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

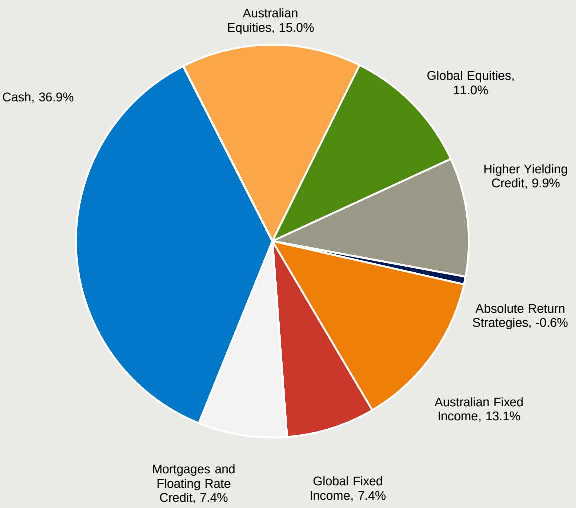
Monthly Report - February 2017 | **For more information about the Fund visit www.schroders.com.au/grow**

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)	0.37	1.87	2.89	-	-	3.39
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.31	1.64	2.43	-	-	2.88

Portfolio inception 09/08/2016, 0 years and 6 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 February 2017

Portfolio review

The Real Return Fund (ASX:GROW) returned +0.31% (post-fee) in February, continuing the positive start to 2017 and building on the strong end to 2016.

In February, the main positive contributions to returns came from equities, with both global and local equities posting decent gains during the month. The Strategy’s exposure to corporate bonds also made a positive contribution. Detracting from returns during the month was stock selection, mainly in Australian equities as resources retreated after a solid run. Also mitigating returns was the stronger Australian dollar.

Outlook and strategy

While I’m a bit “old school” (I still tuck my shirts), I do have Facebook and Instagram accounts and recently started a Twitter account – not to tweet myself – but given others do, I want to know what the fuss is about. To be clear I’m not following Donald Trump and am unlikely to ever do so. The danger with all these social media feeds is threefold. The first is the risk of information overload (too much information to properly process), the second is the risk of too much meaningless information (I don’t really care what someone’s dinner looked like), and thirdly the risk of misinformation (stuff that is just simply untrue, potentially misleading and often just rubbish).

This is exactly the same problem many investors face – there’s too much information (including via the new media formats) that properly processing and drawing meaningful conclusions is pretty difficult, if not damn near impossible and a lot of it is irrelevant. Unless you have a framework to process information and a set of beliefs that underpin this framework then you’ll likely drown in a mire of data and noise - the colour and movement that comes with the instantaneous “analysis” of news, tweets and “alternative facts”.

This is particularly relevant in the current context given the torrent of noise around the global economy and markets … Fed policy, Trump and his “policies”, the European election cycle … the list goes on. It does get tiring just thinking about it. The reason I make this observation is the fact that it’s relevant to understanding what is driving markets. For all the noise, the simple reality is that there are only really a few things that matter in terms of explaining where markets are today and, more importantly, giving us any real insight into where they are going.

From an economic perspective, the 2 things that matter are growth and inflation. ISM’s, non-farm payrolls, retail sales etc, simply help inform us about growth and inflation. Growth and inflation are important because they tell us something about corporate profits and the likely direction of policy.

If we take the current US economic situation, then the flow of data suggests decent growth (maybe on trend or above) and moderate but rising inflation. The growth / inflation mix also suggests that while monetary policy may need to edge tighter, it also suggests no inherent rush to take policy to a restrictive stance to materially slow the economy to effectively dampen future inflation. From a cyclical perspective this is an OK environment for equities and the most likely reason why equities are rallying. Sure Trump’s promises to cut corporate tax rates and reduce red tape might be helping, but arguably they’re simply reinforcing an underlying trend.

The economic story though is only half the story. Above I mentioned the need for beliefs and an investment process that aligns with those beliefs. From our perspective, a key philosophical belief is that valuations matter. There will come a point where the economic story – good, bad or indifferent, is in the price, and more likely, has been over-discounted. Our process compresses these factors into return forecasts which give us some idea as to the returns we can expect from key assets over the next 3 years, based on current valuations – the more stretched the asset, the lower the prospective returns are likely to be.

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*	0.22	1.36	2.12	6.73	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.30	1.74	2.76	8.40	4.59	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

So where does this framework leave us today?

Firstly, with profit margins already relatively high, rising equity prices are simply reducing future returns. Our US equity market forecasts are now below 3% p.a. (based on a rolling 3 year ahead forecast). While the US has been the main beneficiary of the "Trump" linked rally, other developed markets have been dragged along, pulling down future returns across the board. Our framework suggests mid-single-digit returns from the major developed equity markets over this same timeframe. Australia looks a little better (given high yields and better cyclical valuations) but will nonetheless likely deliver below trend returns to investors.

Secondly, credit markets have also embraced the constructive cyclical backdrop and this has been reflected in a sharp narrowing of credit spreads. While there is some, albeit limited scope for further narrowing, there is significant scope for spreads to widen. In return terms this means (at best) low returns and (at worst) poor returns as spreads revert to more sustainable, through the cycle norms. The difference between credit and equity is that even if corporate profits grow strongly, the benefits will flow through to the equity holders with limited benefit to the debt holders – particular now with spreads so narrow. At the margin, we prefer equities to debt.

Thirdly, fixed income investors have seen bond yields rise but the extent of the rise has been modest when considered against the backdrop of the multi-decade bull market in bonds that propelled yields to exceptionally low (and in some cases negative) yields. The modest back-up in yields (most evident in the US) has improved prospective returns but the outright numbers remain low with further repricing likely before bonds become interesting again from our perspective.

In isolation this looks like a fairly bare cupboard. Clearly based on current market levels and broader valuations for key assets, simply owning broad market beta in a set and forget approach will likely come up short against our targets. This is our version of the reality of markets today. That said, we are still confident that our objective of 5% p.a. above inflation is a realistic and achievable objective. Achieving it though won't be easy (given the starting point for markets) and will require us to focus on two things:

We will need to actively manage our market exposures. While our return forecasts are generally modest they won't be linear and the distribution around them – read margin for error - will be high. We will need to actively manage our exposures to ensure we are capturing opportunities when they do present and avoid holding assets that will lead to losses, dragging down returns and making the achievement of our goals more difficult.

We will also look to exploit opportunities "one-level-down". What I mean by this is that while broad market returns may look constrained, there are clearly opportunities at a sector and cross market level that can be exploited to contribute positive returns to the portfolio. Examples include the mispricing of A-REITs vs the broader market, the impact of rising inflation on inflation linked securities vs nominal bonds and the potential for some significant moves in currencies as economies and markets realign. This together with the contribution from active stock-selection will be an important fillip for the modest underlying contribution from relatively expensive broader markets.

Consistent with this, we made several changes to the portfolio in February. We took profits on the long resources vs the broader equity market position following strong performance from resources in recent months. This was part of a series of positions that we'd put in place to capture the broader reflation theme. The second key change was to take further profits on the long global high yield credit position we established around 12 months ago when spreads were significantly wider, and having seen spreads compress materially (as outlined above) future returns will be modest with risks increasingly skewed to the downside.

In aggregate we are defensively positioned. Our cash holdings are clearly elevated relative to what we would expect to hold over the longer term. This reflects our broader views on the lack of adequate risk premium across a broad spectrum of assets and leaves us well positioned to both benefit from any market

Fund details

ASX Code	GROW
Fund size (AUD)	$26,717,563
ASX Quoted Price	$3.5811
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 February 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.

Contact www.schroders.com.au
E-mail: info.schroders@linkmarketservices.com.au

Schroder Investment Management Australia Limited ABN 22 000 443 274 Australian Financial Services Licence 226473 Level 20 Angel Place, 123 Pitt Street, Sydney NSW 2000 Phone: 1300 136 471 Fax: (02) 9231 1119

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