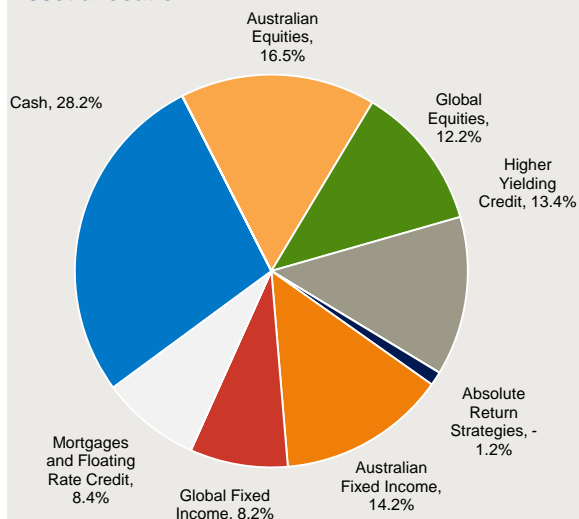
Total return %

Schroder Real Return Fund (Managed Fund) (pre-fee)
Schroder Real Return Fund (Managed Fund) (post-fee)*

	1 mth	3 mths	6 mths	1 yr	3 yrs p.a.	Inception p.a.
Schroder Real Return Fund (Managed Fund) (pre-fee)	-0.17					0.64
Schroder Real Return Fund (Managed Fund) (post-fee)*	-0.25					0.44

Portfolio inception 09/08/2016, 0 years and 2 months

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 September 2016

3 months	0.35%
6 months	0.89%
1 year	1.74%
3 years. p.a.	2.11%

*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 October 2016

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

Portfolio review

The Schroder Real Return Fund (ASX: GROW) produced a modest negative return in October (-0.17%) against a backdrop of declining equity markets and rising sovereign bond yields. While the fund itself is relatively defensively positioned, there were few places to hide given the breadth of the retreat in markets. Over the last 3 months the Real Return Strategy upon which the Schroder Real Return Fund (ASX: GROW) is based has returned 0.78%. The Strategy's performance objective is to target 5% pa above inflation over a rolling 3 year period. Against this metric the Strategy's return of 5.6% pa (nominal) equates to just under 4% pa in real terms over this period (with inflation running at around 2% or slightly lower). For reference, Australian equities in accumulation index terms have returned just under 4% nominal (2% in real terms) over the same period.

One thematic that did continue to play-out through October was the unravelling of the support for "bond" or "yield" proxy investments – like A-REIT's, utilities, infrastructure and health care stocks against what is still a relatively modest rise in bond yields and a modest re-assessment of the risks around inflation (globally) and central bank policy. To be clear the shift in thinking around the broader policy environment is important, even if marginal, due to the extent that the policy backdrop has supported asset prices. It also highlights how sensitive many of these assets can be to small shifts – there are a lot of "temporary" investors in these assets, temporary in the sense that they're not long term holders but have bought the yield story against a low yield global environment but are acutely sensitive to the capital volatility that may also come with it. To give some idea of the sensitivity, Australian 10 year bond yields have risen by 0.5% since early September, while A-REIT's have fallen by over 15% since early August - more than a correction, but still only back to levels of February this year. Our valuation models are still flashing red and it would likely take another fall of this magnitude to get us interested in these assets.

The flip side of the unravelling of the bond proxy story was the recovery in the resource sector. During October, the ASX 200 Resource index posted gains of 1.2%, well ahead of the -6.4% (average of ASX 200 Utilities, Healthcare and A-REIT sectors) losses in the defensive sectors. This recovery is something we have been positioned for, both from a stock selection point of view within the active Australian equity portfolio, as well as through a short A-REIT futures position against the broader market and through the more recent addition of a long resource futures position, again against the broader market. Netting these trades effectively takes us long resources and short A-REITs.

Outlook and strategy

The issues reflected in the above comments have been brewing for some time. Investors have literally piled into yield proxy assets as a response to the low / no yield environment – and ignoring – at least temporarily - the risks involved in these investments. For a long time now we've highlighted these risks and responded by holding an elevated (by most objective standards) cash weighting within the portfolio – accepting that returns on cash are below our objective – but noting the heightened risk around owning overpriced and under rewarded assets. The reality though is that by and large holding cash over equities has been the right strategy – at least over the last 18 months where vanilla, Australian cash has outperformed Australian equities (including dividends) and been line ball with US equities which have essentially flat-lined in price terms since early 2015 (notwithstanding the significant volatility in equities and risk assets more broadly through the later part of last year and early this year). While investors may have been able to take some advantage of the volatility, long term strategic holders of equities have not been rewarded for this additional uncertainty.

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*	0.02	0.65	2.31	3.18	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	-0.19	0.54	2.77	3.34	4.62	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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Fund details

ASX Code	GROW
Fund size (AUD)	\$21,697,838
ASX Quoted Price	\$3.5153
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 October 2016

Outlook and strategy continued

We do not expect that our cash weighting will be elevated indefinitely – albeit it has been for a while – but corresponding to the extreme distortions in risk pricing facilitated by central bank policy experimentation. That said, until such time as risk pricing changes – and the moves we've seen in A-REIT's are only modest in the context of how far these have run, we don't anticipate it will be changing materially soon. Sure there are lots of potential volatility catalysts (the US election outcome being one) but until either high rates reset risk premium or recession sees risk asset prices fall, we will remain cautious.

Reflecting this theme we have reduced our exposure to risk, but this time through our global high yield debt exposure. Global high yield spreads widened significantly through the later part of 2015 and early 2016, offering attractive prospective returns, and with spreads so wide, relatively low risk. However, much of this attractiveness has now been realised as spreads have narrowed materially. While there is still some potential for spreads to narrow further the risks are becoming more asymmetric (limited upside, potentially greater downside).

Adding to the case to remain cautious on risk is the steady upward trend in US inflation (still modest but nonetheless trending up). On the back of this we have modestly trimmed duration (another 0.1 years) and added a US inflation breakeven trade which should pay-off should inflation continue to trend higher.

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.

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