Schroder Real Return Fund
ASX: GROW

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

Monthly Report - November 2017

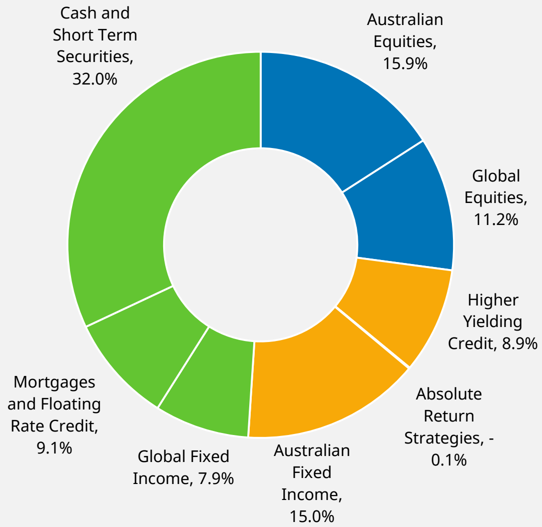
For more information about the Fund visit www.schroders.com.au/grow

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)	0.72	2.50	2.54	6.67	-	6.25
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.65	2.27	2.08	5.72	-	5.31

Portfolio inception 09/08/2016, 1 years and 3 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%
6 months	0.89%
1 year	1.83%
3 years. p.a.	1.90%

*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 November 2017

Portfolio review

The Real Return Fund (ASX: GROW) produced a solid return of 0.65% (post fees) in November. This took the 1 year return on the strategy to 5.72% (post fees). With inflation (as measured by the RBA's Trimmed Mean measure) running at 1.8%, the real return on the strategy is in line with 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. I'd reiterate the point I made last month. This does not mean that the level of risk in markets at present is low.

November was on balance another good month for risk assets reflecting an ongoing cocktail of reasonable growth, low(ish) inflation and gun shy central banks. Equity markets gained (with the exception of the UK and Europe) and credit spreads retraced some of their recent modest widening. Also helping performance was a rally in Australian bonds (as the RBA showed little sign of raising rates), a weaker AUD and a rally in GBP as the UK moved closer to an agreement on Brexit.

With risk assets (equities in particular) performing well in 2017, it's obvious that if we'd held more equities our total returns this year would have been higher. The reason we haven't held more risk assets is that when we view the world through a valuation lens and assess what this means for future returns the outlook (at least in the medium) looks poor. This has been the story for some time and as each month ticks on, and markets tick higher, the outlook looks more problematic – particularly for US equities. Not all investors care about valuations and we accept their usefulness in the short run is limited. Clearly other factors have dominated lately and more conservative stances have not been rewarded.

Outlook and strategy

Above I mentioned the impact of the "growth, inflation, central bank cocktail" on markets. Disentangling these effects is difficult, particularly in the later phase of the cycle which is probably where we are now. Decomposing returns from key equity markets in the QE era is instructive here. Over the last 7 years (a period I'd characterise as being the beneficiary of significant expansion of central bank balance sheets), US equities have returned 13.4% p.a. against a return from Australian equities of a "meagre" 8% p.a. If we decompose these returns into the contributions from dividends, EPS growth and changes in market multiples the difference in returns is almost entirely explained by a re-rating of the US market with PE multiples expanding from around 14x earnings in 2010 to around 22x earnings in 2017. In other words, almost half the gain in US equities (6% of the 13.4%) can be accounted for simply by investors being prepared to pay significantly more for each dollar of earnings. In the case of Australia, market multiples are largely unchanged at around 17x. While dividend yields in Australia are clearly higher than in the US, the sum total of dividend yields and EPS growth was broadly the same in both markets.

This difference in valuations can be linked to several factors. Firstly, that investors are now more confident about future earnings growth in the US than they are in Australia and prepared to pay-up for that anticipated optimism (Trump's anti-regulation stance is seen as a positive). Australia is again being viewed as "old economy", while the US is seen as being more exciting and innovative. Secondly, that US liquidity conditions and persistently low interest rates (0% for much of this period) and bond yields, lowered discount rates applied to future earnings, and, altered relative valuation considerations in favour of equities.

This may mean that US equity valuations can stay extended until (amongst other things) confidence about the US earnings outlook fades or interest rates rise (or at least expectations regarding interest rates rise). The potential common thread here is wages / inflation. Rising wages threaten profit margins and, perhaps more significantly, will likely drive a rise in core inflation. Rising core inflation in turn threatens the benign interest rate environment as central banks respond (or not) to this cyclical rise in inflation. We may not be quite there yet (meaning the market may continue to focus on the positive), but the evidence as we see it suggests 2018 might see significant challenges on this front.

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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*	0.47	1.45	1.35	4.16	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.75	2.40	2.14	5.78	4.67	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

Finally, several months ago I tried (probably badly) to draw some contrasts between the increase in seismic activity around Bali's Mount Agung volcano (and the evacuation of residents) despite no eruption at the time and the lack of volatility in markets (not the lack of risk). As the news reports attest, several months on and things have changed with Mount Agung erupting and causing all sorts of issues for residents and tourists alike. Interestingly we have seen a modest increase in market volatility in recent weeks despite markets generally still behaving. Clearly no causality here but I think still a useful (if poor) analogy – but I think worth some reflection!

As the above would indicate we have not changed our positioning materially during November. That said, we did further adjust the portfolio to benefit from the potential rise in inflation (and inflation expectations in 2018). Specifically, we used the significant flattening in the US yield curve to take profits on our long held US curve flattening position (primarily a deflation hedge trade that served its role well particularly in 2016) and added to our short A-REIT v Australian equities position on the basis that we continue to believe A-REIT's are expensive and as essentially a bond proxy asset, vulnerable to any rise in interest rates globally. Overall though positioning remains cautious with our focus on having low risk participation to the upside should the risk rally persist, but with a clear focus on mitigating the downside when things (eventually) turn.

Fund details

ASX Code	GROW
Fund size (AUD)	$44,312,485
ASX Quoted Price	$3.6922
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 November 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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