Schroder Real Return Fund
ASX: GROW

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

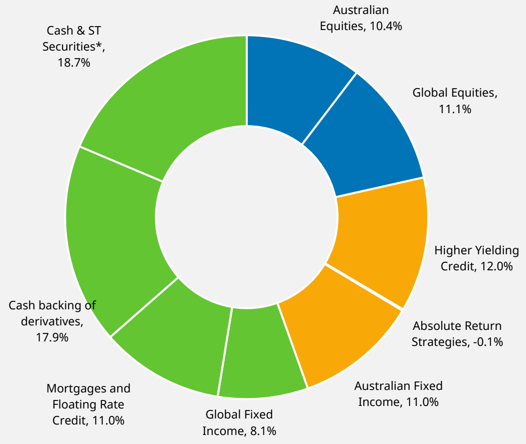
Monthly Report - October 2018 — For more information about the Fund visit www.schroders.com.au/grow

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)	-1.59	-0.53	2.84	-	-	4.61
Schroder Real Return Fund (Managed Fund) (post-fee)*	-1.66	-0.75	1.93	-	-	3.67

Portfolio inception 09/08/2016, 2 years and 2 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 September 2018	
3 months	0.37%
1 year	1.82%
3 years. p.a.	1.77%
5 years. p.a.	1.98%

*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 October 2018.

Portfolio overview

The Schroder Real Return Fund (ASX: GROW) returned -1.6% (pre-fee) in October, leaving the 1 year return at 2.84% (pre-fee). While above inflation, this return is below the strategy's medium-term return objective. October was a volatile month and for context, Australian equities fell -6.1% during the month to be up just 2.9% over the equivalent 12month period. Strategy volatility remains low and we would consider the October drawdown consistent with our downside risk objectives.

Market review

October is known for market crashes and last month lived up to its reputation, with sharp falls in equity markets. The month began with rising US bond yields and growing fears around trade, with President Trump threatening to add tariffs on the remaining Chinese imports not already covered, and tentative signs the tariffs were impacting on the US economy. This uncertainty led to falls in equity markets, with the worst intra-month volatility since 2008. Unlike recent experience, markets weren't saved by the US earnings season, which saw the best growth since late 2010 and was overall generally better than expected. However, some notable misses saw Tech stocks perform poorly relative to the rest of the market. Another interesting theme from the month was the poor performance from markets that generally perform will during market chaos, the most notable being US Treasury Bonds which ended the month with higher yields.

While a bounce back in the last few days of October limited the losses from equity markets, global equities ended the month with a -6.8% return. The Australian equity market was also a sea of red with a -6.1% return. Government bond yields in major markets were mixed over the month, with US 10-year government bond yields increasing by 0.08% in October to end the month at 3.14%, while German government bond yields fell 0.09%, and Japanese bond yields were unchanged. Australian bonds fell marginally ending the month 0.04% lower at 2.63%. Unsurprisingly credit markets posted negative returns, given the falls in equity markets. What was surprising was that the falls were relatively muted given the extent of the equity market damage.

Largest contributors

The drag from weak equity markets was hard to avoid in October. That said, our relatively modest equity weighting helped limit the downside, while currency (USD & JPY), cash and duration produced positive returns overall.

Largest detractors

Equities were the main detractor over the month of October accounting for most of the negative returns. Our exposures to both investment grade credit and high yield also detracted but only to a relatively modest extent versus equities.

Portfolio activity and key themes

Having cut equity exposure to around 11% in the September quarter, the Real Return fund was well positioned for the sharp falls in equity markets through October. Our concerns reflected a long list of factors including: stretched valuations (especially in the US), rising trade tensions (tariffs) and the impact this would have on supply chains, the impact of the impending US mid-term elections, growing evidence in support of rising US inflation (and the Fed's likely response), concern that the US earnings season might not match lofty expectations and/or provide some evidence that margins were starting to be impacted by higher wage costs, and the likelihood that US growth had peaked.

Our base case is that this correction will provide an opportunity to add back some risk (tactically) as we believe that recession risk in the US is still a late 2019 or 2020 story and the odds of this haven't really changed. That said, we have remained on the sidelines as most of the factors outlined above are still playing out, and, from a technical perspective, we haven't seen either a broadening out of the sell-off (into other assets) or "capitulation" that typically presents a clear re-entry point. We think it's possible (even likely) that there's more weakness to come. We're holding off buying for now.

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*	-0.70	-0.19	0.40	1.97	-	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	-1.60	-0.89	-0.11	1.84	3.71	SCH11

*Both funds on offer are unlisted. An application into these funds may be made through an application form attached with the Product Disclosure Statement, 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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Portfolio activity and key themes continued

Outside this, key thematic positions in the portfolio remain focused on the impact of rising US inflation, narrow risk premiu m across most risk assets, currency realignment and balancing carry against risk. The US inflation thematic is playing out with increasing evidence to support our thesis. Th e October payroll numbers, particularly the evidence of rising wages support this idea. Rising inflation challenges the notion of the long -held view of the "Fed put", with the Fed now having less flexibility to reverse its tightening course should markets waiver. Its replacement may well be the "Trump put" given the link Trump has made between th e health of the US equity market and the quality of his Presidency. Whether this be in the form of a trade deal with China or further fiscal stimulus (more tax cuts a nd/or infrastructure spending), it is likely that all options will be considered should October trends prevail. That said, further fiscal stimulus on top of an already overheating economy would force the Fed's hand into more aggressive rate rises.

Policy mistakes are usually the root cause of recessions and we see the next recession as being no exception. This will ensur e an interesting end to the cycle and one that investors may need to strap themselves in for. As this cycle moves closer to the end, volatility is sure to pick up and while we expect this volatility to bring some opportunities, we don't want to lose sight of the bigger picture story that we are closer to the end than the beginning.

Market outlook

Equity

Equity declines were broad based in October with declines in the order of -5% to -10% for the major markets. With the exception of the US, calendar year returns to the end of October are firmly in the red. The US is only marginally positive. We remain cautious on equities near -term but do not believe this is the start of the bear market, but rather more evidence that the current bull market is nearing its end. We are looking for a re -entry point but would see this as a tactical buying opportunity only. While the US is setting the current tone, it remains our least preferred equity market in a medium -term context given its structural overvaluation and overheating economy. Our preferred markets remain Australia and Japan given their relative cheapness. Emerging markets are starting to look a little more intere sting but we would prefer to see more evidence of capitulation (and more attractive valuations) and / or a peak in the USD before buying. We are continuing to avoid REITs g iven their vulnerability to rising inflation and bond yields.

Fixed Income

Sovereign yields remained relatively removed from the carnage in equity markets in October, suggesting that part of the chall enge for equity markets was them coming to grips with rising inflation and higher bond yields. The US is leading the way here and we expect that pressure from an overhe ating economy and the tightening labour market to continue to exert pressure. While our US breakeven inflation trades underperformed in October, we continue to believe they are a good hedge against rising inflation in the portfolio.

Credit also remained relatively unaffected by equity weakness, which was somewhat unusual as credit often leads turning point s in the economy and in risk assets. This was particularly the case in high yield, with spreads moving only modestly wider during the month. In the absence of a bigger wid ening, we are not inclined to add to credit risk at this time as credit spreads remain relatively narrow, meaning limited upside to credit returns. That said, in the absence of an imminent major economic downturn, credit still offers a good trade-off between being cautious on risk and maximising risk adjusted returns.

Currency

Currencies were mixed in October, with a slightly weaker AUD and a stronger JPY offsetting weakness in equities. That said wi th the AUD already down -12% from its January peak, the mitigating effects on declining risk assets were more muted than normal. We remain bearish on the AUD over the medi um term. The JPY remains a good risk mitigating option. GBP looks cheap but continues to be battered by Brexit uncertainty.

Fund details

ASX Code	GROW
Fund size (AUD)	$53,303,429
ASX Quoted Price	$3.6132
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 October 2018

Investment style

Our approach to inflation plus (or real return) investing is to choose the portfolio that we believe 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 premia, and consequently, the asset allocation of the portfolio are constantly reviewed. The portfolio will reflect those assets that in combination we consider 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

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