Schroder Real Return Fund
ASX: GROW

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

Monthly Report - August 2017

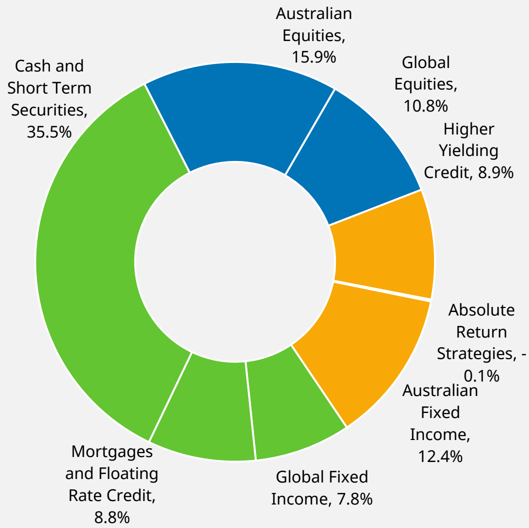
For more information about the Fund visit www.schroders.com.au/grow

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)	0.47	0.04	5.11	-	-	5.30
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.39	-0.19	4.17	-	-	4.36

Portfolio inception 09/08/2016, 1 years and 0 months

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

Asset allocation



* Includes floating rate notes, term deposits, negotiable certificate of deposits, cash and other cash equivalents.

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 June 2017	
3 months	0.51%
1 year	1.84%
3 years. p.a.	1.91%
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 August 2017

Portfolio review

The Real Return Fund (ASX: GROW) returned 0.4% in August (post-fee), taking the Fund's 1 year return to 4.2% (post-fee). One year returns are below the Fund's objective reflecting the strategy's defensive positioning given the vulnerability of markets to bouts of volatility.

Most markets posted modest returns in August as continued signs of healthy global growth were partially offset by geopolitical tensions in the Korean peninsula. This saw small gains across a wide range of assets held by the Fund, with the largest contributions coming from Australian equities and higher yielding credit.

Outlook and strategy

My wife and I have two different approaches to shopping. Her first question is, "what is the most popular?", while I always question what is the best value for money. Both valid but very different approaches to dealing with the difficulty of making informed purchases. These approaches are also reflected in markets and astutely captured in a quote by Benjamin Graham, the father of security analysis and mentor of Warren Buffett, "in the short run the market is a voting machine, but in the long run it is a weighing machine." As investors we believe that popularity can be fickle and difficult to forecast, but at the asset class level, valuation provides a fundamental anchor point, and the power of mean reversion wins out in the end.

This relates to the dilemma investors face at the moment, as based on our analysis, all the major asset classes are expensive. If we are right, at some stage markets will adjust downwards to rebuild value, as the weighing machine takes hold. This is reflected in the defensive nature of our portfolios. Nevertheless, we retain some exposure to risk assets as we see any pull back as likely to be a short sharp fall as greed gives way to fear, and not a more damaging bear market where the fundamentals fall apart due to a global recession. We would expect to use such an opportunity to re-risk the portfolio (as we did in late 2015 / early 2016).

One part of our defensiveness is an elevated level of cash, and this is related to the pervasive nature of asset class overvaluation. Finding cheap assets is problematic in this environment, which defaults to a higher level of cash due to a lack of things to own. Also, a characteristic of low inflation environments is the negative correlation between equities and bonds, whereby bonds generally perform well when equities get hit and provide diversification to risky assets. This diversification allows investors to run with higher levels of equity risk. However, with bonds currently arguably more expensive than equities, this diversification benefit comes at a cost. If you can't diversify away some of a risk easily, it means the only way you can reduce your risk is to reduce your exposure.

We believe that the market generally discounts the true value of cash. Cash has several very useful characteristics that make it valuable in portfolio construction. It usually provides a guaranteed positive return; it is liquid; it is highly correlated with inflation; and provides optionality. Of these characteristics: optionality is the most interesting and one we have previously used to the advantage of the Fund. Having cash on hand allows the portfolio to take advantage of any market set back, and is very valuable given markets are on the expensive side and the likelihood of a setback is elevated.

Another issue around the elevated level of cash is that this only represents the asset weights of the Fund and not the full risk exposure. Active positions like the stock selection of our underlying asset class managers, currency positioning, and our relative value trades generally do not use up underlying capital as they generally net out to zero in capital weight terms. Thus the level of cash in the portfolio does not fully represent the underlying risk of the portfolio.

Schroders

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*	0.19	-0.10	1.29	3.44	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.23	-0.26	1.54	4.34	4.15	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

Through the second half of last year and into early this year, reflation was a key theme we successfully incorporated into the portfolio. This theme was one we expected to be short lived and have not been surprised with the lack of follow through this year, which has caught many investors out. We expect the reflation trade to re-establish itself next year. The current theme imbedded into our portfolio is one of higher volatility. Market volatility has been exceptionally low recently and this is not expected to continue indefinitely, especially in an environment where central banks become less supportive – the US Federal Reserve is expected to begin reducing its balance sheet, and the European Central Bank is expected to taper their bond purchases. This is captured in the portfolio in several trades: high cash levels and defensive risk positioning; put options on the S&P500; US dollar and Japanese Yen exposure, and a short US tech equities / long US utilities relative value position.

Simon Stevenson

Fund details

ASX Code	GROW
Fund size (AUD)	$41,175,956
ASX Quoted Price	$3.6102
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 August 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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