Schroder Real Return Fund
ASX: GROW

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

Quarterly Report - June 2018

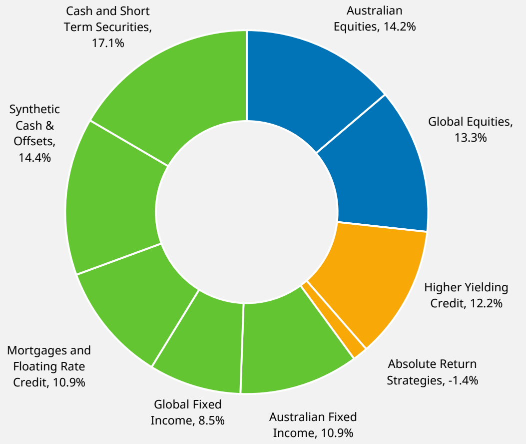
For more information about the Fund visit www.schroders.com.au/grow

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)	0.85	1.72	4.84			5.35
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.78	1.49	3.91			4.42

Portfolio inception 09/08/2016, 1 years and 10 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%
6 months	0.98%
1 year	1.91%
3 years. p.a.	1.82%

*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 June 2018

Portfolio review

The Real Return Fund (ASX: GROW) returned 0.8% (post fee) in June and 1.5% (post fee) for the quarter taking the fund's 1-year return to 3.9% (post fee), well above inflation, but below its target CPI+5%. On a 3-year basis the fund's return is also below its objective.

Outlook and strategy

June was a challenging month as markets were buffeted by trade war tensions. Early in the month, President Trump imposed steel and aluminium tariffs on Europe, Canada and Mexico, prompting each country to retaliate with tariffs on US products. The Trump administration also announced a $US34bn list of Chinese goods that will be subject to tariffs beginning July 6.

Diverging economic trends saw a widening gap between global central banks, with the US Federal Reserve signalling more aggression in its policy tightening, and while the European Central Bank indicated it will end its bond purchases in December, it made clear interest rates will remain at their present level until at least the middle of 2019, if not longer. The June quarter also saw Italian politics cause volatility in bond markets as anti-establishment parties formed a government.

Developed market equities eked out modest gains in the month and the quarter, with emerging market equities suffering sharp falls in both time periods. The Australian equity market was the best performer returning 3.3% in the month of June and 8.5% over the quarter. This has been consistent with our view that the Australian equity market offers some of the best prospective returns, and an area we have had the most disagreement from clients. We have had a preference for the Australian equity market over global, and in particular the US market. Since end January the Australian equity market has returned 4.8%, while the US equity market returned -2.9%.

Global and Australian government bond yields closed June at similar levels to which they started. Over the quarter there were significant moves in German and US yields, with German yields lower and US yields higher. In global credit markets, poor performances were put in by emerging market bonds and to a lesser extent investment grade credit. High yield bonds unusually did well as lack of supply supported the market.

The primary driver of returns over both the last month and quarter has been Australian Equities, which has outperformed as the Australian dollar has sold off, while expectations of any RBA rate hike continue to be pushed out even further in to the future. The strategy's absolute return strategies, in particular the US inflation breakeven position also contributed to returns.

US politics has been front and centre for around two years now, but more recently it has moved from a tailwind into a headwind. Donald Trump has shown himself to be very different from the usual politician, in that he is following through on his election promises. While markets initially focused on the "positive" policies, what we are now getting is the good with the bad. There were four key areas that Donald Trump focused on in the run up to the election: immigration, tax, trade and infrastructure. Tax and trade have been the key movers of markets recently.

President Trump has asserted that if you are in a trade deficit, like the US, trade wars are "good and easy to win" — an assertion Bloomberg News has already labelled as "fake news". The general view of economists is that everyone loses in a trade war, although markets have behaved more in line with President Trump's views. While the US equity market has returned 2.6% year to date, the Chinese equity market (Shanghai Composite) returned -15.6%, and the Chinese currency has also fallen, while the US dollar is higher.

Most modelling suggests the direct impacts of a trade war are small, and given that tit for tat tariffs reduce both imports and exports, the direct effect on GDP is small. However, for me it is the indirect costs that are the real risk. These are around the impact on confidence. For corporates there is the disruption to supply chains as many large firms now source parts globally, rising input prices, and uncertainty around export sales. This will have an impact on investment and hiring. The consumer will also be hit by rising prices which will reduce spending in real terms.

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*	0.40	0.64	0.77	2.63	N/A	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.61	0.97	0.85	3.69	3.89	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

This is in line with the economists' view, so why the divergent market performance? First, the tax cuts in the US have been a positive for the US equity market, earnings are expected to be up 35% this year, supported by corporate tax cuts. Second, the full potential impact on corporations has yet to be priced in, but this will become more so as companies report on the impact to their businesses.

The key question is: how far does this go? You have a President that acknowledges he does not admit he is wrong and his Chinese counterpart who noted that when somebody hits you on the cheek "in our culture, we hit back". This is not an environment that suggests an early breakthrough, so we have to think about a potential circuit breaker.

Given this has been driven by the Trump administration, while China, Europe and other countries caught up in this have so far been measured in their retaliation, the key is the US political landscape. This year is a mid-term election year and while it is highly likely the Republicans will maintain control of the Senate, current polling suggests the Democrats will take Congress in the November election. Mid-term elections are about turnout and President Trump has energised the Democrats. An early approach by Republicans to energise their base was to focus on the likelihood of impeachment if Congress was to fall to the Democrats, as this was the successful strategy used during President Clinton's term.

However, this approach was not favoured by President Trump, who believes he has a better political antenna than the establishment, and his belief is that immigration and trade will bring out his base. Given this, the trade war will most likely continue to grow, and the circuit breaker will be unintended consequences of this approach – a large confidence hit and dysfunctional markets, which will force President Trump back to the negotiating table.

Reflecting this outlook, the Real Return Fund has a defensive positioning, admittedly one we have held for a while. Our equity exposure is low at 27.5%, while including higher yielding credit and emerging market debt the risk exposure of the fund is 39.6%. The fund has a bias away from US equities which we see as not only vulnerable from trade tensions but also due to stretched valuations, our preferred equity market remains Australia. While bonds are the traditional safe haven, we have maintained our low duration level (0.7 years) as we are cautious on the US inflation outlook. To protect the portfolio we are using currency markets, owning US dollars and Japanese Yen, over Australian dollars. We still think the Australian dollar is expensive and it will perform poorly in a risk off environment. We also continue to hold put options on the S&P500.

Fund details

ASX Code	GROW
Fund size (AUD)	$46,105,827
ASX Quoted Price	$3.6180
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 June 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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