

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

Quarterly Report - December 2016

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

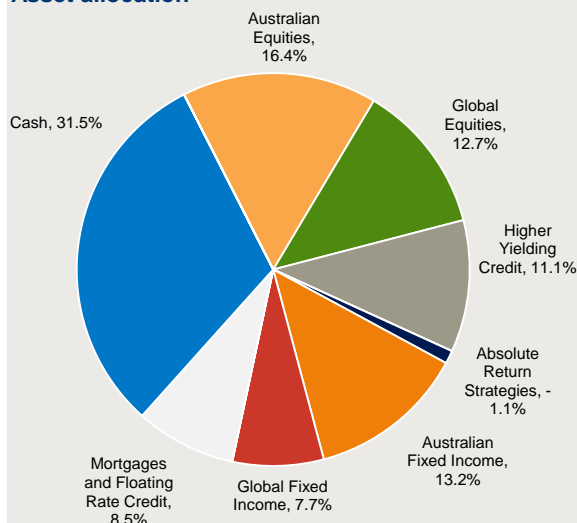
Total return %

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)	1.37	2.06	-	-	-	2.89
Schroder Real Return Fund (Managed Fund) (post-fee)	1.30	1.83	-	-	-	2.53

Portfolio inception 09/08/2016, 0 years and 4 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 December 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) ended the year on a strong note, returning 1.3% in December and 1.8% over the quarter (net of fees).

The second half of 2016 was dominated by the theme of 'reflation' – a recovery in global growth and an uptick in inflation. This was a major turnaround from the deflationary fears that dominated early in the year. While inflation is rising, it remains low, and in combination with better growth, saw a sweet spot for equities and a problematic environment for bonds. This trend was turbocharged with the election of Donald Trump as US president, leading to a sharp rally in equities, and a large rise in bond yields, into the end of the year. The Strategy has been positioned for reflation, via a low duration level, a US breakeven inflation trade, a tilt to global high-yield debt, a short A-REIT position and a relatively large exposure to Australian resource equities. Given this, recent activity has been modest, with a small addition to duration the main change in portfolio positioning.

Outlook and strategy

Our outlook for asset classes continues to be one of low returns, as starting point valuations are somewhat stretched. While bond yields have risen and bond proxies (A-REITs a prominent example) have fallen sharply, we still see these markets as expensive, offering minimal, if any return over the next couple of years. These markets remain vulnerable and could post further losses.

Prospective equity returns are low in absolute terms, as all equity markets we cover are expected to provide returns below their long-run averages, albeit these are still generally higher than those expected on bonds. Within the equity universe, there are some big differences in return prospects. Australia, on our numbers, offers the highest prospective returns, while US equities in comparison have a more modest outlook. The strong performance of credit in 2016 has left the risks around credit somewhat asymmetric – not much upside but significant downside should circumstances turn against company debt.

Turning to emerging markets, we do not think that their recent underperformance has made emerging-market equities (or debt) cheap enough to justify the risks, despite the fact that we see emerging-market equities offering one of the highest expected returns in our universe. What this return forecast does not capture is the potential downside for emerging markets if things (Trump, the US dollar etc.) go awry.

Markets and economies continue to face significant risks. Risk assets have been quick to embrace the positives from Trump's agenda. However, there are several aspects that, if implemented, would not be market friendly – protectionist policies have the potential to inhibit economic growth while boosting inflation. The rise in the anti-establishment, reflected in the several surprises in 2016, will continue to see Europe as a potential source of volatility, with major elections in France and Germany, and continued fragility in European banks.

On the economic side, we see the risk of an inflation surprise on the high side more likely than a shock to the downside, given the relative tightness of the US labour market and the tepid response by the Federal Reserve to date of only two increases in the US cash rate. That would obviously be bad news for bond holders but it might also damage equities were the Fed to respond with higher interest rates. Also, debt levels are at record levels and will rise further if the shift to fiscal stimulus takes hold, limiting authorities' ability to respond to any adverse shock.

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*	1.09	1.78	3.71	5.43	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	1.36	2.14	4.72	6.55	4.92	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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Outlook and strategy continued

We are therefore approaching 2017 from a perspective of being 'alert but not alarmed'. This may have a familiar ring because we have argued this perspective for some time. While markets have not stood still over the year, we have not seen the sort of broad price action that is required to reset the market outlook, nor have we seen enough change to fundamentals to rejig the assumptions on which our return forecasts are based.

As a final observation, it is clear that achieving high real rates of return by simply hoping for strong underlying market performance would be optimistic (based on our numbers anyway). This is not dissimilar to the outlook we were confronted with as we entered 2016 and we were often asked whether CPI plus 5% was still an achievable target. Having met our objective last year in the Schroder Real Return CPI Plus 5% Fund that shares the same strategy and objective as GROW. It is a reminder that appropriate active asset allocation, sector, and stock selection can significantly contribute to performance in this environment, and will continue to be important if decent rates of return are to be achieved.

Fund details

ASX Code	GROW
Fund size (AUD)	\$23,248,733
ASX Quoted Price	\$3.5688
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 December 2016

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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