Schroders

April 2019

Schroder Real Return CPI Plus 5% Fund Wholesale Class
Monthly Report

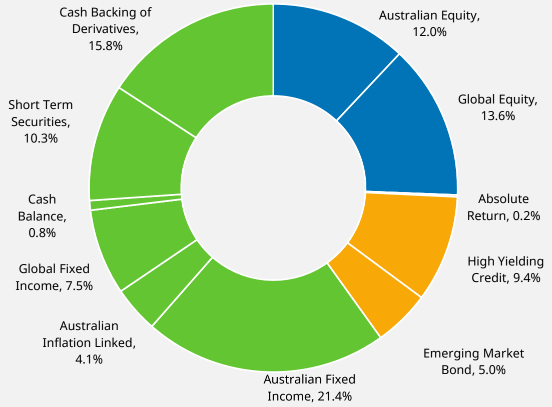
Total return %

	1 mth	3 mths	1 yr	3 yrs p.a.	5 yrs p.a.	Inception p.a.
Schroder Real Return CPI Plus 5% Fund (pre-fee)	1.46	3.87	4.66	5.77	5.39	6.92
Schroder Real Return CPI Plus 5% Fund (post-fee)	1.39	3.64	3.72	4.83	4.45	5.97
Distribution^	0.00	0.00	3.50	4.61	4.73	4.38
Growth^^	1.39	3.64	0.22	0.22	-0.28	1.59

Portfolio inception 01/07/2010, 8 years and 10 months

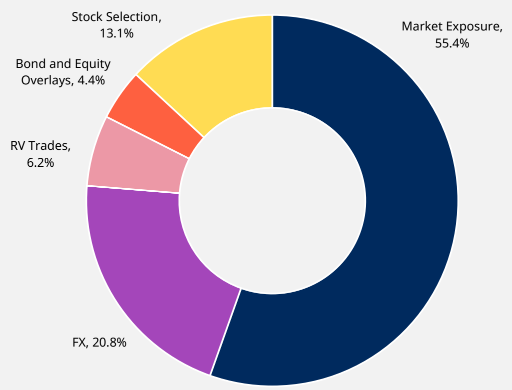
Past performance is not a reliable indicator of future performance. Returns over 12 months are annualised.

Asset allocation - Capital Weights



* Includes floating rate notes, term deposits, negotiable certificate of deposits, cash and other cash equivalents.

Asset allocation - Risk Weights



RBA CPI Trimmed Mean* as at 31 March 2019

3 months	0.28%
1 year	1.60%
3 years. p.a.	1.71%
5 years. p.a.	1.84%
Since Inception	2.07%

*The RBA CPI Trimmed mean returns are published quarterly by the ABS. Historical returns may be subject to revisions.

^ Represents distributions as a proportion of total net return
^^ Price to price return excluding distribution reinvestments
Portfolio refers to the Schroder Real Return CPI Plus 5% Fund Wholesale Class

Unless otherwise stated figures are as at the end of April 2019
Numbers may not total to 100 due to rounding
* Inception date of the Schroder Real Return CPI Plus 5% Strategy is 1 October 2008, as represented by the Schroder Real Return CPI Plus 5% Fund - Professional Class

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.

Portfolio review

The Schroder Real Return CPI+5% Fund returned 1.4% (post fees) in April, continuing the strong start to 2019. This saw the one-year return to April at 3.7% (post fees). The positive April outcome largely reflected the strategy's equity exposure, with equity market posting strong returns. Our absolute return strategies also had a good month, adding significantly to returns. The strategy's exposure to higher yielding credit and investment grade bonds rounded out the month, also positively adding to performance.

Market Review

After healthy returns in the first quarter, risk assets continued to rally in April. Equity markets posted strong gains while higher yielding credit also posted solid returns due to better than expected economic data in both China and the US, expectations that central banks will remain accommodative, and anticipation of a positive resolution to the US-China trade talks. Business surveys suggested a bounce in manufacturing activity in the US and China, and given the consensus was for further weakness, this was a positive surprise. While activity data recovered somewhat, inflation data remained benign, with the US Federal Reserve (Fed) expected to ease policy when it next moves the cash rate. In Australia, a lower than expected inflation figure saw speculation around the Reserve Bank of Australia cutting the cash rate.

Global equities returned 3.8% in local currency, while the Australian market also posted a solid rise of 2.4% over the month. Continental European equities were the standout in April, with some individual markets posting high single digit returns; for example, the German market (Dax) saw a 7.1% return in the month. China A shares, which were the global standout in the first quarter, disappointed in April with a small negative return. Within Australia, cyclical, financial and IT sectors performed strongly, while defensive sectors, health care, and REITs underperformed. Global government bond yields rose in April, with 10-year yields in the US rising by 0.10% to end April at 2.50%. 10-year yields also rose in other markets, rising by 0.08% in Germany and 0.04% in Japan. In Australia, 10-year yields followed a similar pattern, rising by 0.01% to end the month at 1.79%, with the rise limited by the soft inflation report. Credit markets, particularly high yield credit, had a solid month in April.

Largest Contributors

From a total return perspective, the key driver in April was the strong performance of equity markets. However, a significant positive contribution also came from absolute return strategies, with positive returns from our S&P calls, our short A-REIT relative to the broader market, and long US breakeven inflation positions. Positive contributions also came from our debt positions, with higher yielding and investment grade corporate bonds posting positive outcomes.

Largest Detractors

April was a hard month to find any detractors. Given the strength in equity markets, and the defensive positioning of the strategy, the futures overlays on equity positions, which are used to modestly lower the fund's equity exposure, meant that some return was left on the table.

Portfolio activity and key themes

For all the articles on yield curve inversion last month, there was little fanfare in the press when the curve managed to steepen back into positive territory in April. Perhaps we didn't need to be told as market performance reacted accordingly, with risk assets continuing their advance while bonds took a breather. While hovering a mere 10bps above inversion (as measured by US 10-year bond yield minus the 3-month bill rate) is hardly a comfortable margin of safety, it does help elevate some of the recession rhetoric until more economic data is released.

Typical inversions before a recession tend to be measured in months, not days. The yield curve remained inverted for at least six to 12 consecutive months prior to past recessions, whereas the most recent inversion lasted a week. The magnitude of the inversion is also a determining factor, with the maximum inversion over 50bps in early 2007 and almost 1% at the start of 2001 making the most recent 5bp inversion seem paltry. There is also the choice of yield curve. The US 10-year bond yield minus the 2-year bond yield inverted ahead of the 10yr-3m curve in the past two recessions, but has remained positive (and improving) throughout 2019.

However, this doesn't mean recession risks should be ignored altogether. The Fed's near-term forward spread, which was proposed in June 2018 as a more accurate predictor of recessions, has remained negative since the start of March. Components of our ROC Recession Model are starting to flash red, however continue to cluster to indicators that lead a recession by 12-24 months. We therefore still believe the probability of a recession is rising, but more a 2020 story or beyond.

Now this does not mean that it is time to reach blindly for risk. An economic recession and a profit recession can differ in timing and magnitude, along with the severity of the market's reaction. Increasing wage pressure and lack of price inflation is expected to lead to a margin squeeze for US corporates. With US equities making a new high at the end of April, we need to see continued earnings growth to alleviate this fear and justify the recent rally. Analysts have been cutting US earnings forecasts YTD and downgrading 2019 EPS.

Schroder Real Return CPI Plus 5% Fund Wholesale Class

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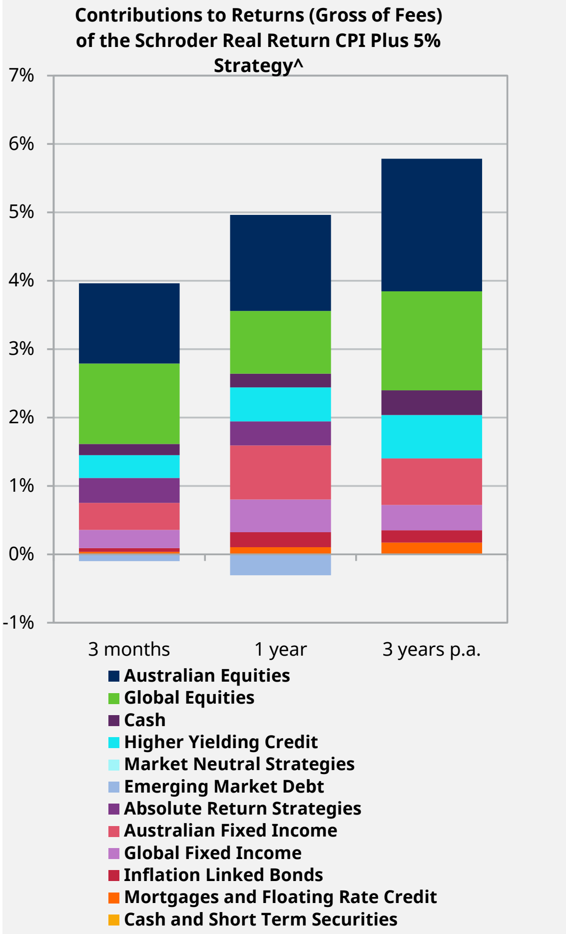
Performance



Fund details

APIR code	SCH0047AU
Fund size (AUD)	$1,906,433,296
Redemption unit price	$1.1468
Fund inception date	July-2010
Buy / sell spread	0.20%/0.20%
Management costs	0.90%
Minimum initial investment	$20,000
Distribution frequency	Normally twice yearly - June and December

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

^Strategy relates to the Schroder Real Return CPI Plus 5% Fund Professional Class

Portfolio activity and key themes continued

Early results for the current US earnings season show earnings are currently above forecasts, but this is usually the case as companies successfully manage expectations and is probably not enough to trigger significant upgrades. Our earnings revision momentum model remains a negative outlook supporting this concern, however this measure looks to be rebounding from very low levels, at the end of Feb, potentially indicating that revisions may be bottoming.

To help boost demand and extend the cycle, we need to see rate cuts from the Fed or a boost in global growth. While the recent Fed pause was taken positively, until the Fed cuts, a pause can still be viewed as restrictive policy, especially if growth continues to weaken, dragging down the neutral rate with it. Global growth on the other hand is starting to show some signs of life. The Chinese economy appeared to be stabilising sooner than expected in April, with GDP coming in at 6.4% year on year. M2 credit growth rebounded to 8.6% YoY and total social financing bounced to 10.7%, which could help boost global growth in the second half of the year. However, most gains in credit growth appeared to come from regional banks lending to local governments, which some have chastised as a cover to help avoid defaults on local government financing vehicles as opposed to a new boost in infrastructure. Another positive note has been the strong rebound in German auto sales, as the backlog from the emissions scandal starts to clear. Whether this is enough to boost Eurozone growth, particularly given the potential for a new EU-US trade war, remains to be seen.

Therefore, we believe we are at a crossroad where global economic headwinds may turn into temporary tailwinds, but stretched equity valuations and the potential for a recession on the horizon lead us to remain cautious until further improvements are observed. We believe that until global growth or business sentiment improves, markets may face another bout of volatility, as the tension between high equity valuations and the potential for murky or disappointing data plays out. Rather than taking a strong directional view, we prefer to build in positive convexity into the portfolio. We remain conservatively positioned in growth assets but continue to hedge upside risk via US equity call options, to help participate in any further rally in risk assets.

Market Outlook

Equity

Equities continued with their strong rally, with MSCI ACWI delivering over 16% YTD in both AUD and USD terms. Developed markets took the lead in April, with Japan, Europe and the US delivering the strongest performance between 3-5% in local terms. Emerging markets returned a more subdued but still impressive 2%, with China taking a breather delivering less than 1% in USD terms. Developed market growth appears to be bottoming, whereas EM ex China growth continues to slow, despite recent surprises in China data. Chinese stimulus remained measured and targeted towards Chinese consumption, so less likely to result in a broad improvement across EM ex Asia as in the past.

After strong performance, we closed out half of our US equity market call options which were set to expire in April. We still maintain 2.5% notional exposure and look to potentially add back if pricing improves. We are using call options given the uncertainty in the outlook, which will allow us to participate in any market upside, by minimising any losses if equity markets start to weaken. Overall, we still remain relatively defensive with our base case another bout of volatility.

We still prefer markets such as Japan and Australia where valuations are more attractive, unlike the US where we expect negative returns over the next three years. Within emerging markets, we prefer Asia ex Japan, where our three-year expected return remains attractive. China stimulus and improving credit impulse should help buoy China and broader Asia. Rebounding PMIs in Taiwan and South Korea are pointing to a potential bottoming in the trade/tech cycle, which should further benefit the region.

Fixed Income

Sovereign yields backed up after a strong March, with the US 10-year moving from 2.4% to a high of 2.6% in late April, before ending the month at 2.5%. Australian government bonds followed a similar pattern, however weaker than expected CPI data at the end of April pushed yields back down to their March close.

Credit fared much better thanks to continued spread compression, with US and Australian investment grade delivering almost 0.6% and US HY delivering 1.4% in local price terms over the month.

We continue to hold sovereign and investment grade bonds to help increase the yield of the fund but also provide downside protection during growth shocks. We maintain our allocation to high yield assets at present. While valuations are less attractive, we believe the removal of tightening from the Fed along with still low probability of default should help keep a lid on spreads for the near term, allowing us to earn a similar expected return to risk assets but with reduced relative volatility.

Currency

The US dollar index rose modestly over the month, mainly pushed by strong declines in the SEK and CHF. EUR and GBP were mostly flat, whereas the JPY depreciated around 0.5% versus the USD. Emerging market currencies were also flat, with the JP Morgan EMCI index delivering -0.13%. The AUD fell almost 0.7% against the dollar, after it fell towards US$0.70 due to the weaker than expected CPI print, causing the market to price in a higher likelihood of an RBA cut.

The recent Brexit extension removed the short-term risk of the UK crashing out of the Eurozone in March, so we sold the GBP put options we were using to cover our GBP holding. We continue to favour the GBP on valuation grounds, but hold a small position given the likelihood of continued volatility.

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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.

Schroders

Schroders: A dynamic approach to investing

Annual returns for a range of asset classes ranked by performance

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EM Equities 55.3%	A-REITs 20.0%	A-REITs 15.0%	A-REITs 12.0%	Gbl High Yield 33.1%	A-REITs 30.4%	EM Equities 43.0%	A-REITs 33.0%	EM Equities 25.6%	Aust FI 14.9%	Gbl High Yield 61.1%	Gbl High Yield 19.9%	Aust FI 11.4%	A-REITs 33%	Gbl Equities 49.3%	A-REITs 26.6%	A-REITs 14.3%	Gbl High Yield 16.8%	EM Equities 27.1%	Aust FI 4.5%
Aust Equities 18.7%	Aust FI 12.0%	Aust Equities 10.4%	Intl FI 11.6%	EM Equities 16.9%	Aust Equities 28.0%	Aust Equities 22.8%	Aust Equities 24.2%	Aust Equities 16.1%	Aust Credit 10.7%	EM Equities 39.2%	Intl FI 9.3%	Intl FI 10.5%	Gbl High Yield 23.1%	Aust Equities 20.2%	Gbl Equities 15.6%	Gbl Equities 11.8%	A-REITs 13.2%	Gbl Equities 13.4%	Aust Credit 3.9%
Gbl Equities 17.1%	Aust Credit 11.1%	Intl FI 8.3%	Aust FI 8.8%	Aust Equities 14.6%	EM Equities 21.4%	Gbl Equities 16.8%	EM Equities 23.4%	Cash 6.8%	Intl FI 9.2%	Aust Equities 37.0%	Aust Credit 7.1%	Aust Credit 9.1%	Aust Equities 20.3%	EM Equities 13.8%	Intl FI 10.4%	Intl FI 3.3%	Aust Equities 11.8%	Aus Equities 11.8%	A-REITs 2.9%
Gbl High Yield 6.6%	Intl FI 9.7%	Aust Credit 6.7%	Aust Credit 7.8%	A-REITs 8.9%	Gbl High Yield 16.1%	A-REITs 12.5%	Gbl High Yield 12.9%	Intl FI 6.6%	Cash 7.6%	A-REITs 9.2%	Aust FI 6.0%	Gbl High Yield 7.4%	EM Equities 17.0%	Gbl High Yield 9.0%	Aust FI 9.8%	Aust Credit 3.0%	EM Equities 11.7%	Gbl High Yield 9.0%	Cash 1.9%
Cash 5.0%	Aust Equities 6.4%	Gbl High Yield 6.2%	Gbl High Yield 5.0%	Intl FI 6.6%	Gbl Equities 10.7%	Gbl High Yield 7.9%	Gbl Equities 12.1%	Aust FI 3.5%	Inflation 3.7%	Intl FI 8.0%	EM Equities 5.7%	Cash 5.0%	Gbl Equities 14.7%	A-REITs 7.3%	Aust Credit 8.1%	Aust FI 2.6%	Gbl Equities 7.9%	A-REITs 5.7%	Inflation 1.8%
Inflation 1.9%	Cash 6.2%	EM Equities 6.1%	Cash 4.8%	Cash 4.9%	Intl FI 8.9%	Intl FI 6.6%	Cash 6.0%	Aust Credit 3.2%	Gbl Equities -24.6%	Aust Credit 6.1%	Cash 4.7%	Inflation 3.0%	Aust Credit 9.9%	Aust Credit 4.3%	EM Equities 7.3%	Aust Equities 2.6%	Intl FI 5.2%	Aust Credit 5.1%	Intl FI 1.6%
Aust Credit 0.8%	Inflation 5.8%	Aust FI 5.5%	Inflation 2.9%	Aust Credit 3.7%	Aust Credit 7.1%	Aust Credit 6.0%	Intl FI 4.4%	Gbl High Yield 2.9%	Gbl High Yield -27.6%	Cash 3.5%	Inflation 2.8%	A-REITs -1.1%	Intl FI 9.7%	Cash 2.9%	Aust Equities 5.6%	Cash 2.3%	Aust Credit 3.8%	Aust FI 3.7%	Gbl Equities 1.5%
Intl FI 0.3%	Gbl Equities 2.7%	Cash 5.3%	Aust Equities -8.8%	Aust FI 3.0%	Aust FI 7.0%	Aust FI 5.8%	Aust Credit 3.9%	Inflation 2.9%	Aust Equities -38.4%	Inflation 2.1%	Aust Equities 1.6%	Gbl Equities -6.0%	Aust FI 7.7%	Inflation 2.7%	Gbl High Yield 4.8%	Inflation 1.7%	Aust FI 2.9%	Intl FI 3.7%	Aus Equities -2.8%
Aust FI -1.2%	Gbl High Yield 0.4%	Inflation 3.1%	EM Equities -14.5%	Inflation 2.4%	Cash 5.6%	Cash 5.7%	Inflation 3.3%	Gbl Equities -2.1%	EM Equities -41.2%	Aust FI 1.7%	A-REITs -0.3%	Aust Equities -10.5%	Cash 4.0%	Intl FI 2.3%	Cash 2.7%	Gbl High Yield 1.3%	Cash 2.1%	Inflation 1.9%	Gbl High Yield -3.0%
A-REITs -5.6%	EM Equities -18.1%	Gbl Equities -9.6%	Gbl Equities -27.1%	Gbl Equities -0.2%	Inflation 2.5%	Inflation 2.8%	Aust FI 3.1%	A-REITs -8.5%	A-REITs -55.7%	Gbl Equities 0.7%	Gbl Equities -0.4%	EM Equities -19.2%	Inflation 2.2%	Aust FI 2.0%	Inflation 1.7%	EM Equities -4.3%	Inflation 1.5%	Cash 1.7%	EM Equities -5.1%

- **Australian Property Trusts** – S&P/ASX 200 A-REIT
- **Australian Equities** – S&P/ASX 200
- **Global Equities** – MSCI World ex Australia A$ Unhedged
- **Emerging Market Equities** – MSCI Emerging Markets A$ Unhedged
- **Global High Yield** – Barclays Global High Yield Index A$ Hedged Index*
- **Australian Credit** – Bloomberg AusBond Credit 0+ Yr Index
- **International Fixed Income** – Barclays Global Aggregate A$ Hedged
- **Australian Fixed Income** – Bloomberg AusBond Composite 0+ Yr Index
- **Cash** – Bloomberg AusBond Bank Bill Index
- **Inflation** – ABS Consumer Price Index

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*Index commenced in 2002. Prior to this annual returns are reported using the Barclays Global High Yield Index plus FX hedging sourced from Thomson Reuters.

Source: *Datastream, 12 months to 31 December (1999-2018)*

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