Schroder Real Return Fund
ASX: GROW

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

Monthly Report - October 2017

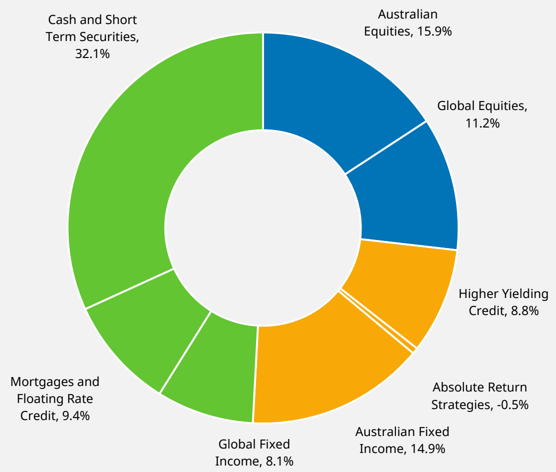
For more information about the Fund visit www.schroders.com.au/grow

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)	1.37	2.24	6.81	-	-	6.06
Schroder Real Return Fund (Managed Fund) (post-fee)*	1.29	2.01	5.85	-	-	5.12

Portfolio inception 09/08/2016, 1 years and 2 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 September 2017

3 months	0.37%
1 year	1.83%
3 years. p.a.	1.90%
5 years. p.a.	2.11%

*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 October 2017

Portfolio review

The Real Return Fund (ASX: GROW) produced a solid return of 1.29% (post fees) in October. This took the 1 year return on the strategy to 5.85% (post fees). With inflation (as measured by the RBA's Trimmed Mean measure) running at 1.8%, the real return on the strategy is slightly ahead of its 5% real return objective over this period. Volatility remains low at less than 2% - reflecting both the low level of aggregate risk in the portfolio and the decline in underlying market volatility. This does not mean though that the level of risk in markets at present is low. Quite the contrary.

October's return reflected a combination of factors. Firstly, it was a good month for risk assets. Equity markets gained across the board and significantly for the Strategy, Australian equities outperformed most major developed markets, especially the US. This has been a key position in the portfolio and one we continue to support. This strength was also reflected in credit with credit spreads continuing their downward thrust. Another important contributor to portfolio performance in October was the $A's depreciation and a modest rise in GBP, both key positions in the Fund. Bond markets also helped, with flatter yield curves and lower bond yields in Australia also delivering positive returns to duration and our curve flattening exposures.

Outlook and strategy

This month will mark 30 years since I started working in financial markets. While I don't remember exactly what happened on my first day, I do remember being inherently nervous starting work just a few weeks after the 1987 stock market crash. While I don't intend to detail a laundry list of lessons learned, there are a couple of things which do stick in my mind.

The first is that this job is hard. While it's easy to look back and identify what you should have done, it's much harder to make decisions in real time, looking forward into a future that is in large part unknowable. While technology means we can now process more data better and faster (and as a result have better back tests) it doesn't change the fact that the future is inherently difficult to predict. Being wise in hindsight is popular but unhelpful. I'm not sure any of this has changed since 1987 – except that my nervousness should have been replaced by unbridled optimism as the bad news had been largely discounted. If only I'd known.

The second is that no process or approach works all the time. Market drivers will change and the response of the "collective investor" aka "the market" will vary. Some strategy somewhere will always be doing better (more risk, less risk, more leverage, whatever the case may be). And in bull markets there's always the bloke at the BBQ … Successful investment processes require a set of beliefs, a coherent, aligned and consistently applied process, and a time horizon to match. By successful I'm referring to strategies that deliver on their objective through time (not necessarily the highest returns in any given environment).

Why is this relevant?

Well it's clear that we would have delivered higher returns if we had held more risk over the last couple of years (particularly in the US and emerging markets and in particular in a narrow group of technology stocks that have been key contributors to the positive momentum). This is only obvious looking backwards as at no time in the last couple of years has our framework suggested these stocks or markets looked to be good value investments. While we've clearly got the extent to which momentum and policy would carry these markets wrong, looking ahead, it's hard to argue that valuations have improved. We'd certainly argue that current valuations imply pretty low returns going forward from key markets (equities, credit and bonds). Does this mean that markets won't continue to rise in the near term? No. But it does suggest there will be a day of reckoning where investors realise that they've already booked their future returns. A day will come when new investors require to be paid a risk premium (commensurate with the risk of these assets) if they are to take on the ownership of these assets going forward.

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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*	0.69	1.16	1.11	4.35	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	1.17	1.87	1.50	6.00	4.46	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

We also need to bear in mind what's driving markets. The positives are broadly synchronised global economic growth, low inflation and market friendly policies (resulting from this growth / inflation cocktail). This has benefited the growth oriented and momentum investor. Yet the disconnect between the bond market (still very low yields) and a relatively buoyant and synchronised global economy suggests something is amiss. I'd suggest that there's an inherent fragility to the global recovery and concern that the Ponzi scheme successive central banks have created across asset markets generally would be vulnerable to any material change in the policy dynamics supporting it.

From our perspective this means we will continue to adopt positioning we deem appropriate given these risks against a current state that looks vulnerable and an uncertain future. This doesn't mean we won't participate in further upside. We continue to have exposure to assets and strategies that will participate in further gains in markets, but we want to do that in a size commensurate to the risks and in a way that leaves us with the flexibility to respond to a change in tone. As markets have risen, volatility has declined meaning "volatility" as an asset is cheap. We have added some US equity call options to the portfolio as it gives us both exposure to volatility but also additional exposure to the US market (currently one of our lowest effective exposures) should the US market continue to run. If it doesn't then we've got plenty of protection to the downside. We will also hold our equity exposure in those markets where we think the risks are least – Australia jumps out to us given its underperformance in the QE driven rally and its better structural and cyclical valuation starting point. It is interesting that Australia has been outperforming recently.

The most likely fundamental cause of a turn in both policy and sentiment is inflation. We think both headline and core inflation will build as we move through 2018 and this may destabilise markets as it will challenge current orthodoxy of low rates forever and challenge central banks to respond. We have in place some effective inflation hedges (cash, inflation linked bonds and the volatility trades described above), and we expect to build more of these into the portfolio in coming months.

Clearly we won't shoot the lights out if markets continue to plough onwards and upwards. We'll participate, but in the lower risk areas. And if markets do start to reflect on an uncertain future and start to price in some risk premium (remember that?), then we're well positioned to manage the transition and to take advantage of the opportunity.

Fund details

ASX Code	GROW
Fund size (AUD)	$42,756,320
ASX Quoted Price	$3.6685
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 October 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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