Schroders

Queensland Regional Roadshow 2019

Matthew Leung – Account Manager

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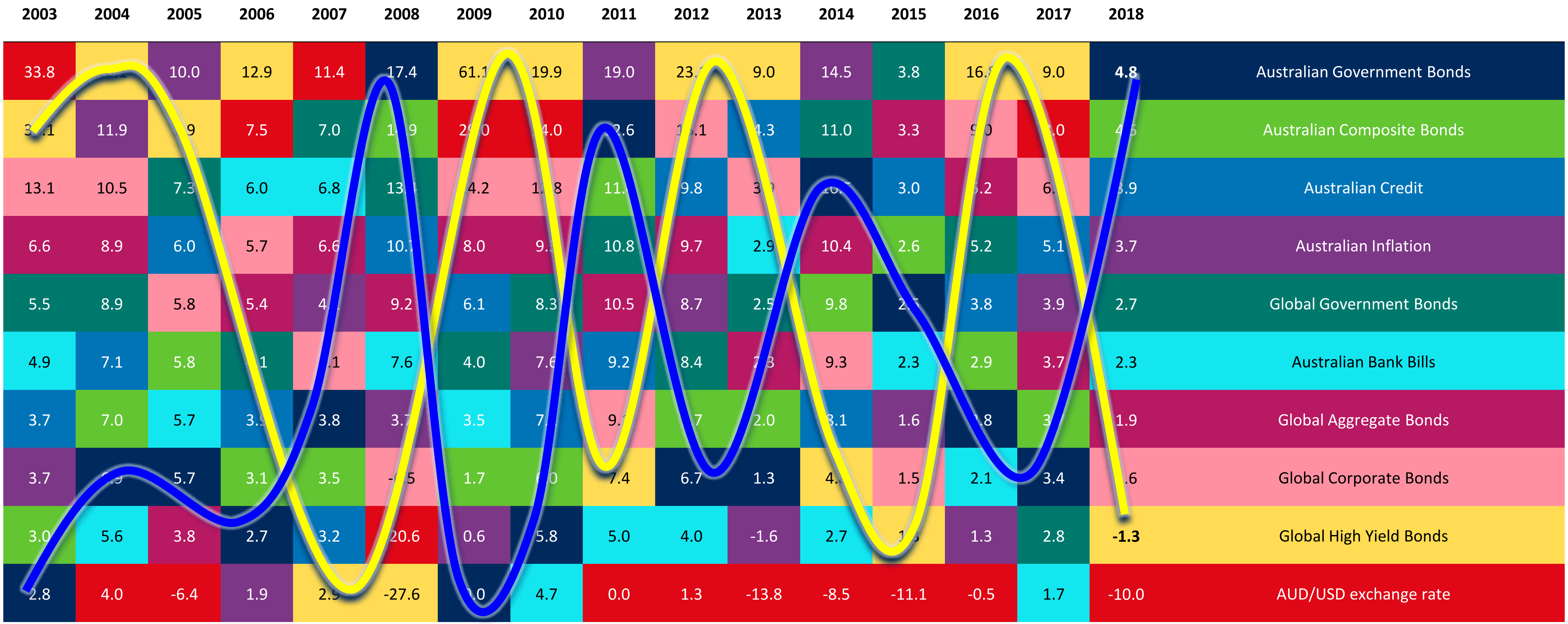
Agenda

- Asset class review
- Market outlook
- What is Schroders doing about it?

Asset class review

Mixed returns across the fixed income spectrum

Asset allocation is key



Source: Morningstar as at 31 December 2018. Index returns are gross of fees. Past performance is not a reliable indicator of future performance. Australian bond indices are the Bloomberg Ausbond 0+ TR indices. Global bond indices are the Bloomberg Barclays Global TR Hedged indices.

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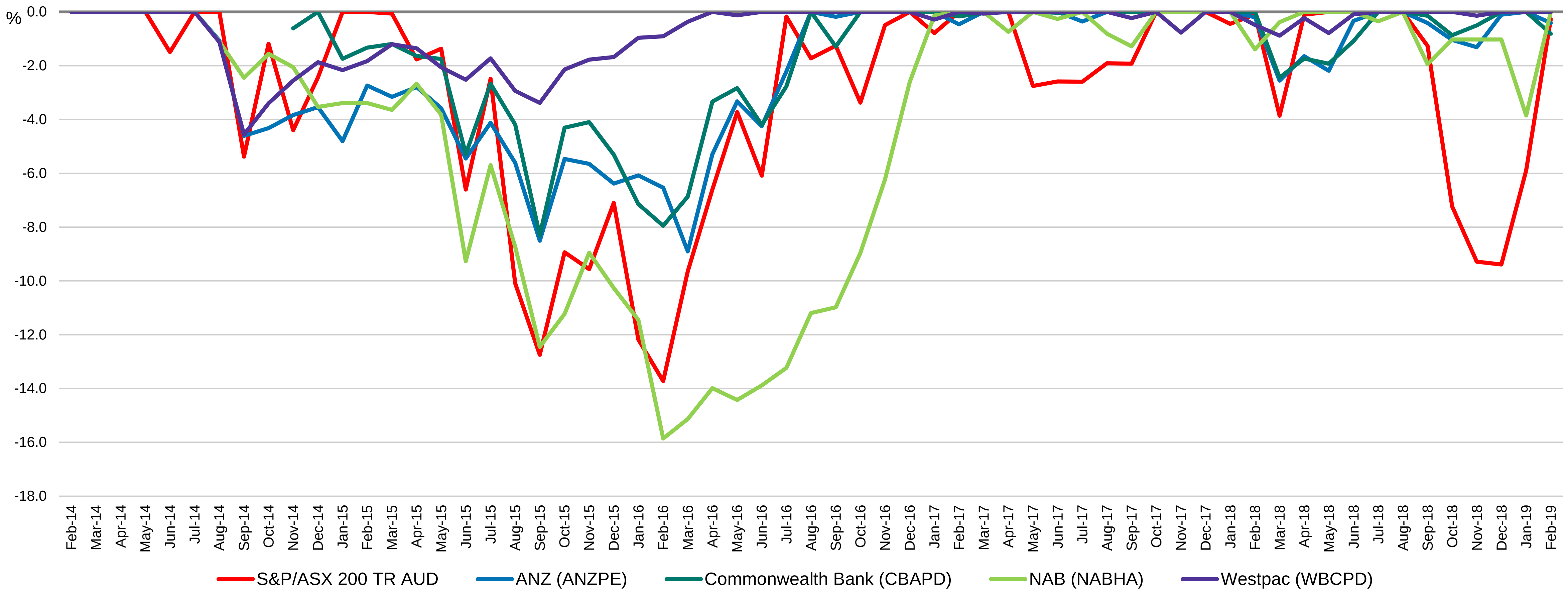
Hybrids behave more like equities than bonds

Volatile and lacking in diversification during risk off scenarios

The potential for equity-like large drawdowns



Source: Morningstar Direct

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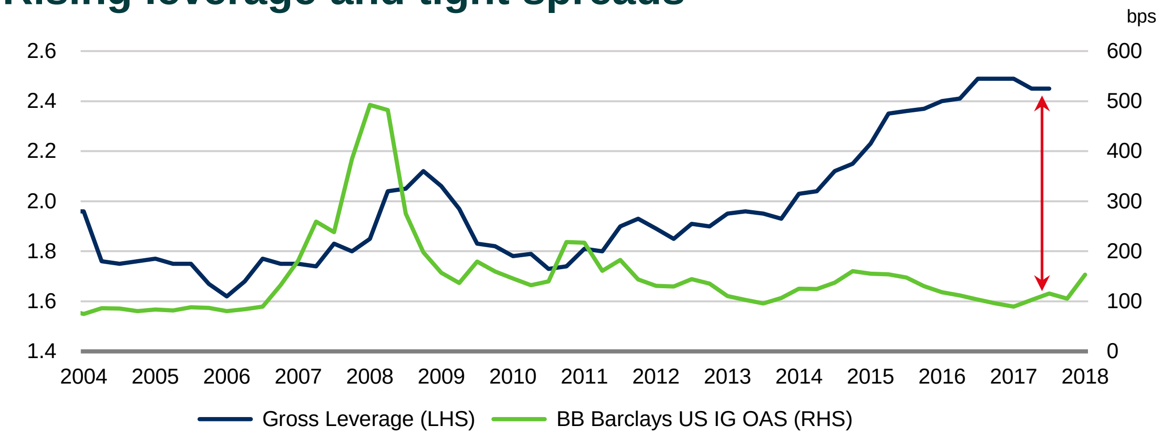
I'm having a BBB time

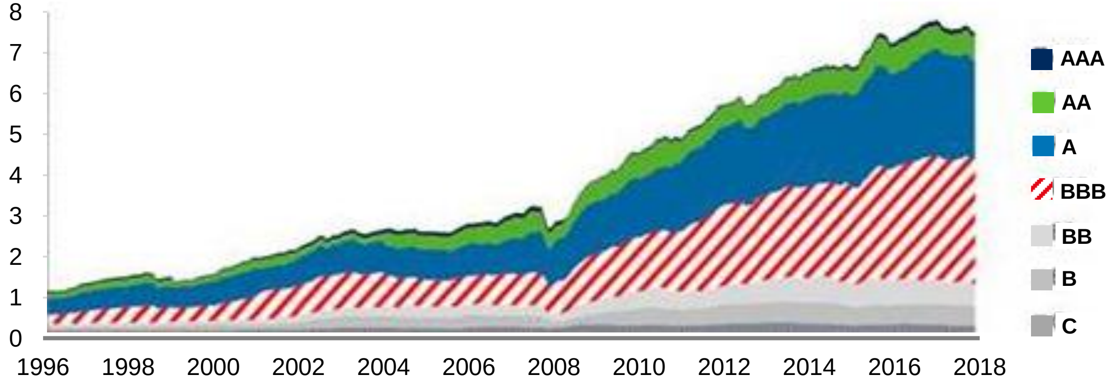
Beware the rising risks

Rising leverage and tight spreads



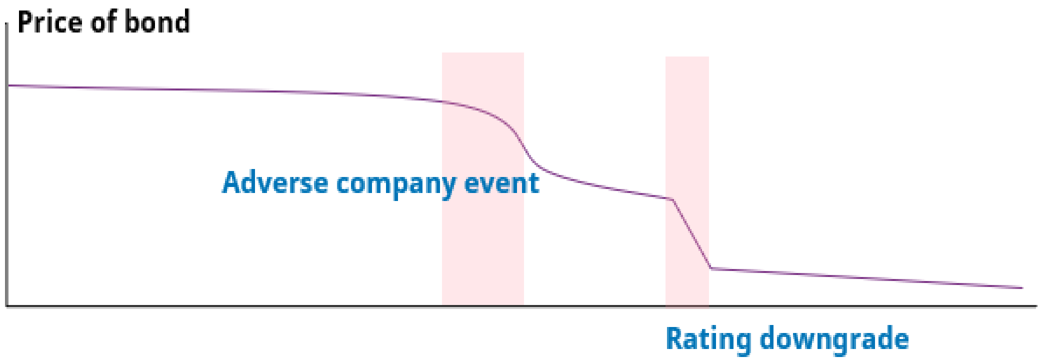
BBB negative migration risk

Value of corporate debt by rating (in $trillions)



Source: Schroders, Bloomberg as at 31 December 2018

Negative migration market versus index returns



- Not all BBBs are the same
- Use fundamental credit research to avoid problematic BBBs and focus on valuations
- Avoid passive management or static allocations. Overweight the lowest quality, most vulnerable companies issuing most debt

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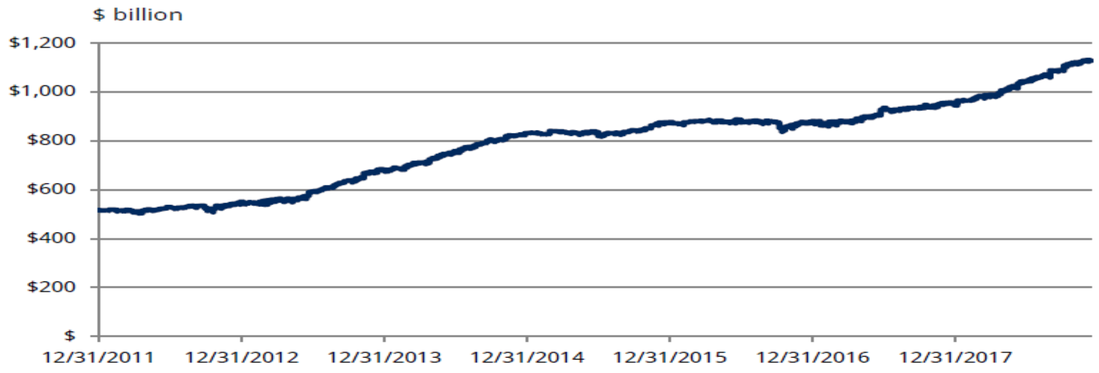
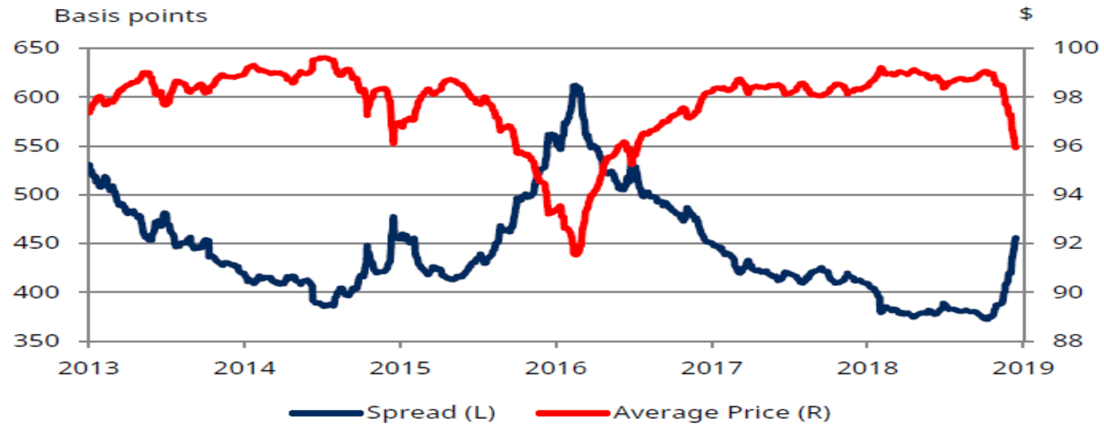
Leveraged Loans

Beware the risks in this sub investment grade market

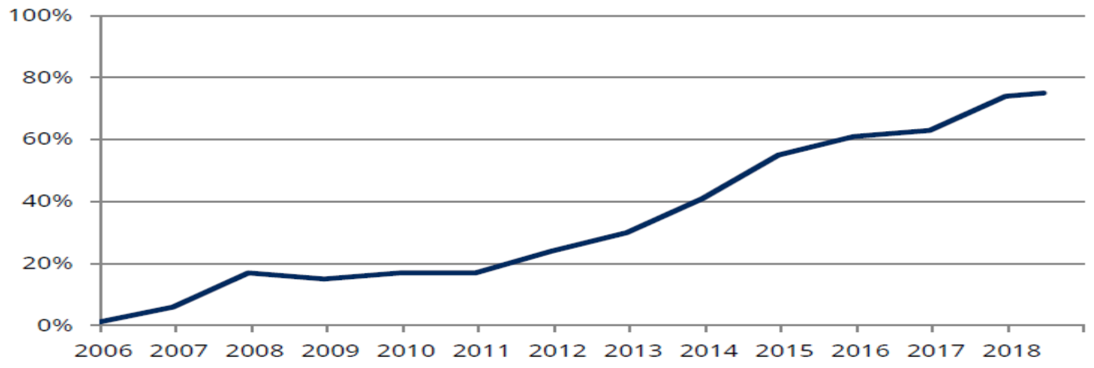
Market has grown significantly



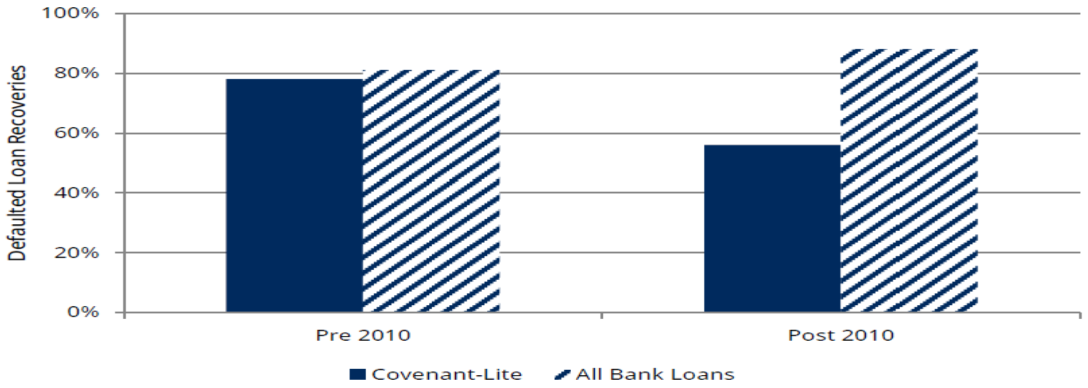
Not immune from volatility



Covenant Lite now the norm



Covenant Lite Loans recoveries already lower



Source: S&P Global to 14 Dec 2018 (top left), JP Morgan to 14 Dec 2018 (top right), LCD (bottom charts)

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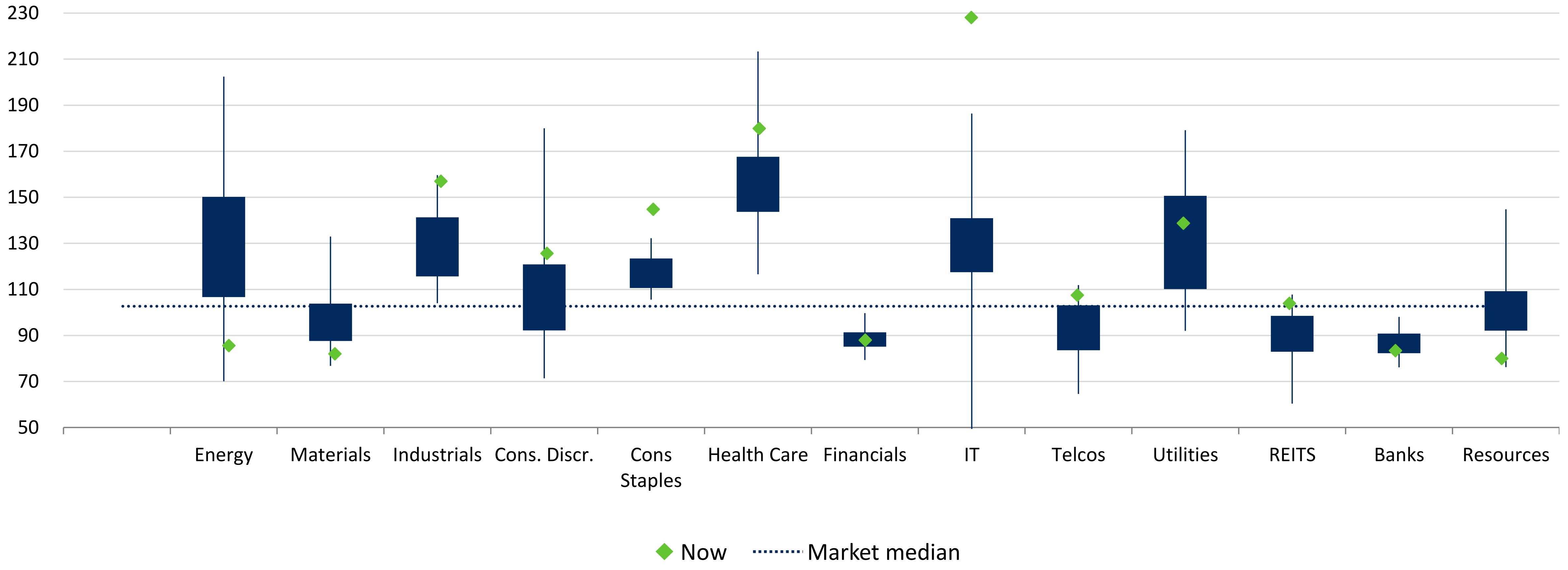
Sector PE ratios have bifurcated to extremes

Continuing to bet on yesterday's winners looks increasingly unwise

ASX200 = 100



5th, 25th, 75th and 95th %-tile shown.
Source: FactSet. Sector PE ratios relative to index PE ratio (ASX200 = 100). Historical ranges over 10 years. To 30 Apr 2019

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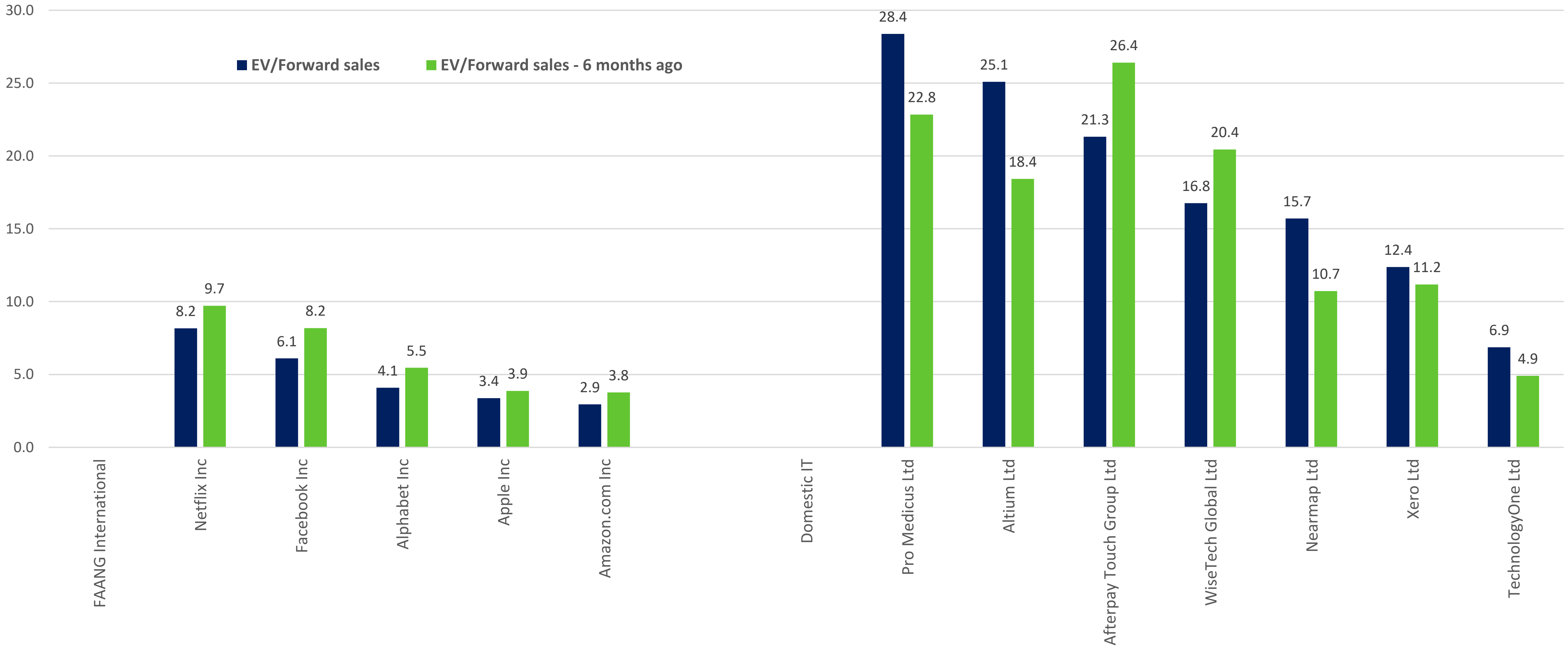
Local tech stocks are expensive, even by global standards

EV to forward sales



Source: Thomson Reuters . Based on latest reported results. For illustrative purposes only, not a recommendation to buy/sell

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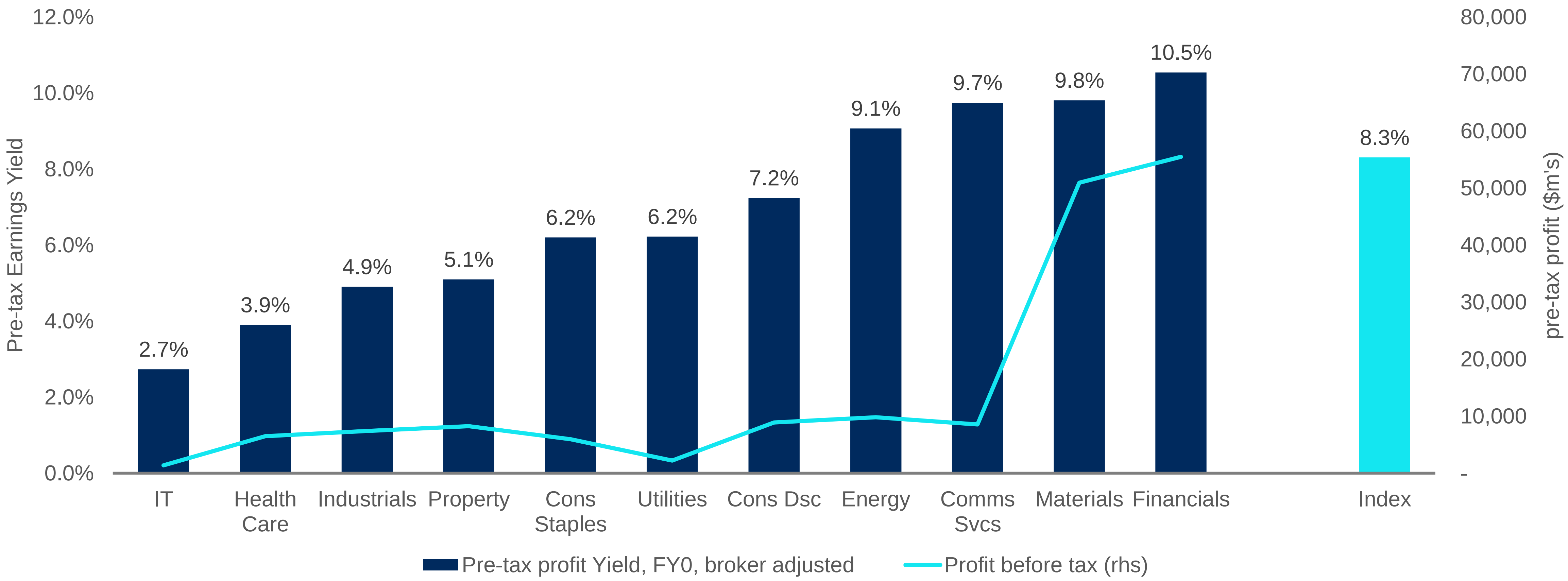
Earnings yields – differentials are extremely wide

‘Jam tomorrow’ remains far more highly prized than yield today



Core portfolio	u/w	u/w	o/w	u/w	o/w	o/w	u/w	u/w	o/w	o/w	o/w

Source: Factset. Property have been adjusted for revaluations.

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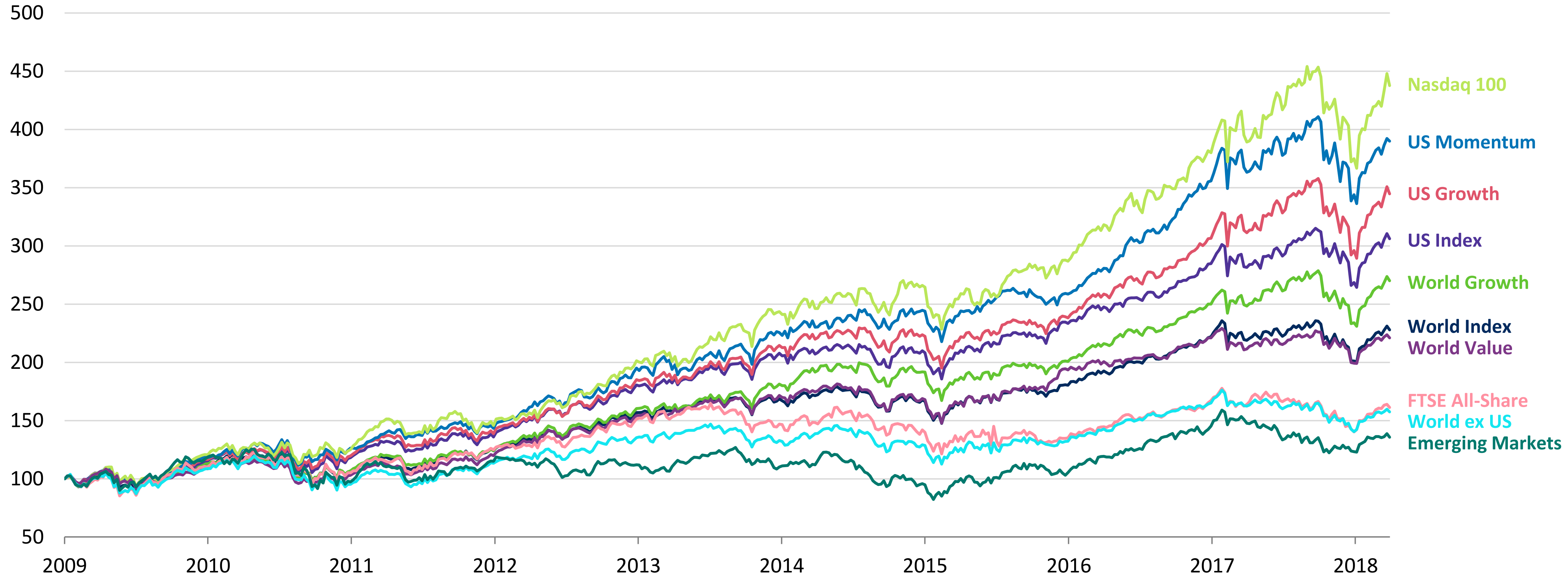
Understanding what is driving the US market

A handful of stocks, sectors and countries



Result: US is now 62% of the index

Source: Schroders, Thomson Reuters Datastream in USD as at 28 March 2019. MSCI indices are Net Dividend Re-invested. The sectors, securities, regions and countries shown above are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

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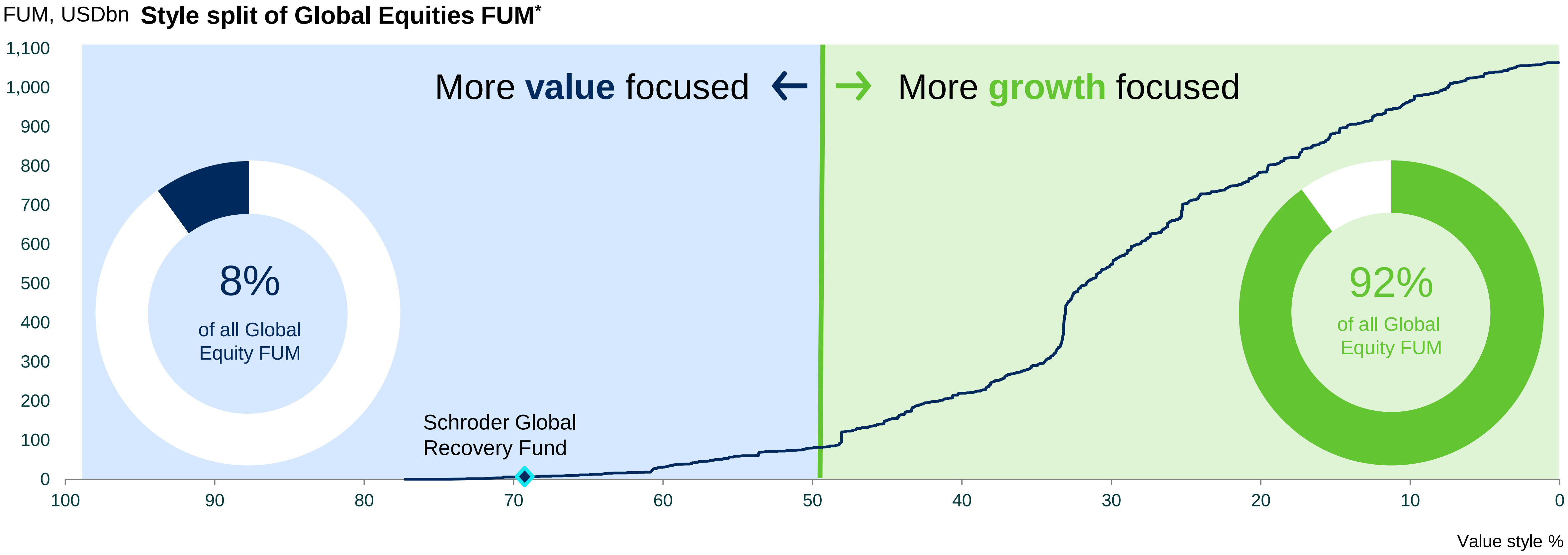
Very few investors have diversified their growth exposure



Source: Schroders, Morningstar Direct, report date: January 2019, data as at 30 September 2018 (most recent date with largest populated group available).
*Morningstar Global Category: Global Equity Large Cap, excludes funds with no style score or no fund size available at 30 September 2018. Based on 2,575 Global Equity Funds.

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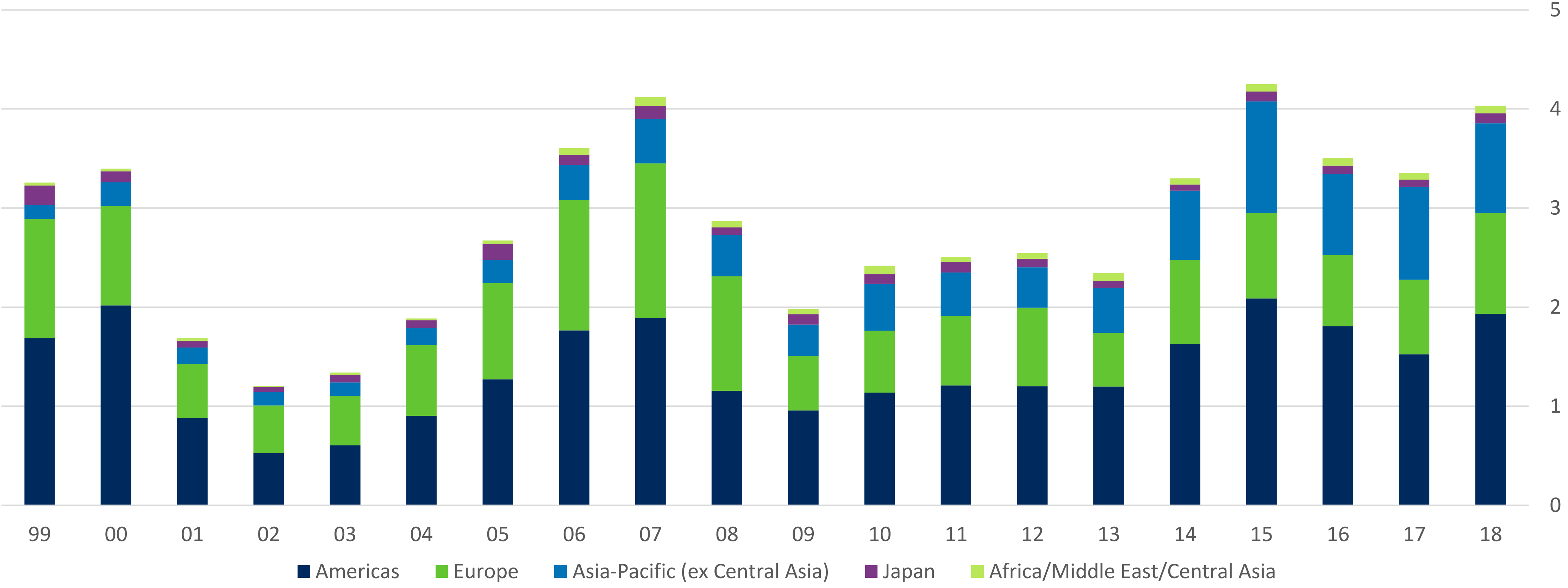
If it looks like a bubble and feels like a bubble

History suggests deal timing could be better!

Global M&A US$tn



Source: Thomson Reuters Deals Intelligence, rolling CY

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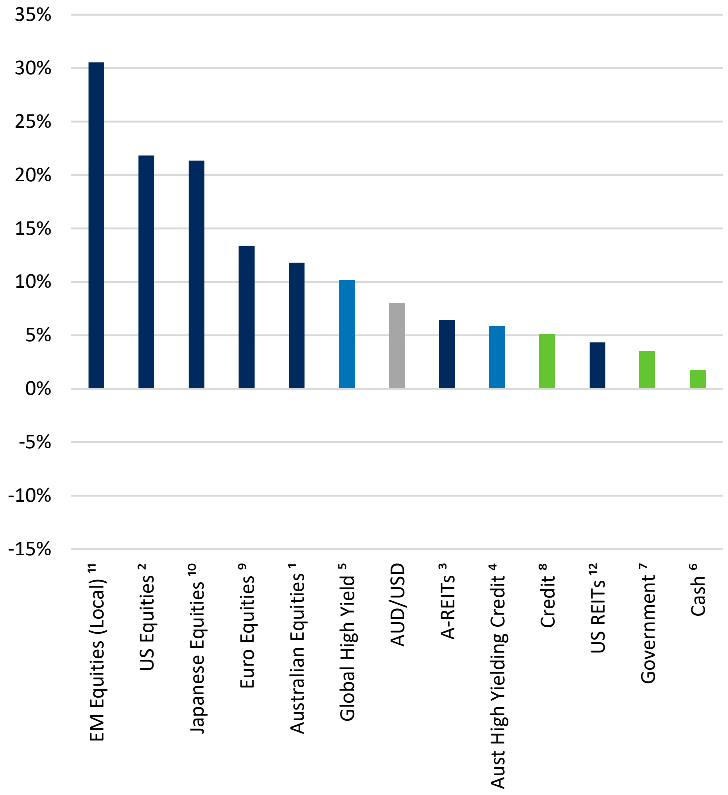
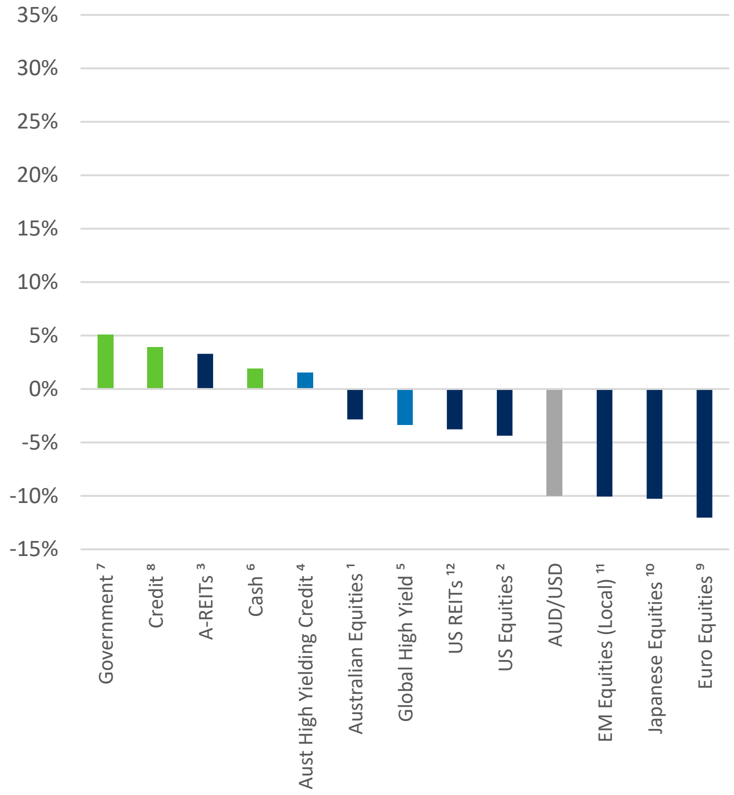
Recent market performance

Gross returns by asset class

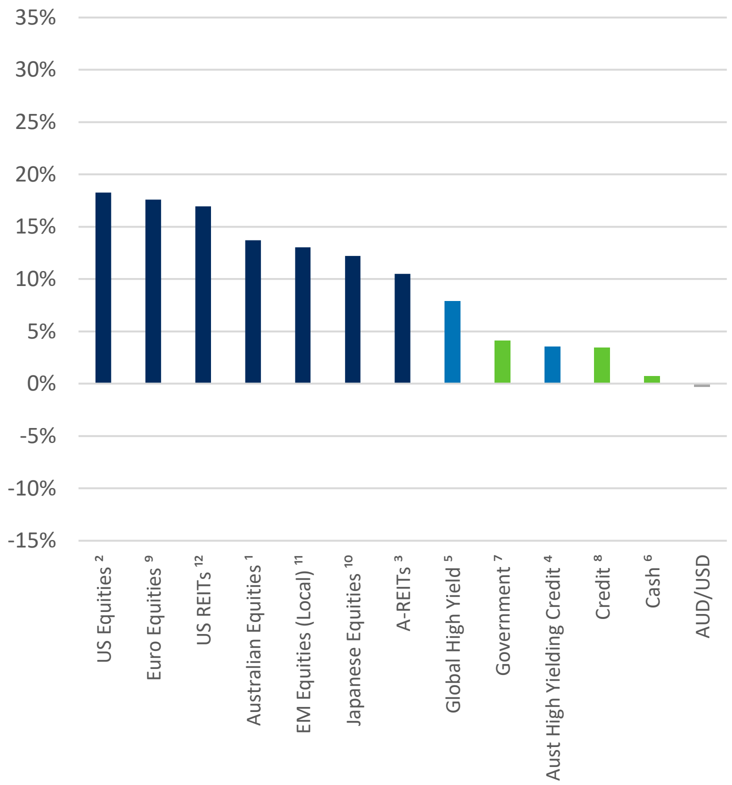
2017



2018



2019 (so far)



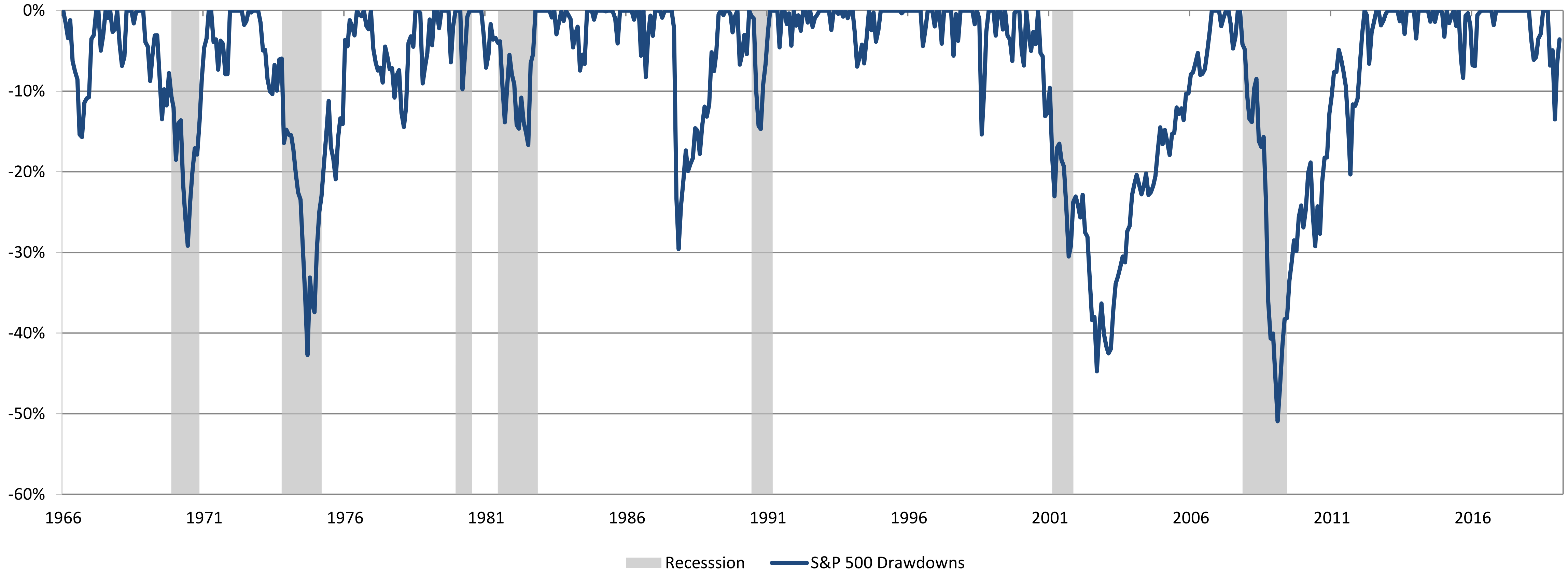
Source: Schroders/Datastream/Bloomberg as at 13 May 2019. 1. S&P ASX 200 Acc; 2. S&P 500 TR; 3. S&P ASX300 A-REIT Acc; 4. Schroder Higher Yielding Credit Pool; 5. Merrill Lynch Global High Yield Index (USD); 6. Bloomberg AusBond Bank Bill Index; 7. Bloomberg AusBond Treasury Index; 8. Bloomberg AusBond Credit Index; 9. Euro Stoxx TR; 10. Nikkei TR; 11. MSCI EM Net TR (Local); 12. S&P US REIT TR. * Past Performance is not a reliable indicator for future performance.

Market outlook

Recessions kill bull markets

Q4’18 was only the trailer

S&P 500 Drawdowns and Recessions

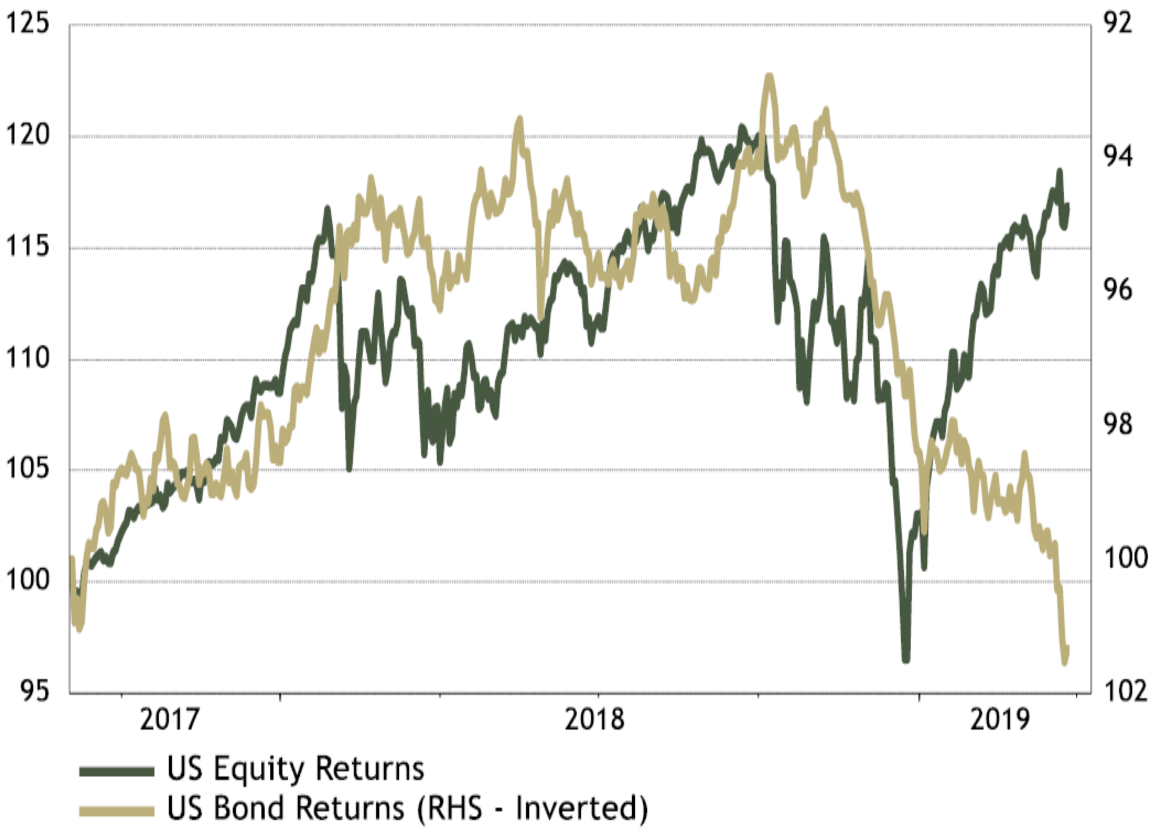


Source: Datastream

Bonds v Equities

Can both be right?

Equity vs Bond Returns



Equities

- Global economy growing
- Inflation low, rates low, the "Fed Put"
- Valuations full but not extreme

Bonds

- Global growth slowing
- Recession risk rising
- No more tightening

Source: ASR Ltd. / Refinitiv

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US Recession

The countdown is still ticking…

	Indicator		Critical threshold	Latest value	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24
					Area Under Receiver Operating Characteristic (AUROC) Curve																							
					Months before start of recession																							
12-24 month Economic indicators	Truck sales	>	0.4	0.6	0.36	0.39	0.42	0.44	0.46	0.47	0.49	0.52	0.54	0.56	0.58	0.60	0.60	0.62	0.63	0.64	0.64	0.66	0.67	0.69	0.70	0.71	0.71	0.72
	Initial jobless claims	<	314.3	211.0	0.29	0.33	0.37	0.40	0.44	0.47	0.51	0.54	0.57	0.59	0.61	0.63	0.63	0.64	0.66	0.67	0.67	0.68	0.68	0.69	0.69	0.70	0.70	0.70
	Capacity utilisation	>	80.9	79.1	0.49	0.53	0.57	0.60	0.62	0.65	0.67	0.69	0.71	0.73	0.74	0.74	0.74	0.75	0.75	0.75	0.75	0.76	0.76	0.76	0.76	0.76	0.75	0.75
	Output gap	>	-0.6	0.8	0.41	0.46	0.51	0.55	0.59	0.63	0.66	0.69	0.71	0.73	0.74	0.75	0.75	0.76	0.77	0.79	0.80	0.80	0.80	0.80	0.79	0.80	0.80	0.80
	Unemployment gap	<	-0.4	-0.8	0.52	0.56	0.60	0.63	0.65	0.67	0.68	0.70	0.71	0.72	0.72	0.72	0.72	0.72	0.72	0.73	0.73	0.72	0.72	0.71	0.71	0.70	0.70	0.69
	S&P GS spot commodity index, 12m %	>	11.6	-3.6	0.56	0.60	0.63	0.65	0.66	0.68	0.70	0.73	0.75	0.76	0.77	0.78	0.78	0.78	0.78	0.77	0.77	0.76	0.75	0.74	0.71	0.70	0.68	0.65
6- 12 month Monetary indicators	Yield curve (10yr minus bills)	<	0.3	0.2	0.62	0.67	0.70	0.73	0.76	0.79	0.82	0.84	0.84	0.85	0.86	0.86	0.85	0.84	0.83	0.81	0.80	0.78	0.76	0.74	0.72	0.70	0.69	0.67
	Fed funds rate, 2yr chg	>	1.9	1.6	0.63	0.67	0.70	0.73	0.75	0.77	0.79	0.81	0.82	0.82	0.83	0.82	0.81	0.80	0.79	0.78	0.77	0.76	0.74	0.72	0.71	0.69	0.67	0.65
	Fed fund rate relative to cycle low	>	3.5	2.3	0.73	0.76	0.79	0.81	0.83	0.85	0.86	0.87	0.88	0.88	0.87	0.86	0.85	0.84	0.83	0.82	0.81	0.79	0.78	0.76	0.73	0.71	0.69	0.67
	Real money base, 12m % chg	<	-2.9	-14.5	0.74	0.76	0.78	0.80	0.81	0.82	0.82	0.83	0.83	0.81	0.79	0.77	0.74	0.71	0.69	0.68	0.66	0.64	0.63	0.61	0.59	0.58	0.57	0.56
	Real M1, 12m % chg	<	-2.0	2.3	0.77	0.79	0.80	0.80	0.81	0.81	0.82	0.82	0.81	0.80	0.79	0.78	0.77	0.75	0.73	0.72	0.71	0.70	0.69	0.68	0.67	0.66	0.65	0.64
	Real M2, 12m % chg	<	2.3	2.7	0.74	0.75	0.76	0.76	0.76	0.77	0.77	0.76	0.75	0.73	0.72	0.70	0.68	0.67	0.65	0.64	0.62	0.61	0.60	0.58	0.57	0.56	0.54	0.53
0-6 month Short term indicators	ISM new orders, 6m % chg	<	-8.0	-6.7	0.70	0.72	0.73	0.74	0.75	0.74	0.71	0.68	0.64	0.61	0.59	0.58	0.57	0.56	0.56	0.56	0.53	0.51	0.49	0.46	0.45	0.45	0.45	0.46
	Private house permits, 12m % chg	<	-20.8	-7.8	0.88	0.88	0.89	0.88	0.87	0.86	0.86	0.84	0.82	0.81	0.79	0.79	0.77	0.75	0.73	0.71	0.70	0.69	0.68	0.66	0.63	0.61	0.58	0.56
	S&P500, 6m % chg	<	-7.0	-2.7	0.89	0.88	0.87	0.85	0.82	0.81	0.77	0.74	0.70	0.67	0.63	0.59	0.55	0.52	0.50	0.47	0.45	0.42	0.41	0.41	0.40	0.41	0.42	0.44
	ISM new orders	<	48.4	57.4	0.89	0.87	0.84	0.82	0.80	0.77	0.74	0.70	0.65	0.61	0.57	0.54	0.52	0.50	0.49	0.47	0.46	0.44	0.43	0.42	0.41	0.41	0.41	0.43
	VIX index	>	24.1	14.5	0.86	0.83	0.83	0.82	0.80	0.77	0.73	0.69	0.67	0.66	0.62	0.59	0.56	0.53	0.50	0.48	0.46	0.45	0.42	0.40	0.37	0.34	0.32	0.32
	MFG average weekly hours, 12m % chg	<	-1.0	-0.9	0.80	0.77	0.73	0.70	0.67	0.63	0.59	0.57	0.54	0.51	0.48	0.47	0.46	0.44	0.44	0.43	0.44	0.44	0.45	0.44	0.44	0.44	0.45	0.45
	Chicago Fed national activity index, 3m	<	-0.8	-0.2	0.90	0.87	0.84	0.81	0.77	0.73	0.69	0.64	0.59	0.55	0.51	0.49	0.46	0.44	0.42	0.42	0.40	0.38	0.37	0.35	0.34	0.34	0.35	0.34
	Consumer good orders, 12m % chg	<	-3.6	2.3	0.84	0.80	0.76	0.74	0.72	0.69	0.66	0.64	0.61	0.57	0.54	0.51	0.48	0.47	0.48	0.47	0.47	0.47	0.47	0.46	0.46	0.47	0.47	0.47

– The AUROC is ratio of times an indicator correctly captures recession compared to when it incorrectly calls recession. A perfect score would be 1.0 and would capture all recession periods with no false calls.

– These curves are run for each time horizon (1 to 24 months ahead) and the indicator threshold that gives the best trade-off between correct and incorrect calls is provided in the table.

– Ratios shaded green are those that the ability of the indicator to call recessions is significantly better than random.

– The dark green shaded number is the best fit and is used to provide the "critical threshold". Indicators that have breached their critical thresholds are highlighted in red.

Key:

AUROC statistically significant

Maximum AUROC

Latest value exceeds threshold

Source: Datastream, Schroders.

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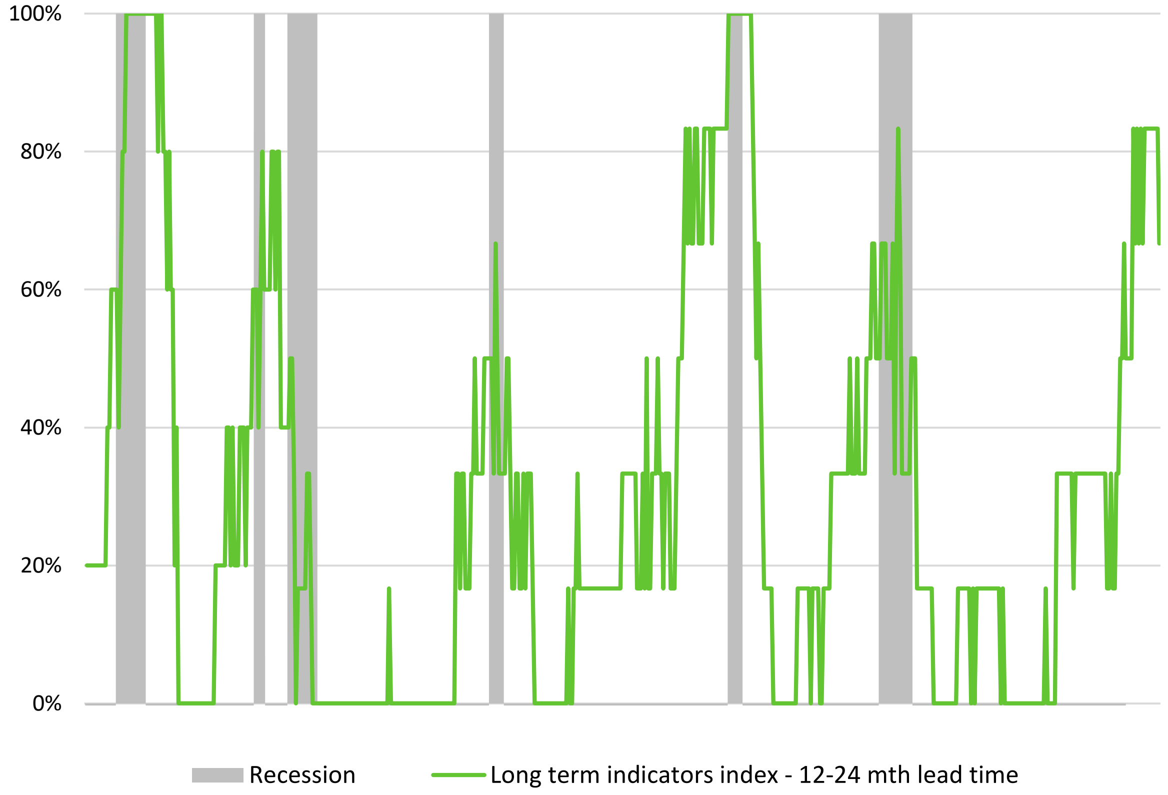
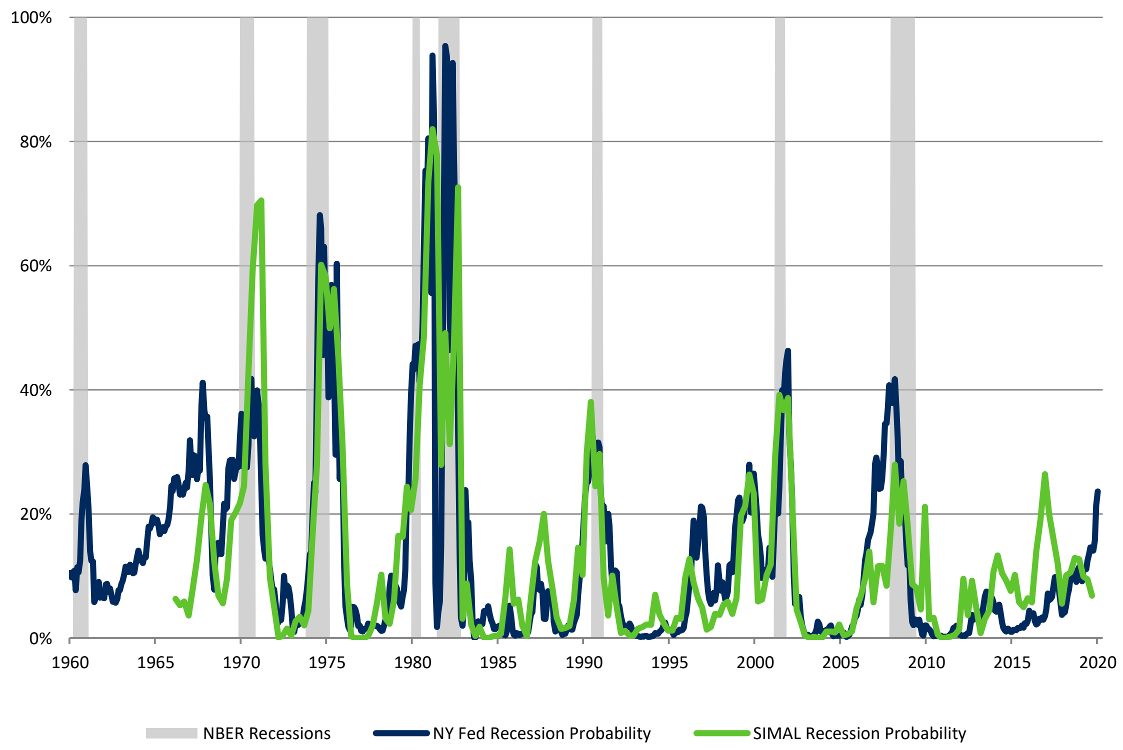
The Fed has paused because risks are rising

Recession is the big risk

US Recession Risk on a 1-2 year horizon



NY Probit Model



Source: Schroders, Datastream

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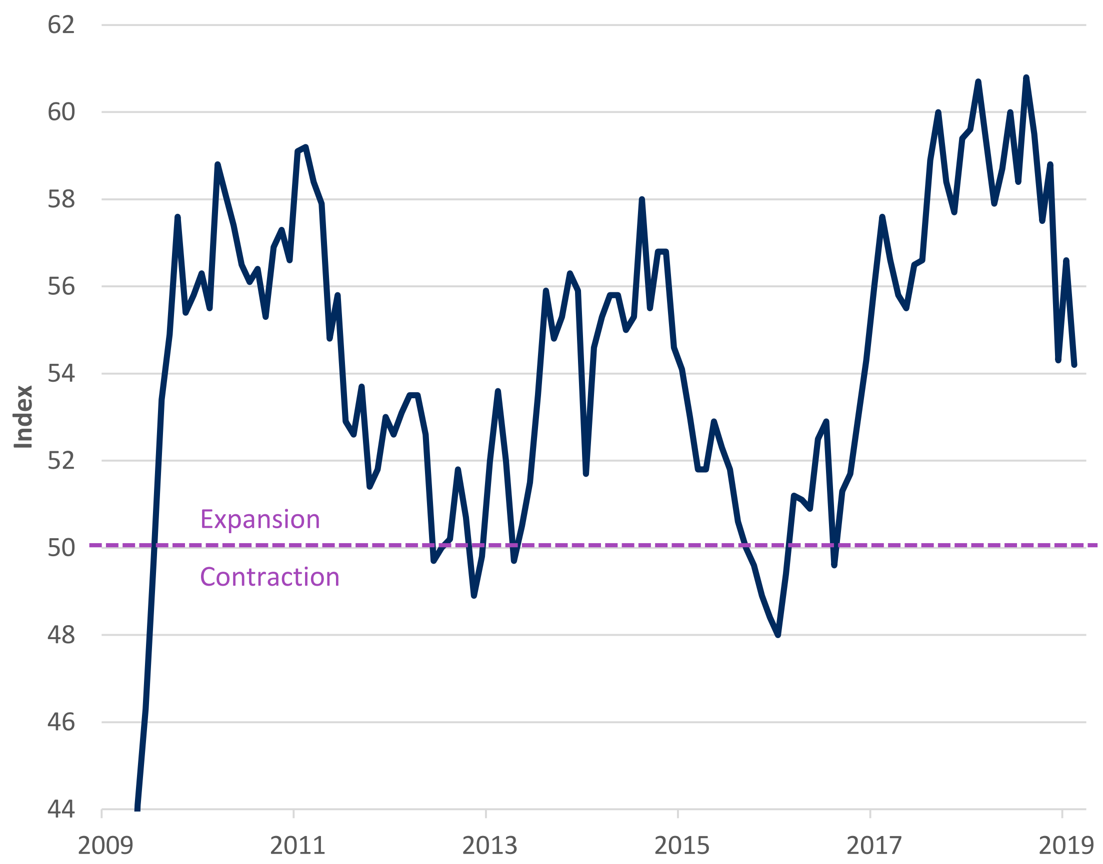
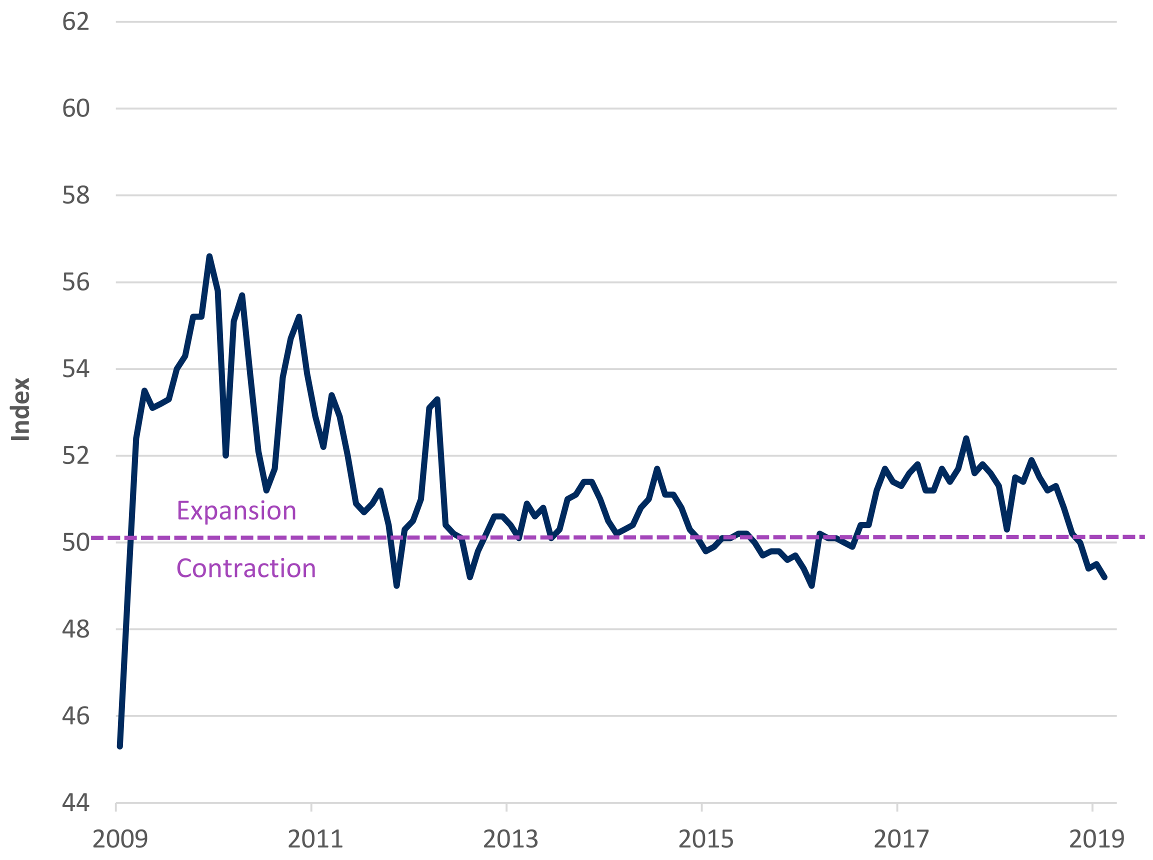
US and China Manufacturing PMIs

Trade War starting to have an economic impact

USA



China

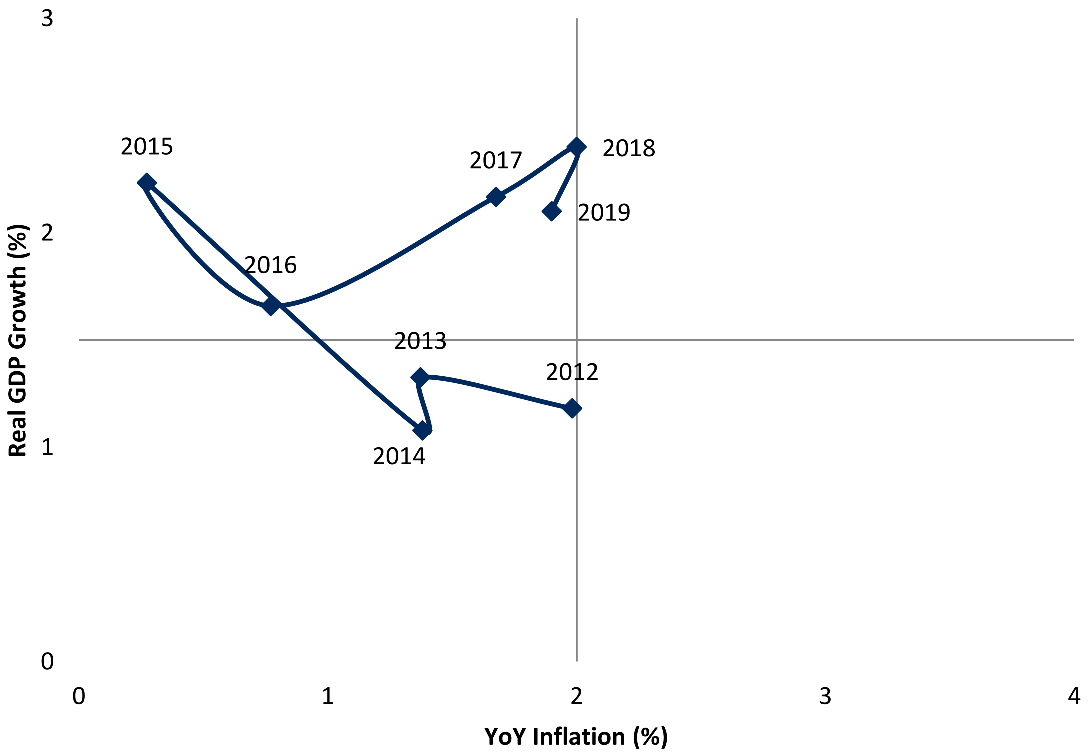


Source: Schroders, Datastream

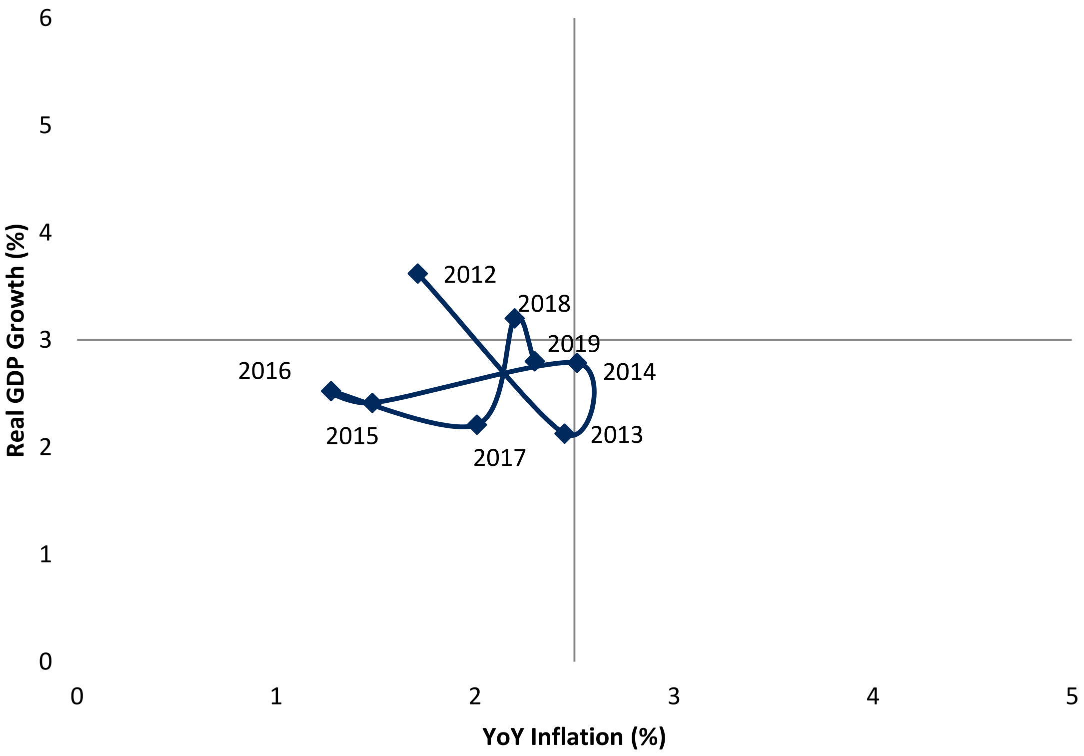
Cycle = Not quite Goldilocks in the US any more

Growth mixed, inflation rising, rates rising, profits peaking

Advanced Economies GDP & Inflation



Australia GDP & Inflation



Source: IMF, IMF estimates for 2019

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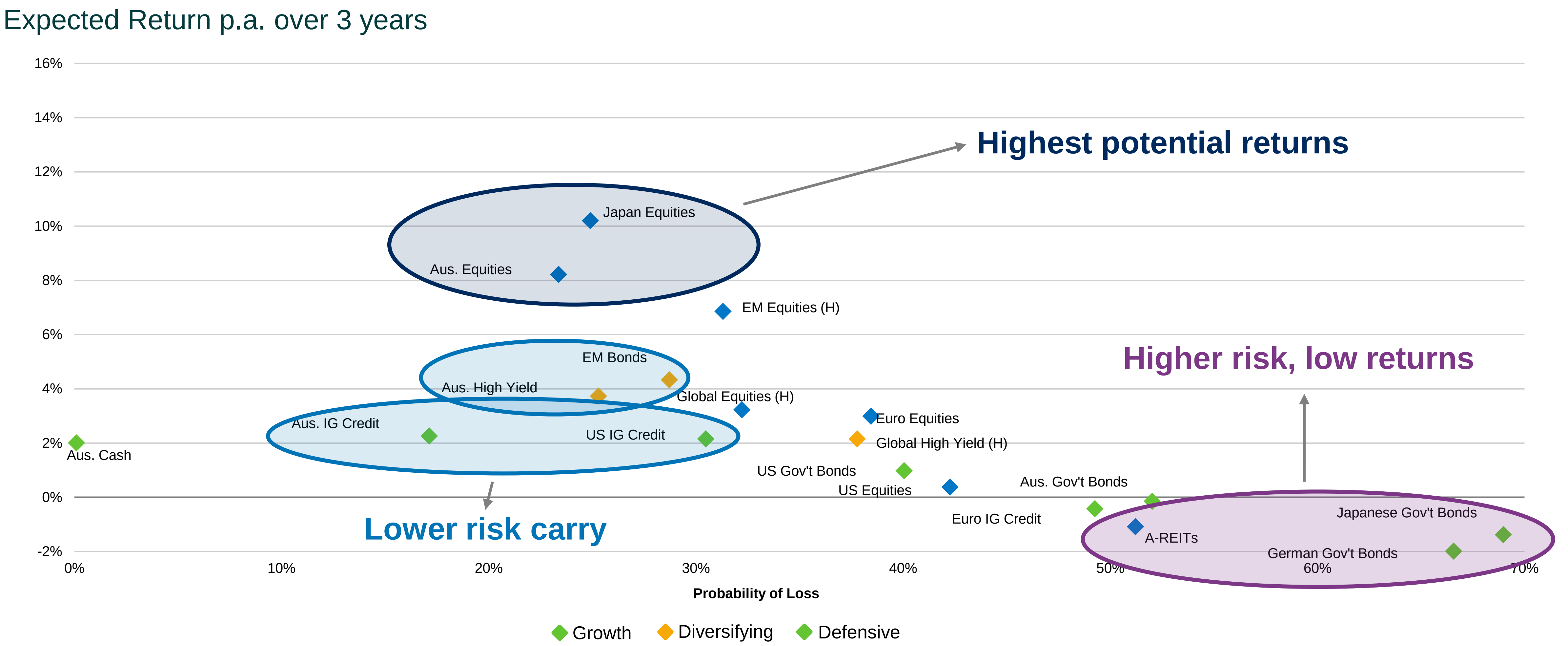
What is Schroders doing about it?

Investment forecasts process

Expected return vs probability of loss – March 2019



Source: Schroders as at 31 March 2019. Countries, stocks and sector weightings and returns are mentioned for illustrative purposes only and should not be viewed as a recommendation to buy/sell

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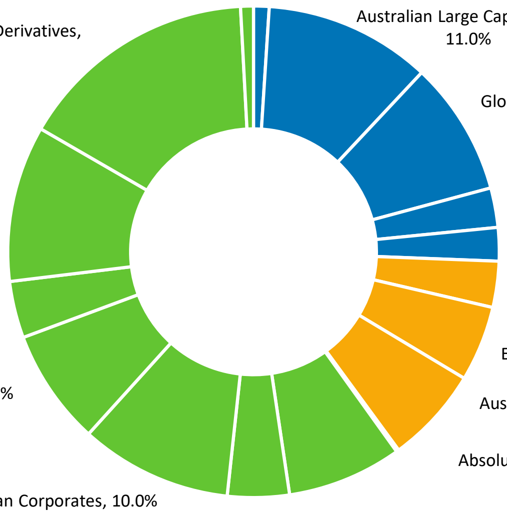
How we are invested

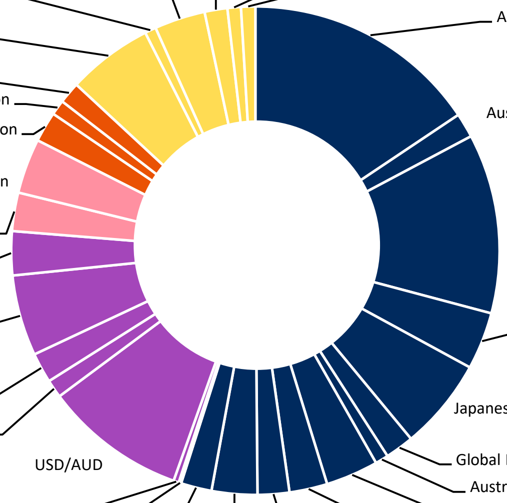
Schroder Real Return CPI Plus 5% Fund as at 30 April 2019

Portfolio – Capital Weights



Additional Portfolio Information			
FX Exposure:	17.7%	Duration:	1.2 yrs
USD (weighted):	7.8%		
EUR:	1.2%		
GBP:	1.5%	Implementation	
JPY:	4.0%	Internal Funds / Pools	75.8%
Other	3.3%	Direct	24.2%

Portfolio – Risk Weights



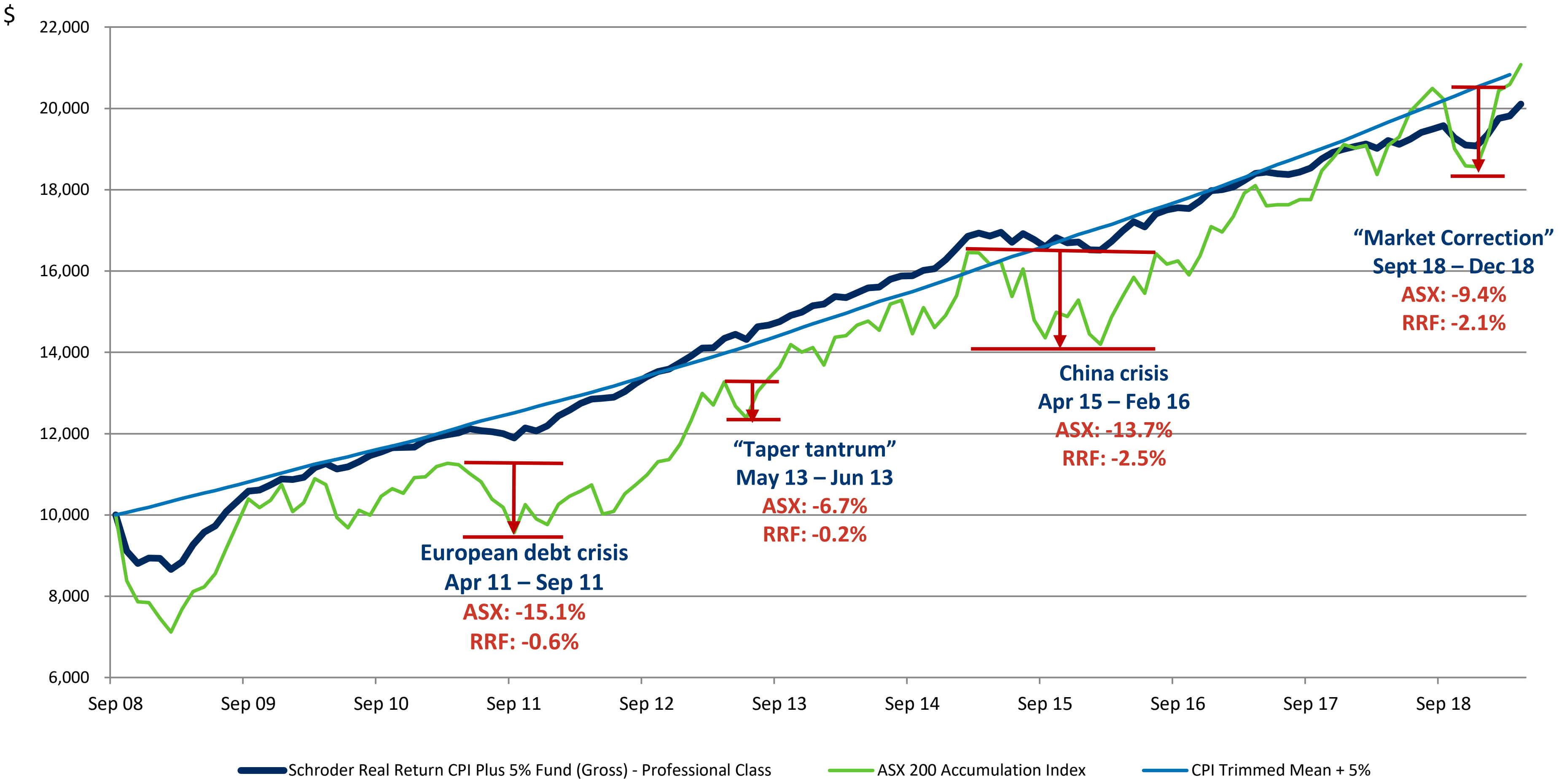
Risk Contribution			
Market Exposure	55.4%	Bond and Equity Overlays	4.4%
FX	20.8%	Stock Selection	13.1%
RV Trades	6.2%		

Source: Schroders

Schroders

Performance since inception

Delivering capital growth whilst managing volatility and drawdowns



Since inception returns (p.a.)

RRF CPI +5%	6.1% Vol: 4.8%
ASX 200	7.5% Vol: 13.3%
CPI +5%	7.4%

Source: Schroders, Datastream, ABS. Cumulative performance shown for the Schroder Real Return CPI+5% strategy (gross of fees) since inception to 30 April 2019. Past Performance is not a reliable indicator of future performance. CPI is measured by the RBA Trimmed Mean as published by the ABS. Performance of the Unlisted Fund is shown to illustrate how a comparable managed fund using the same strategy has performed over longer time periods. Performance of the Schroder Real Return Fund (ASX:GROW) may vary due to differences such as market making activities, variations in implementation strategy and inflows/outflows. Cumulative performance of Schroder Real Return CPI+5% applying wholesale class fee of 0.90%.

Investment process - Opportunities

Markets

Equities: Australia, Japan & Asia

Credit: Australian Investment Grade, RMBS (AAA)

Currencies

Sterling

Japanese Yen

USD (vs AUD)

Themes / Style

Liquidity

Value > Growth

Active > Passive

Volatility

Active Asset Allocation

Inflation Surprise

Downside Protection

Conservative (but not bearish)

Risk stance

Maintain duration (especially long duration US Treasuries)

Volatility hedges like USD, JPY

Source: Schroders

Summary

Where we have been

Where are we going

What are we doing about it

Source: Schroders, December 2018.

Questions?

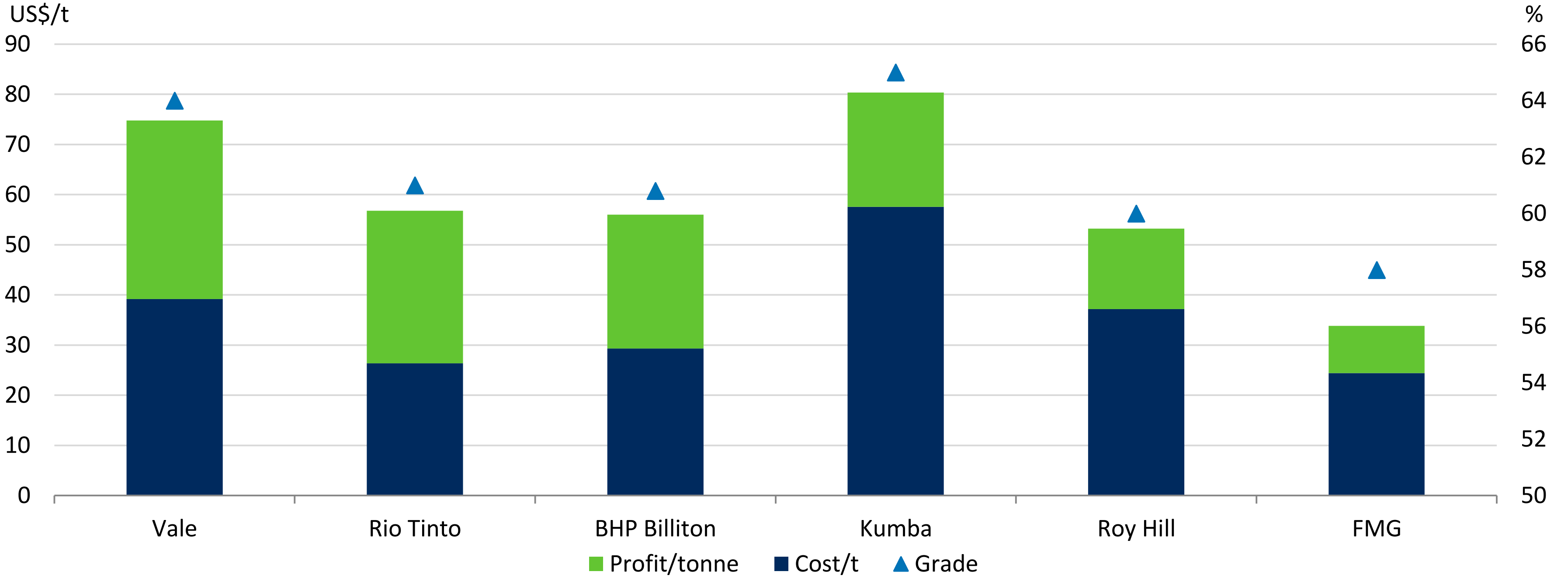
Schroders

Appendix

Iron ore - the Landscape at $61/t

Cash costs are only half of the story

Total sale price (sorted: profit – highest to lowest)



Source: City research (May 2018).

Key position changes

12 Month Trade Log

May 2018

+1.2% JPY Equities

-0.7% AEQ

Add JPY Equities given valuations

June 2018

Add JPY Equities given valuations

+1% JPY Equities

-1% AEQ

July 2018

+0.3 Yrs Duration

-2.5% AEQ

-2.5% IEQ

With potential for correction in risk markets, trim equities and increase duration (~ to approx 1 yr in RRF)

Sept 2018

-1.0% AEQ

+1.0% JPY Equities

JPY equities attractive on valuation, also as a diversifier to AUD exposure

Nov 2018

Increased concern around further downside risks for the market, a lower outlook for inflation over the shorter term, as well as the possibility that the Fed will slow the pace of tightening

+2.0% JPY/AUD

-2.0% USD/AUD

+0.25 Yrs Duration

-2.0% SPI VS A-REIT RV

Dec 2018

Add Equities back to portfolio through reducing short futures overlays

+0.7% IEQ

+1.8% AEQ

Jan 2019

-1.0% Global HY

Trim GHY exposure via CDX given spread compression & high leverage.

Feb 2019

Add 2.5% notional S&P500 Call Option. Provides upside exposure but limits downside should the market re-test the lows

+2.5% Call Option (S&P 500)

Mar 2019

+2.5% Call Option (S&P 500)

+1.5% Put Option (GBP/USD)

Add upside protection in equities and cover Brexit uncertainty.

Apr 2019

Take profits on the S&P500 call option.

Brexit has been extended and ST currency risk has subsided. Closed position

-1.5% Put Option (GBP/USD)

-2.5% Call Option (S&P 500)

Schroders

Objective is threefold

Return important but is not the only thing that matters

CPI +5%[1]

Performance[3]

	Returns (post fee)	CPI[4]	Return above CPI (post fee)
2011	3.6%	2.8%	0.8%
2012	11.7%	2.2%	9.5%
2013	9.2%	2.6%	6.6%
2014	6.5%	2.2%	4.3%
2015	1.8%	2.1%	-0.3%
2016	6.6%	1.6%	5.0%
2017	4.8%	1.8%	2.9%
2018	-0.5%	1.8%	-2.3%
1 yr	3.7%	1.6%	2.1%
3 yrs (p.a.)	4.8%	1.7%	3.1%
5 yrs (p.a.)	4.4%	1.8%	2.6%
SI (p.a.)	6.0%	2.2%	3.7%

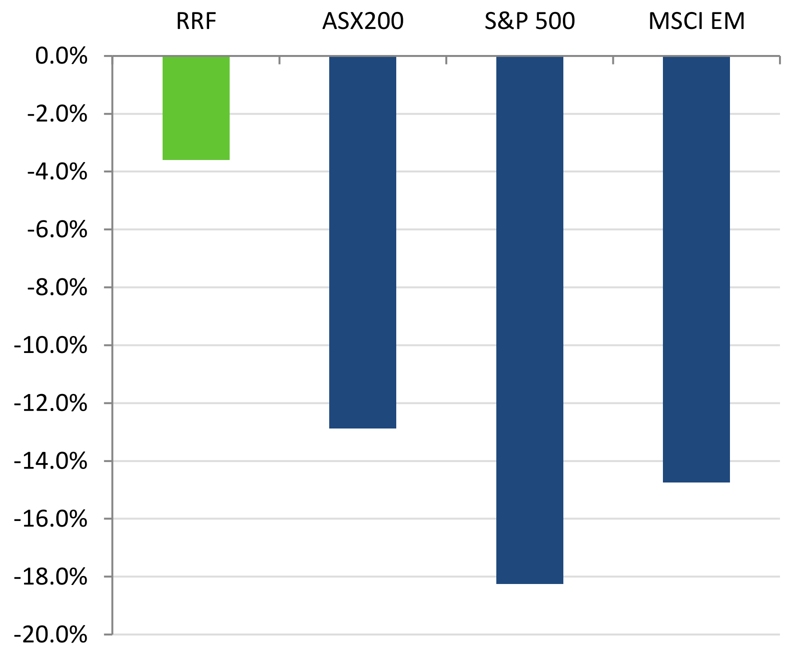
~5% Vol[2]

Volatility

Volatility	ASX 200 Volatility
3.1%	11.8%
1.8%	10.2%
2.8%	11.9%
1.8%	11.4%
4.0%	14.9%
3.3%	12.6%
1.5%	6.4%
2.7%	9.8%
3.6%	10.8%
2.7%	9.3%
3.0%	11.2%
2.8%	13.3%

Min. losses

Worst drawdown Q4 2018



Source: Schroders. Investment objectives are targets only and not guaranteed. Expected volatility and beta are an internal objective only.
[1] Return objective is per annum gross of fee over rolling three year periods. [2] Up to 8% p.a [3]Returns are displayed for the Schroder Real Return CPI Plus 5% Fund (Wholesale Class) as at 30 April 2019. Past performance is not a reliable indicator of future performance. [4]CPI is measured by the RBA Trimmed Mean as published by the ABS until 31 March 2019

Schroders