Schroder Real Return Fund
ASX: GROW

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

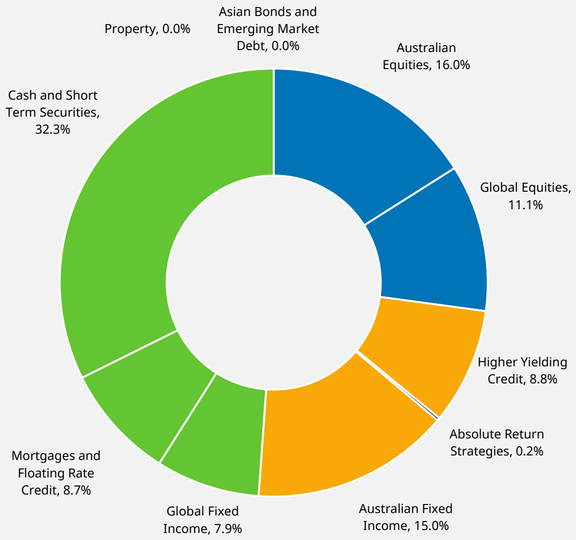
Monthly Report - January 2018 | **For more information about the Fund visit www.schroders.com.au/grow**

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)	0.24	1.23	5.63			5.87
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.16	1.00	4.69			4.93

Portfolio inception 09/08/2016, 1 years and 5 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 31 December 2017

3 months	0.40%
1 year	1.79%
3 years. p.a.	1.84%
5 years. p.a.	2.08%

*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 January 2018

Portfolio review

The Schroder Real Return Fund (ASX: GROW) returned 0.24% in January and 5.6% for the 12 month period. January was a difficult month for the Strategy as a number of our views were tested. Our concerns about demanding valuations in equity and credit markets were not shared by the market, nor was our view that the Australian dollar should be trading closer to USD 0.70 not USD 0.80. At least our thinking on rising inflation and higher bond rates was playing out closer to script with sovereign yields generally moving higher. Interestingly one of the most important positive contributors to January performance was our Emerging Markets Debt exposure which produced stellar gains during the month (helped in part by Emerging Markets currency positions).

Outlook and strategy

What a difference a day makes! Early February was marked by a significant change in sentiment with equities falling sharply, credit spreads widening and volatility (remember that) rising sharply to levels last seen in 2015. The positioning that had dampened returns in January, helped offset the volatility in early February. That said, February is still young, so more about this next month.

Implicit in my comments above is the idea that our returns could have been higher had we held more risk, particularly in the US where momentum has been strong and economic confidence growing. With the benefit of hindsight it is hard to argue with this idea. The reason we didn't is twofold. The first is that these markets offered very little in the way of expected future returns with price gains over the last year or so embedding large amounts of future earnings growth into current prices. The second reflects the fundamental concern we have had for some time about inherent build up in underlying inflation pressure and the risk this posed to bond yields, relative valuations and policy. Early February gave us a glimpse of what could happen if this pressure continues to build as we expect.

To this end, the most significant development of late has been the ongoing accumulation of evidence supporting the idea that inflation is building. While it has been a little harder to see in the official "core CPI" data, plenty of other indicators are starting to glow. The rise in earnings evident in the recent January payroll numbers is challenging the sceptics who have argued that the Phillips Curve is dead (i.e. that wages don't rise as unemployment falls). While we concede that the sensitivity of wage growth to unemployment may have moderated, both history and empirical research suggests that once the US unemployment rate falls to around 0.5% below the NAIRU (or lower), wages will respond. Friday's payroll data supports this idea. While analysis by anecdote is dangerous, the New York Times recently reported on the impact of the tightening US labour market, highlighting that in Dane County, Wisconsin where the unemployment rate is just 2%, manufacturers are hiring prison inmates on full wages to work in factories while they serve out thir sentences. Clearly we are heading into problematic territory.

If this trend continues then we are at a pivot point in the post GFC economy. The liquidity bubble that central banks have built to support economies and asset prices over the last 10 years has been enabled essentially by the fact that excess capacity in labour and goods markets globally has kept inflation suppressed. Strong growth in the US (including additional unfunded fiscal stimulus) together with continued improvements in economic momentum in Europe and Japan have potentially worked off that excess capacity which is causing inflation pressures to rise. The disconnect between policy settings and the macro-economy though remains large. A weak US dollar, narrow credit spreads and high equity prices also imply that financial conditions remain very easy. If inflation pressures continue to build then pressure will revert to central banks to respond, and focus the spotlight even more intently on calibration of policy and its implications for the economy and risk in asset markets. Official rates rising globally and central bank balance sheets shrinking is not something we've seen for a while.

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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*	0.24	0.99	2.17	3.52	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.26	1.39	3.29	4.94	3.86	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%.

Outlook and strategy continued

We have argued this point for some time with little reward to date. Clearly we need to work on our timing. That said, we recognise the futility of trying to be too cute with timing and prefer to position progressively as the risks build rather than nail the day (which is frankly more luck than skill). On this point we have been building inflation protection more directly into the portfolio. Some of this positioning has been more strategic and reflecting other mispricings (like our preference for cash over bonds) and some reflecting a more direct calibration of the portfolio to the potential for inflation surprise. We have reduced portfolio duration (now just 0.7 yrs in aggregate), added inflation breakeven positions and direct inflation linked bonds, cut our defensive curve flattening positions and added to our short position in A-REIT's which we see as being a bond proxy, which like infrastructure assets, gained much of its return through the secular decline in bond yields. To be clear, we are not forecasting a return to a high inflation environment, but we are expecting higher inflation than we're used to and higher inflation than assumed by investors.

As we saw in early February, the transition to this environment, while most directly felt in rate markets and rate sensitive assets, will also reverberate in equities as investors re-appraise their confidence in central banks and policy settings, review the discounted value of future earnings and compare relative valuations which are likely to make interest rate based assets relatively more appealing. Caution is still warranted.

Fund details

ASX Code	GROW
Fund size (AUD)	$46,438,636
ASX Quoted Price	$3.6422
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 January 2018

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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