Schroder Real Return Fund
ASX: GROW

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

Quarterly Report - March 2018

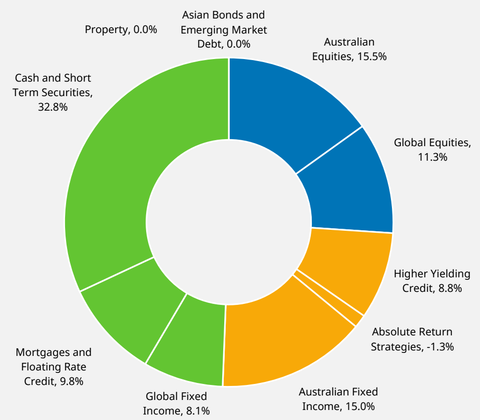
For more information about the Fund visit www.schroders.com.au/grow

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)	-0.48	-0.05	4.09	-	-	5.10
Schroder Real Return Fund (Managed Fund) (post-fee)*	-0.55	-0.27	3.16	-	-	4.16

Portfolio inception 09/08/2016, 1 years and 7 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%
6 months	0.79%
1 year	1.79%
3 years. p.a.	1.84%

*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 March 2018

Portfolio review

Market volatility remained elevated in March and risk assets continued to re-price. The net result was a modest negative return on the Schroder Fund (ASX:GROW) Real Return of -0.6% (post-fee) for the month, leaving the return for the March quarter slightly negative at -0.3% (post-fee).

The pick-up in volatility that began in February continued into March with most major equity markets posting low single digit losses. Australian equities were amongst the worst performers dropping around 4% in local currency terms. All major sectors declined, with the more defensive sectors outperforming. This trend was also reflected in credit markets with credit spreads generally moving wider across the month. Bond yields drifted lower in March, but given the weakness evident in risk assets over the period, the rally was relatively modest. Despite trade war fears and equity weakness the US dollar recovered a touch in March, with the AUD losing ground. GBP also gained ground amid UK Brexit negotiations.

The Strategy's negative return in March primarily reflected the drag from weaker equity markets and wider credit spreads. While the Strategy's cash, duration, and currency positions helped offset this, it was insufficient to turn the drag from weak risk assets into a positive overall return. Also weighing on returns in March was the mild retracement in bond yields, which adversely impacted the inflation trades we've been building in the portfolio over recent months. This includes the short A-Reit v ASX 200 which was adversely impacted by the outperformance of A-Reit's during the month.

Outlook and strategy

The March quarter reflected one of the worst starts to the year since the GFC in 2008, in stark contrast to the very positive end to 2017. In many ways conditions aren't all that different to late last year. Global growth remains relatively robust, inflation low and policy conditions broadly still favourable. At the margin though there has been a shift with seemingly unbridled optimism replaced by a more "realistic" assessment of the risks and challenges ahead. Higher underlying market volatility, lower equity prices, a more measured assessment of the risks of the large technology stocks amid growing pressure from the Trump administration for greater regulation in this area, and a generally (albeit still modest) widening in risk premium reflect this. From our perspective, 2018 is running much "closer to script" – our script anyway, than 2017. Timing though is everything!

The critical question though is where to now. Is this an opportunity to add risk assets to portfolios, or, is it the beginning of the end of the extended bull market? We think the most likely outcome is probably somewhere in the middle.

On the positive side, the macro-economic picture remains reasonable. The global growth trajectory remains reasonably robust, economic indicators are, by and large, still very positive and on our analysis, the risk of recession this year remains low. Consistent with this, the near term outlook for profits looks reasonable.

Furthermore, while we have detailed our concerns about rising inflation, inflation pressure will build through time meaning we are still some way away from the point at which central banks (the US Fed leading the way) will need to shift the policy bias from "tightening" from a very accommodative starting point, to "tight". It is the latter that will significantly raise recession risk.
However, strong economic conditions come with a cost, and that cost is reflected in rising core inflation (which is essentially why rates are rising) and perhaps more significantly given the contribution central banks have made to rising asset prices, a significant reduction in the flexibility of central banks to respond to volatility. The Fed Put can no longer be relied on. Investors will need to think a little more deeply about the risk of the investments they make as they no longer rely on Central banks to bail them out.

Post-fee performance of other Real Return products offered by Schroders

Schroders

	1 mth	3 mths	6 mths	1 yr	3 yrs p.a.	mFund Code
Schroder Real Return CPI Plus 3.5% Fund Wholesale*	-0.30	0.12	1.58	2.67	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	-0.63	-0.12	2.19	3.41	3.01	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

The most obvious immediate "wild card" is the risk of a global trade war (or at least one between the US and China). While mutual self-interest would suggest this may ultimately end up as more bluster than substance, it does have the potential if it accelerates to harm growth (particularly in the US and China) and add to inflation (a "stagflationary" risk). Unlike the US/North Korean "war of tweets" which had a low probability, high impact and arguably binary outcome, challenges to the global trade platform have potentially more real economic consequences. We see it as a significant risk given the dynamic of the tussle between the US and China for broader global economic and political leadership which is unlikely to dissipate for some time.

To some extent these factors have been reflected in recent market volatility, but from a valuation standpoint most assets still reflect relatively demanding valuations / optimistic assumptions. Notwithstanding this, structural equity valuations (especially for the US) are still demanding. To put this in context, the weakness in US equity markets during February and March has raised our 3 year US equity return forecast from -1% pa to +2% pa, significant, but hardly reflecting a compelling case to buy US stocks, particularly with our US bond return forecast closer to 3% pa. Likewise the gap between interest rates (short and long) and the economy remain large – meaning the upside risk to yields remains (despite the moves we have seen already).

To summarise, we don't believe we are staring into the abyss (this is not 2008), but the end of the cycle is in sight. We are judiciously adding some risk, so far mainly in higher yielding credit at the expense of more vanilla fixed income, but for the reasons outlined are treading cautiously.

Fund details

ASX Code	GROW
Fund size (AUD)	$45,380,251
ASX Quoted Price	$3.6266
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 March 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.

Contact www.schroders.com.au
E-mail: info.schroders@linkmarketservices.com.au

Schroder Investment Management Australia Limited ABN 22 000 443 274 Australian Financial Services Licence 226473 Level 20 Angel Place, 123 Pitt Street, Sydney NSW 2000 Phone: 1300 136 471 Fax: (02) 9231 1119