Schroder Real Return Fund
ASX: GROW

A smarter way to invest. An easier way to grow your wealth.

Quarterly Report - June 2017

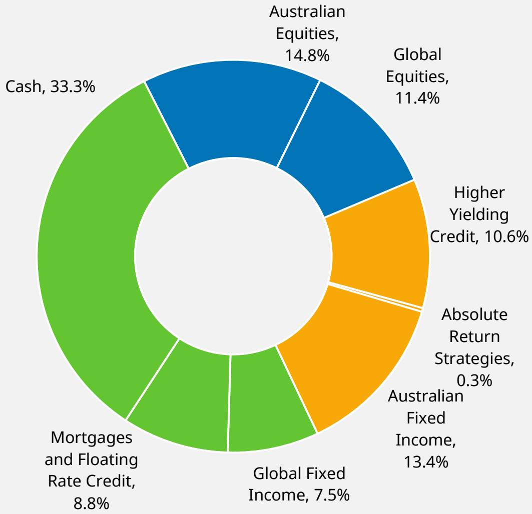
For more information about the Fund visit www.schroders.com.au/grow

Total return %	1 mth	3 mths	1 yr	3 yrs p.a.	5 yrs p.a.	Inception p.a.
Schroder Real Return Fund (Managed Fund) (pre-fee)	-0.30	0.98	-	-	-	5.27
Schroder Real Return Fund (Managed Fund) (post-fee)*	-0.38	0.76	-	-	-	4.43

Portfolio inception 09/08/2016, 0 years and 10 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 March 2017	
3 months	0.48%
1 year	1.86%
3 years. p.a.	1.97%
5 years. p.a.	2.18%

*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 June 2017

Portfolio review

The Real Return Fund (ASX: GROW) returned -0.4% (post-fee) in June, and 0.8% (post-fee) for the quarter June was a challenging month as most assets found gains hard to come by. While equity markets eked out very modest gains, there was considerable diversity within the market, with emerging markets outpacing developed markets. In Australia, healthcare was the standout sector rising over 6% in the month, whereas REIT's and Energy fell -4.8% and 6.9% respectively. The former was driven in part by concerns about higher yields, the latter due to weak oil prices. Bond yields rose towards the end of June as the Fed lifted rates and central banks generally proffered hawkish rhetoric particularly around the moderation in central bank balance sheets. There was also action in currency markets with Sterling rattled by the poor showing of the Theresa May and the Conservatives in the UK election. The Australian dollar moved higher.

While the Strategy benefitted from the collapse in A-REIT's relative to the broader market, the offset was the positive (albeit very modest) duration position against rising in bond yields. Similarly the fall in GBP post the election and the rise in the AUD also detracted. Benign trends in equities and credit contributed little to returns.

Outlook and strategy

This time last year we reviewed the return objective for the Schroder Real Return strategy and concluded that it remained an achievable return objective – albeit one that we would need to *"be active and aggressive in managing asset allocation…and utilise active management at a strategy level to ensure maximum incremental return through alpha generation*". At the time, many were arguing that decent real returns would be difficult to achieve against the consensus low return world backdrop and suggesting that there might be a case to lower the return target. We resisted. In the ensuing 12 months, risk assets have generally exceeded our relatively moderate expectations meaning that our targets have been met and/or exceeded without the need or opportunity for significant variability in asset allocation or the necessity to take undue risk. A word of caution though – our forecasts are framed on a 3 year horizon and not intended to imply returns will be delivered in a linear fashion. Stronger than expected returns in year 1 simply implies returns have been pulled forward. The challenge from where we stand today remains acute.

In a cyclical context the global economy is in reasonable shape. The major economic blocks (US, Europe, Japan, China and Asia) are expanding and while growth risks remain visible, recession on a 1- 2 year window seems a low probability outcome (barring of course a shock).

None of this though changes the structural challenge faced by the global economy which effectively guarantees low growth (in both nominal and real terms) over the longer term. These factors have been well documented but as a refresher include:

- Historically high leverage limiting the potential for credit expansion to fuel sustained growth;
- Structurally low rates and ballooning central bank balance sheets (which together with high public sector leverage limit the ability of policy makers to reflate in the face of a growth / deflationary shock);
- The demographic constraints of aging populations in key parts of the global economy (China, Europe and Japan especially);
- Moderate trend growth in productivity (barring a technological induced productivity shock);
- Specific debt and overcapacity problems in China (the world's most recent structural growth engine);
- Rising income / wealth inequality and the rise of the political economy;
- In Australia's case specifically pressures on national income brought about by the unwinding of the Terms of Trade boom.

The structural valuation backdrop for both bonds and equities remains problematic.

In the case of equities, structural valuations have deteriorated over the last 12 months as equity prices have risen without a commensurate improvement in earnings prospects. This is evident across a range of structural valuation metrics. While importantly the situation is more acute for US equities than other major markets, the structural valuation risk from all major markets is to the downside.

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*	-0.21	0.68	1.45	5.21	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	-0.29	0.69	1.88	6.69	4.69	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 leave us?

Firstly, the task has not gotten any easier. Narrower credit spreads and more demanding equity valuations mean we are starting behind the"8 ball". Beta, derived from mainstream assets is unlikely to provide us with the boost we've enjoyed in recent years. However, markets rarely move in straight lines and current narrow risk premium are unlikely to be permanent, particularly if central banks start the long path back to policy normalization (whatever that is). Managing this adjustment will be an important contributor to returns over the medium term. The two critical objectives to avoid as much of the repricing as possible and to re-enter markets when risk premium have rebuilt and prospective returns rebuild.

Secondly, broad market beta is not our only tool. At the sub-asset class level there is considerable opportunity to both add incremental return and manage risk. We expect the realignment of currencies and interest rates to be an important source of return. For example, opportunities in GBP and the AUD as well as in European and US yield curves are being exploited for this purpose. In fact we currently see the management of these types of strategies to be almost as important in achieving our objectives (particularly in the short run) as our broad market beta exposure.

In short, the environment is unlikely to do us any favours. We expect that the above in combination will be what gets us to where we need to be, but we also need to bear in mind we are very mindful of risk – particularly the minimisation of downside risk. One implication of narrow risk premium is that there is little room for error and downside risk is elevated. Avoiding this will be just as important as capturing return on the upside.

The bottom-line is that we need to be realistic. Achieving CPI+5% from here even over a 3 year timeframe will be tough, but as we have seen over the last 12 months it remains an appropriate objective, so too do our risk targets.

Fund details

ASX Code	GROW
Fund size (AUD)	$35,345,084
ASX Quoted Price	$3.6034
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 June 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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