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

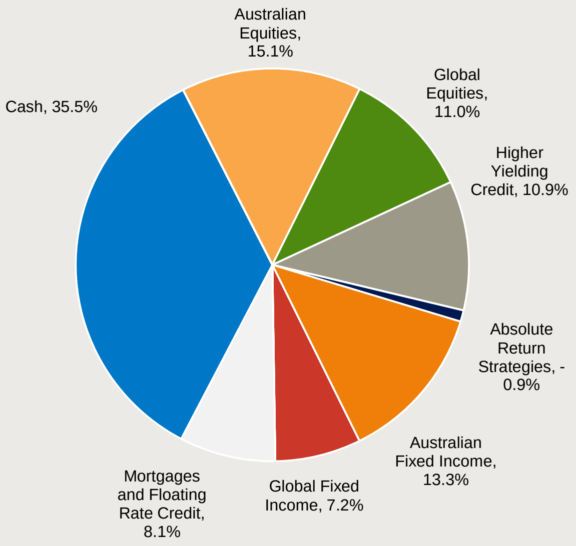
Monthly Report - January 2017 — For more information about the Fund visit www.schroders.com.au/grow

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)	0.12	2.35	-	-	-	3.01
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.04	2.12	-	-	-	2.57

Portfolio inception 09/08/2016, 0 years and 5 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 31 December 2016

3 months	0.45%
6 months	0.81%
1 year	1.63%
3 years. p.a.	1.99%

*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 January 2017

Portfolio review

The Real Return Fund (ASX: GROW) had a modest start to 2017 posting a 0.04% (post-fee) return in January amid a mixed performance by markets. A key drag on performance was the almost 5% appreciation of the Australian dollar during January. Equity markets were mixed over the month. The US stock market rose as the rally inspired by the election of US President Donald Trump continued into its third month while other markets including Australia’s fell. Credit, particularly higher-yielding credit, performed strongly as the US-dominated market responded to promises of fiscal stimulus and less red tape from the new US administration.

Significantly, the Real Return Strategy’s performance for the year to January was 7.99%*, well above Australian inflation for the closest corresponding period of 1.6%, leaving the Strategy’s real return at a healthy 6.3% for the 12 months. This was a pleasing result, given the uncertainty that prevailed for much of 2016 around where returns might come from.

Outlook and strategy

What a difference a year makes. This time last year investors were seemingly fixated on the looming risk of deflation amid a collapse in the oil price, a threat that prompted central banks to amp up their monetary experiment with negative interest rates. At the time, we argued that deflation fears were overdone and that negative interest rates were a highly problematic response to these concerns and that they were unlikely to be a panacea for what was largely the consequence of some significant structural imbalances. Wind the clock forward and the inflation focus has shifted 180 degrees. Inflation concerns now dominate and a run of decent economic numbers, especially in the US and Europe, combined with Trump’s proposals, is reinforcing this view.

Some inflation is a good thing. It’s been a clear and stated objective of policy makers since the global financial crisis to maintain low inflation, a stance that is particularly helpful in a highly indebted world. Remember debt? You could be forgiven for thinking that it’s no longer relevant in the world of Trump. Where inflation goes from here though is critical for markets. Like anything, too much wouldn’t be good, particularly given the extreme central-bank-policy accommodation still being pursued (even in the US where the official rate has risen).

There are two key issues here to think about. First, how high, how fast and how pervasive will the rise in inflation be? Our central case is that the trend core inflation will rise further, fuelled by the gradual tightening in the labour market (particularly in the US) and the wider effects of higher oil prices. For the US, protectionist trade policies and pro-cyclical fiscal stimulus (in the form of tax cuts or infrastructure spending) will add upward momentum to the inflation bias. That said, there are still some big unknowns (like whether tax cuts and spending initiatives will be offset and how much of either will be enacted), which will affect how far, how fast and how pervasive. We think the upward trend will be modest – US core inflation might rise from 2.2% in the 12 months to December to 2.5% to 3% but there is some risk to the upside.

*Based on the performance of a representative account, the unlisted Schroder Real Return CPI Plus 5% Fund Wholesale Class

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*	0.04	1.80	2.46	6.51	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.08	2.41	2.97	7.99	4.88	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

Second, what impact will this have on markets and asset prices more broadly? All else being equal, higher inflation should mean higher interest rates (both official rates and across the yield curve). This (again all things being equal) should have a negative effect on asset prices as discount rates rise. It will also reduce the appeal of assets that have been priced off extremely low bond yields vis-à-vis bonds and cash deposits. The most vulnerable here are the bond proxies (A-REITs), something we have warned about for some time. (A-REITs slumped 4.6% in January even though bond yields were little changed over the month.) Of course, all else is never equal. The extent to which higher inflation is being driven by stronger demand will help earnings. This, to some extent, will mitigate the implications for valuations. That said, as the risk premium on equity markets (especially the US equity market) is extremely narrow, we are leaning towards the valuation story outweighing any boost from stronger growth.

In a shorter-term context, the post-US-election risk rally and bond sell-off has done several things. First, it's reduced prospective returns from equities and credit and lifted prospective returns from bonds. While it's premature to get too excited about the latter as we think yields will go higher still, the gap is narrowing. Consistent with this, notwithstanding the record levels of policy uncertainty pervading the global landscape (just ask Malcolm Turnbull), market volatility remains extremely low. It's difficult to see how this can persist and we think that being too relaxed seems imprudent at this point.

Portfolio construction for the Real Return Strategy reflects this thinking. During January, we reduced our equity exposure (in favour of cash). Month-end overall equity exposure was about 26% with the US our least-preferred market. We've also kept portfolio duration low, given our view that the rise in bond yields is not yet over.

Fund details

ASX Code	GROW
Fund size (AUD)	$24,543,065
ASX Quoted Price	$3.5702
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 January 2017

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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