Schroder Real Return Fund
ASX: GROW

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

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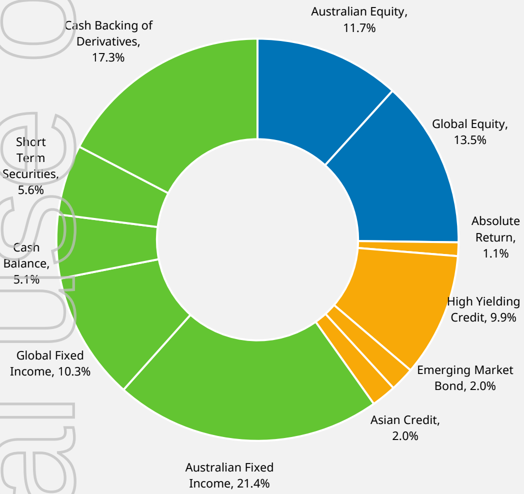
Monthly Report - November 2019 — **For more information about the Fund visit www.schroders.com.au/grow**

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)	0.99	1.45	9.05	5.63		5.56
Schroder Real Return Fund (Managed Fund) (post-fee)*	0.92	1.22	8.07	4.68		4.62

Portfolio inception 09/08/2016

Past performance is not a reliable indicator of future performance. Returns over 12 months are annualised

Asset allocation



Fund objective

To achieve a return of CPI plus 5% p.a. before fees over rolling 3 year periods while minimising the incidence and size of negative returns in doing so. CPI is defined as the RBA's Trimmed Mean, as published by the Australian Bureau of Statistics.

RBA CPI Trimmed Mean* as at 30 September 2019

3 months	0.38%
6 months	0.82%
1 year	1.55%
3 years. p.a.	1.68%

*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 November 2019

Portfolio overview

The Schroder Real Return Fund (ASX: GROW) returned 0.92% (post fees) in November, taking the return for the year to November to 8.23%. The 1-year return is now well above our target of real 5%, however the 3-year return is still lagging its objective due mainly to the tough environment for most asset classes in 2018. Volatility and downside risk remain low and consistent with the strategy's objectives.

Largest contributors

November was a strong month for most asset classes. This saw positive contributions to returns across the board. Equity positioning provided the largest contribution to performance, split relatively evenly between Australian and global. The strategy's currency holdings added to performance, with the Australian dollar falling over the month. Our exposure to foreign currency added value. With Australian bond yields falling, the strategy's exposure to this asset class also added to performance.

Largest detractors

With most asset classes posting positive performances in November, there were very few negative contributors in the month. While cash holdings contributed positively to overall returns, in a strong market environment like November, even stronger returns could have been achieved had this cash been invested elsewhere.

Market Outlook

The end of November saw the MSCI All Countries World Index a hair's breath away from its January 2018 peak and the S&P 500 pushed on to reach new all-time highs. At the same time, the narrative over the past few months has been of manufacturing recessions, inverted yield curves and lofty corporate profit expectations. How can equities continue to rise with this negative backdrop? One side of the debate has focused on how a weak manufacturing sector will ultimately lead to retrenchment and pull the consumer down, pushing the economy into recession, whereas the other side suggests supply lines will ultimately be rerouted and the eventual depletion of inventories would lead to restocking causing manufacturing to catch up to strong consumption allowing the cycle to continue. We are now entering the phase where we will find out which of these two occurs.

Our thesis for last year was that the trade war's economic impact would be greater than expected. While we didn't disagree with the medium-term impacts being modest, we thought the short-term impact would be more acute, due to the impact on corporate confidence from the increase in uncertainty and impact of re-jigging supply lines. We also believed that given the strong political momentum behind the trade war, it would cause equity markets to riot to bring both sides back to the negotiation table. This eventually played out, helped in some part with thin liquidity into year-end 2018, causing the S&P 500 to fall over 9% in December alone. We used this as a buying opportunity and adding back to risk assets.

However, as 2019 rolled on, we took risk back off the table as valuations returned to being stretched and our corporate profit model indicated EPS growth below zero, while analysts were still anticipating 8% growth. Trade wars re-escalated at a worrying pace, manufacturing continued to weaken globally, and liquidity once again became a problem as the US Treasury planned to rebuild its reserves at the Fed by $400bn, placing great strain on the USD funding market.

A turning point occurred in September, when after the repo crisis where overnight repo rates jumped from below 2% to 10% intra-day, the Fed stepped in and provided significant liquidity. To put the liquidity injection into context, the 9 months of balance sheet reduction throughout 2019 was reversed in a mere 8 weeks. That was the fastest rate of change since the depths of the GFC. This influx of liquidity has helped calm markets during seasonally challenging liquidity periods and should help prevent a similar liquidity crunch that we experienced in December 2018.

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*	0.65	0.97	2.79	6.68	3.83	SCH12
Schroder Real Return CPI Plus 5% Fund Wholesale*	0.89	1.51	3.37	8.09	4.59	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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Market Outlook continued

Another positive turn occurred in November, when global manufacturing Purchasing Manager Indices (PMIs) returned above 50 for the first time since May. Global manufacturing PMIs bottomed in July, 18 months after the peak in 2017 which is the typical lifecycle for manufacturing slowdowns. This change, combined with tightening of credit spreads amongst other factors, saw our global profit model tick up. So far this indicates that manufacturing has the capacity to catch up to strong consumption and tight liquidity constraints have been removed, at least for now.

This pivot back towards liquidity provision from central banks has the potential to continue to underwrite risk seeking behaviour and extend the cycle even further, paving over the slowdown in manufacturing created by the trade war. However, the economy remains late cycle and structural pressures continue to build. Valuation measures both structurally and cyclically has resulted in our return forecasts being materially lower than forecasts 3-years ago, and clearly lower than returns delivered over the last 3-years. With these subdued return expectations, dynamic asset allocation becomes more important in delivering to an objective based outcome

While we still wait to see confirmation of many of these signals, we are taking this improvement in our cyclical and liquidity outlook to participate more in the potential shorter-term risk rally by investing an additional % into equities and 3% to diversifying assets. However, this should be taken into consideration with our overall positioning which still remains conservative at 25% growth and with interest rate duration of 2.1 years at the fund level. We believe volatility will likely remain and the potential for a recession is a key risk, as it would quickly remove the earnings support that markets will require to continue to edge higher. We therefore continue to focus on limiting volatility and drawdown, while keeping an eye on recession risk and the outlook for corporate profits.

Equity

November continued the positive trend of 2019 with equity market rising over the month, as signs of progress towards a "phase one" trade deal between the US and China boosted sentiment. Developed markets outperformed emerging markets, with the US equity market the best performing major market over the month.

We have retained our relatively cautious view on equities. However, in the month we did add to the strategy's exposure, taking the equity position to 25% from 20%. While valuations are problematic and expected returns over the next three years are expected to be muted, the change reflects the US Federal Reserve's addition of liquidity into the system post the Repo market disfunction.

Within equities our preferred markets are Australia and Japan, while we continue to lean against "growth" as a style factor given its stellar outperformance and increasing disconnect with fundamentals.

Fixed Income

Improving sentiment had a negative effect on global bond markets, seeing rising government bond yields across the major economies and negative returns from government bond indices. In contrast, Australian government bond yield fell, supported by continued softness in the Australian economy.

We remain attracted to duration and are currently positioned with around 2.1 years of duration in aggregate in the portfolio. Over the medium term we do expect rates to move lower, and, if the downside risks to growth unfold, we would expect duration to be an important contributor to total returns.

With respect to credit we maintain a neutral stance in the investment grade space, particularly in Australia where the high quality of the sector provides some low risk carry. We are a bit more cautious further down the credit curve. However, in line with equities, we added to our credit exposure in November. We added 1% to global high yield and added some more diversity into our credit holding with a 2% allocation to Emerging Market corporate debt.

Currency

We believe that one of the main motivators for the RBA in cutting rates is to continue to keep the AUD as weak as possible. This should be helped by it being still fair value / slightly expensive on our valuation screens. The AUD softened in November, in line with the weaker Australian economy. We continue to hold our GBP positioning, on the basis that the risk of a hard Brexit would appear to have abated, and valuations suggest that a relatively negative outcome is priced into markets.

Fund details

ASX Code	GROW
Fund size (AUD)	$52,806,135
ASX Quoted Price	$3.7411
Fund inception date	August-2016
Management costs	0.98%
Distribution frequency	Normally twice yearly - June and December

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.

Unless otherwise stated figures are as at the end of November 2019

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