

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

Monthly Report - April 2017

For more information about the Fund visit [www.schroders.com.au/grow](http://www.schroders.com.au/grow)

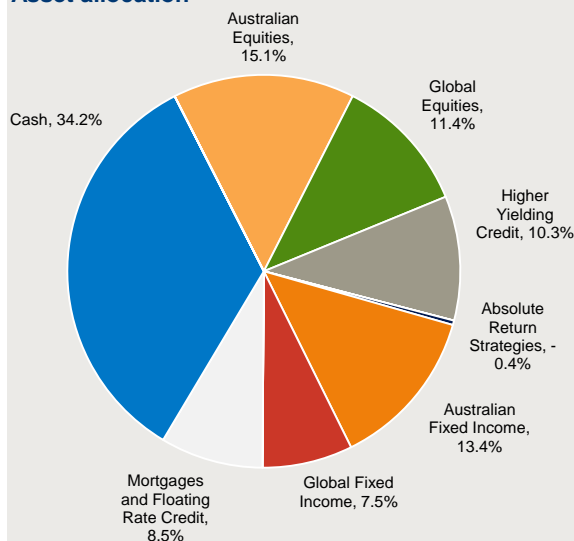
## Total return %

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)	1.01	2.22	4.62	-	-	5.29
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.93	1.99	4.16	-	-	4.61

Portfolio inception 09/08/2016, 0 years and 8 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 31 March 2017

3 months	0.48%
6 months	0.96%
1 year	1.86%
3 years. p.a.	1.97%

\*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 April 2017

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

## Portfolio review

The Real Return Fund (ASX: GROW) returned a solid +0.93% (post-fee) in April driven by reasonable returns from equity markets, a solid performance from credit as spreads retraced, as well as positive contributions from our currency positions reflecting both a weaker \$A and the moderate recovery in sterling. Likewise, with bonds having a modest rally and yield curves flattening, our interest rate positions also contributed. Stock selection in Australian equities was also positive over the month.

## Outlook and strategy

I was recently told that our return forecasts were "too pessimistic" and, as a consequence, this would make achieving our return objectives more difficult. My response was to point out that having more "optimistic" forecasts might be comforting in the short run to investors "long" growth assets, but what matters is not what we forecast, but what actually happens. Being as close to reality as possible with our forecasts is much more important. The more realistic the view of what may lie ahead, the better the decisions we'll make to prepare for it.

Let's consider our current forecasts. Our forecast methodology has been calibrated to capture both underlying structural trends and cyclical valuations. We compress these factors into a 3 year timeframe and express risk in probability of loss terms – a more meaningful risk metric than volatility.

Our current forecasts for broad asset class returns and risk can be broadly summarised as:

- Generally relatively low (all less than 8% p.a.) and relatively compressed (mostly between 2% and 6% p.a.), neither pessimistic nor optimistic but rather (in our view) realistic;
- Projected returns from bonds and bond proxies (like A-REIT's) remain particularly low, albeit slightly improved in the case of US and Australian government bonds; and
- The key US equity market offers investors limited return in absolute terms and not much different to the return offered by US government bonds (where's the risk premium?).

If we are right (granted a big assumption), there are a number of significant implications:

Firstly, typical balanced style portfolios will struggle to deliver the sorts of outcomes investors expect over the medium term. Multiplying our 3 year return forecasts by the typical balance fund's Strategic Asset Allocation (SAA) effectively locks in a relatively low return (in the order of 5% nominal or 2.5% real) or about half what investors expect but with significant expected volatility (around 8% p.a.). Furthermore, with the risk premium across most assets low, the likelihood of a rebuild in the risk premium is high, implying significant downside / drawdown risk is likely.

Secondly, active asset allocation within narrow ranges is also unlikely to solve the problem given the structural anchoring to equity market outcomes, and the relatively narrow tactical ranges in which asset allocation can be (and for that matter is able to be) adjusted. This is an inherent structural flaw within the SAA model. The practical implication is that this significantly limits the ability of managers of these types of portfolios to "turn the dial" sufficiently in an environment of compressed and clustered returns or where equity returns are moderate.

## 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*	0.66	1.38	3.21	5.59	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.87	1.98	4.44	7.33	5.01	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](http://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

Thirdly, complex and illiquid alternatives are unlikely to provide the solution to the return shortfall as they are building off the same underlying market environment. There is no free lunch— particularly in a world of overvaluation.

As noted above, it is not our intention to be bullish or bearish, just realistic. If we are right, or even broadly right, then how we approach portfolio construction will matter a lot in terms of the outcomes we achieve.

Given this, we are approaching the task of achieving our real return objective over the next 3 years with 2 key ideas in mind.

Firstly, that it's going to be challenging. Starting points matter in the current environment of low expected returns to key assets, static beta exposures will be insufficient. Where, how and when we take risk will be important. We know that returns won't be linear, meaning that an active and importantly unconstrained approach to asset allocation should be an important part of a strategy to close the shortfall gap implied by current valuations and subsequent returns. Avoiding drawdowns and deploying capital judiciously will be vital.

Secondly, while broad asset class returns look problematic, there are better opportunities at what we'd describe as a "sub-asset class" level. In this bucket we would put currencies (as they realign to reflect evolving fundamentals and risks), relative value opportunities as broader themes adjust, and in interest rate markets in particular as economic conditions (including inflation) and the policy backdrop realign. We also expect that judicious security selection at the sector level will be important as both a source of return and a risk mitigator.

The portfolio continues to reflect these ideas. We have been managing the fluctuations in asset prices relatively aggressively over the last 18 months or so as markets have oscillated between deflation / recession and inflation / growth. We've bought risk when it was cheap (Sept'15 and Q1'16 and sold it as risk premiums have narrowed, depressing future returns. Our overall exposure to typical growth assets is currently on the low side as we have trimmed risk amid the recent rise in equity prices and narrowing in credit spreads. Cash is elevated but off its highs.

We've added exposures to emerging market debt (but mainly for currency exposure and diversification), sterling as it fell sharply post Brexit and we saw a significant improvement in its valuation, and traded in and out of deflation positions in resource stocks and inflation linked bonds. While we have trimmed some of this risk, we remain cautious on bonds and bond proxies like A-REIT's and continue to reflect this.

Our return forecasts suggest that starting from where we currently are, a challenging path lay ahead. More optimistic forecasts would not make the challenge any easier – in fact, it could take us down the wrong path making it harder to achieve our objectives. Our approach is framed around the idea that valuations matter and that sensible, unconstrained and active asset allocation is vital. We are complementing this through the opportunities at the sub asset class level and believe that in combination we will achieve our objectives without taking us down a path of leverage or complexity – approaches which in the past have been brutal when risk has turned.

### Fund details

ASX Code	GROW
Fund size (AUD)	\$31,429,579
ASX Quoted Price	\$3.6414
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 April 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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