Schroder Real Return Fund
ASX: GROW

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

Monthly Report - August 2018

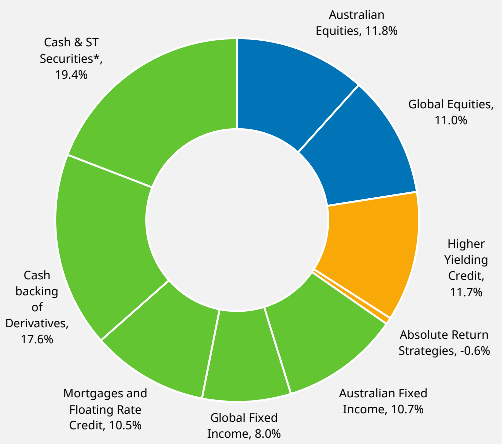
For more information about the Fund visit www.schroders.com.au/grow

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)	0.69	2.26	5.94	-	-	5.61
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.62	2.03	5.00	-	-	4.67

Portfolio inception 09/08/2016, 2 years and 0 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 June 2018

3 months	0.46%
6 months	1.02%
1 year	1.85%
3 years. p.a.	1.78%

*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 August 2018

Portfolio review

The Schroder Real Return Fund (ASX:GROW) had a solid August, returning 0.7% (pre-fee) and taking the 1 year return to 5.9% (pre-fee), around 4% above the CPI for the period. Volatility and drawdown risk objectives remain consistent with our objectives.

Outlook and strategy

August itself was a mixed month for markets as trade tensions impacted confidence. Continued strength in the US dollar together with uncertainty over how far President Trump would go with his tariff showdown with China continued to drag emerging markets down. For developed markets it was more of a mixed bag with the ever resilient US equity market posting solid gains, while Australia and Europe followed the EM trend lower. From a thematic perspective “growth” continued to outperform “value” which adversely impacted performance from a stock selection perspective given the inherent “value” style bias in the QEP Dynamic Blend strategy we have been utilising for some of our global equity exposure. Australian equity stock selection was also not immune from this and also detracted from performance. Credit markets remained remarkably resilient with spreads trading within a relatively narrow range in most markets. From a performance perspective, our broader defensive positioning has put us in good stead to weather increased uncertainty.

On 1 October the first of the Schroder Real Return funds will be 10 years old. When it launched, we were in the eye of the GFC storm. Market volatility was extreme, liquidity had collapsed and investor confidence had been decimated. 10 years later and you could be excused for wondering what all the fuss was about. Market volatility is low, central banks continue to provide liquidity, and investor confidence – particularly with respect to US stocks – is high. We’re certainly scratching our heads, wondering when the bull market will end. In another 10 years it will all be clear, but right now we can only guess … and stick to process. I’ll come back to this point later …

When we launched the original Real Return fund 10 years ago, our aim was to reshape the way we thought about, and constructed portfolios. Our primary goal was to shift focus away from trying to “add value” against a strategic asset allocation (SAA), and instead focus purely on constructing a portfolio to achieve our clients’ objectives - typically defined as a decent “real” rate of return, moderate volatility and preserving their capital in times of significant drawdown. We wanted investors, irrespective of when their investment commenced and/or the timing of their cash-flows along the way to get a similar experience, aligned with these relatively simple, fundamental objectives. It is an old investment saying, but you can’t “eat” relative returns and the GFC was a great reminder. What we owned and when we owned it was key.

We also knew this task would not be easy. We were challenging convention and had nowhere to hide. Unlike typical asset allocation frameworks where the SAA is the benchmark (or in single asset class portfolios where there is a benchmark portfolio), there is no “neutral” or “risk-free” portfolio we can default to that will deliver us our objective. “ALL” decisions would in effect be “active” decisions and require a necessary trade-off between potential returns and the risk of being wrong. A forward looking and unconstrained framework was risky and even if we achieved our objectives there would always be an opportunity cost as on any given day, by definition, something would be performing better than the portfolio (equities in a bull market, bonds in a bear market).

We were though sure of 2 things: the investment process would be critical to the achievement of our objectives over the long term, and, that we would inevitably make mistakes and learn a lot along the way.

10 years down the track and my belief in the importance of process has been reinforced. That’s not to say our process has been perfect. It certainly hasn’t predicted every wobble (or lack thereof) in markets and more recently it has steered us away from risk assets too early. But, it has provided us with a roadmap by allowing us to systematically process and interpret information in a way that aligns with our investment beliefs, ensuring we’re at least heading broadly in the right direction. It’s also helped our clients understand what we do and how we’re responding to different environments. Perhaps most significantly, it’s also helped us more clearly identify where we need to improve.

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*	0.26	1.30	1.24	3.43	-	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.35	1.72	1.45	4.81	4.18	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

On this point, the biggest challenge we've had has been in reconciling deteriorating asset valuations with the deep and seemingly limitless pockets of central banks. Our valuation focus has caused us to lean against risk in most assets while the challenge of assessing output gaps (and hence inflation risks) has made it difficult to identify the triggers to which policy makers would need to respond. Growth, in the absence of inflation has allowed the party to roll on. At the same time the collapse in volatility significantly tempered (temporarily) the contribution active asset allocation could make. Volatility creates opportunity and over the last couple of years there hasn't been too much of this.

But, the cracks are appearing. Seemingly bullet proof assets (like Sydney house prices) are falling and while volatility may still be exceptionally low in the US equity market (as it records its' longest "bull market") other markets are finding the going tough. For example, emerging market equities (in USD terms) are down around -20% from their January highs, the Australian dollar is down -12%, and the Facebook share price is down -25% from its highs. Who would have thought?

This proves nothing other than what goes up can come down, particularly if it disconnects from fundamentals. That said, we are in the later stage of this market cycle. While the US economy is doing well, the fact that US inflation and wages are now rising means it is overheating. Monetary policy will need to continue responding. This plus the economic policy uncertainty presented by President Trump, particularly with regards to the highly political tariff war with China (amongst others) is a significant contributor to rising instability outside the US.

While we can't go back in time and add risk to capture past gains, the flip-side of shedding risk (even if too early), is that it does leave us relatively well positioned should these trends broaden. Likewise, the realignment of monetary policy and key currencies are important return opportunities for us in the near term. Asset allocation is back (not that it really ever went away), but if market conditions are starting to turn, then the assets we own and how much of them will be the critical decision once again (just as it was before, during and after the GFC).

It is true to say that investors in recent years would have achieved higher returns in balanced funds than via an objective based approach like ours – given the strength and persistence of (primarily) the US equity bull market. Our own Schroder Balanced Fund has for example delivered higher returns over the last 3 & 5 years than the original Real Return fund (CPI+5%). The odds of this persisting though are lengthening. While history doesn't repeat – it does rhyme and with risk pricing distorted (just as it was in 2006 & 2007), the arguments in favour of a more flexible approach are strong.

Fund details

ASX Code	GROW
Fund size (AUD)	$55,645,993
ASX Quoted Price	$3.6629
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 August 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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