Schroder Real Return Fund
ASX: GROW

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

Monthly Report - April 2018

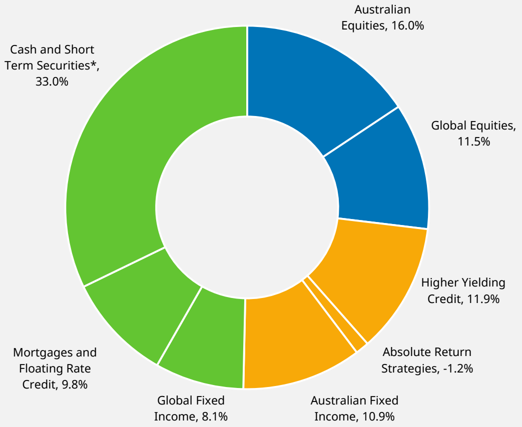
For more information about the Fund visit www.schroders.com.au/grow

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)	1.14	0.86	4.23			5.54
Schroder Real Return Fund (Managed Fund) (post-fee)*	1.07	0.64	3.30			4.60

Portfolio inception 09/08/2016, 1 years and 8 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 March 2018

3 months	0.53%
1 year	1.91%
3 years. p.a.	1.82%
5 years. p.a.	2.09%

*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 April 2018

Portfolio review

The Schroder Real Return Fund (ASX:GROW) had a solid month in April, producing a 1.1% (post-fee) return. Month-to-month returns have fluctuated this year and despite the solid April outcome, overall returns so far this calendar year remain moderate. In broad terms, most major asset markets have struggled this year making consistent positive returns hard to find. The 1 year return remains below target. From a risk / downside risk management perspective the portfolio has been reasonably well positioned for the rise in volatility (and broader weakness in asset markets) that has unfolded this year. However, the near term headwinds for returns remain strong meaning our risk focus is likely to remain elevated for a time.

The main driver of the solid April outcome was the upswing in equity markets with most markets bouncing following falls in March. A weaker AUD also helped given the Strategy's position to be effectively short the AUD vs key global currencies. With bond yields moving higher, the portfolio benefitted from its relatively short duration positioning as well as the performance of most of the inflation protecting trades.

Outlook and strategy

In recent commentaries we have focused heavily on the fundamental risks to asset markets. Our emphasis has been on the risk posed to asset prices by relatively demanding valuations in many asset classes and the risks posed by rising inflation pressure and the implications of this for medium term central bank accommodation. None of this has materially changed.

One thing we have said relatively little on has been geo-political risk, not because it isn't important, but simply because forecasting geo-political outcomes, especially in the Trump era is difficult, and by and large geo-political risks are rarely triggered – at least the big ones anyway. 2017 was case in point where US and North Korean "shirt-fronting" and the seemingly heightened risk of miscalculation by either party did not derail markets. In fact despite climbing the "wall of worry", volatility was amongst the lowest on record and market gains outsized. Why? Firstly because of the low odds of it actually escalating, and, more fundamentally, because the macro-economy was humming (greed trumped fear).

There are though several important developments that suggest geo-political considerations will loom larger in coming years. Research by the US Federal Reserve confirms a broad uplift in geo-political risk, consistent with (amongst other things) a lessening of the dominance of US economic and political leadership, the growing significance of China as both an economic and political superpower, and exacerbation of wealth inequality as a result of the economic policies pursued by major developed economies post the GFC. Populist politics has become the global norm and this is reshaping the economic and political debate. Given the pervasiveness of the drivers of these developments, this trend is only likely to increase.

The challenge from a portfolio management perspective is how to properly reflect these considerations in our portfolios. While each potential flashpoint will have its own nuances, it is worth considering (as an example) how we are thinking about China.

China's rise has been dramatic. In the year 2000 China's economy was US$3.7tn (36% of the US) in PPP terms, it has risen to be currently US$23tn (120% of the US), and by 2023 the IMF forecasts it to be US$37tn (150% of the US). This rise has had a profound impact on the global economy and will continue to be a dominant feature in the future.

We view these impacts through three broad lenses: the re-entry of China into the global economy; the geo-political implications; and the Chinese economic and financial structure.

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*	0.68	0.57	1.57	2.69	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.93	0.55	1.95	3.48	3.51	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

Firstly, with respect to China's re-entry to the global economy, we see the biggest impact as the contribution of Chinese workers to the global labour force, contributing to a sharp fall in the capital to labour ratio. This has increased the supply of labour and placed downward pressure on global wages, impacting both inflation and the ability of central banks to maintain low / positive inflation, extending the business cycle and lowering economic volatility (although at the potential cost of more financial instability). Internally, we have seen China focus on its lack of capital and embark on an historic investment program, supporting both commodity exporters, but also countries that produce and export significant amount of capital equipment (Germany is a good example).

Secondly, the rise of China has so far been benign in a geo-political sense, as the doctrine of "hide your strength, bide your time" (Deng Xiao Ping) has been dominant. However, the ascent of President Xi Jinping has led to a much more aggressive China on the global stage. The two main implications of the political rise of China are a partial de-globalisation of the world economy as it breaks into two strategic blocks - one centred on the US and one on China. Another impact will be an increase in global defence spending as geo-political tensions rise between the two super-powers. The upside is the boost this is likely to provide for innovation and future productivity. The downside is the increased risk of military conflict.

Finally, the rapid rise of debt financing of the Chinese economy has seen episodic fear of a financial crisis, with rising debt generally viewed as a precursor to a financial crisis. The unusual nature of China's credit boom is that it was not driven by excessive demand but by excessive supply. This is not an inflationary environment and has allowed authorities flexibility to step in whenever Chinese growth begins to disappoint. Losses must be borne from mal-investment at some time, but as long as inflation remains subdued, it suggests that it will be a lowering of growth over time, rather than a big bang approach. And if a financial crisis does occur, the chance of a big bang approach is low and it is more likely be a long drawn out process similar to that of Japan, given the highly interventionist approach of Chinese authorities.

Given the uncertainty over the outlook for China, and the potential impact on Australian assets, the portfolio has tended to diversify away some of this risk via a short Australian dollar exposure. We believe the deflationary impacts of the re-entry of China into the global economic system have mostly passed and think markets are underestimating the risk of rising inflation and the portfolio currently is hedged against this potentiality. Lastly, we see the risks of geo-political shocks rising and believe in this environment it is more crucial than ever to be cautious about overpaying for assets.

To summarise, rising geo-political risks are likely to present both risk and opportunity in financial markets. Trying to guess the potential of a low probability but high impact event (such as a military escalation) is a mug's game. That said, markets will episodically overreact and having a more fundamental anchor to our process does allow us to position around these risks.

Fund details

ASX Code	GROW
Fund size (AUD)	$46,026,556
ASX Quoted Price	$3.6654
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 April 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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