November 2011 Monthly Report

Schroder Australian Smaller Companies Fund

Total return %	1 mth	3 mths	1 yr	2 yrs p.a.	3 yrs p.a.	Inception p.a.
Schroder Australian Smaller Companies Fund (post-fee)	-3.4	-4.2	-8.8	2.2	13.1	-4.4
S&P/ASX Small Ordinaries Accumulation Index	-3.7	-7.1	-12.1	-1.6	15.0	-9.4
Relative performance (post-fee)	**+0.3**	**+2.9**	**+3.3**	**+3.8**	**-1.9**	**+5.0**

Please refer to www.schroders.com.au for post-tax returns

Past performance is not a reliable indicator of future performance

Inception Date: 17 Dec 2007, 3 years and 11 months.

Market cap	Portfolio[1]	Benchmark[2]
ASX 1 - 50	0.0%	0.0%
ASX 51 - 100	1.9%	0.0%
ASX 101 - 300	65.9%	100.0%
Non Index	27.2%	
Cash	5.0%	

Top ten holdings %	Portfolio[1]	Benchmark[2]
DuluxGroup Limited	4.1%	1.1%
Resolute Mining Limited	3.9%	0.7%
GrainCorp Limited	3.6%	1.6%
Fletcher Building Limited	3.4%	1.3%
Medusa Mining Limited	3.4%	1.1%
Adelaide Brighton Limited	3.2%	1.5%
Technology One Limited	3.2%	0.0%
Skilled Group Limited	3.1%	0.4%
SP AusNet	3.0%	1.4%
Telecom Corporation of NZ	2.7%	1.0%
Total	**33.6%**	**10.1%**

Characteristics	Portfolio[1]	Benchmark[2]
No. of stocks	59	194
Portfolio turnover* (1 yr)	44.5%	
Volatility (3yr standard deviation)	16.5%	19.8%
Tracking error (3yr historic)	6.8%	

Commentary

The S&P/ASX Small Ordinaries Accumulation Index fell by 3.7%, while the Schroder Australian Smaller Companies Fund (post-fee) fell by 3.4%, outperforming by 0.3% for the month.

"We have met the enemy and he is us." Pogo Comic, 1970 (I know, I thought the source would be far more highbrow too!)

Each month that goes by seems to be more dominated by macro than the last, despite a pretty high base we are now starting from. It almost seems to be at a point where people are losing sight of the big problem and instead focus on the minutia of the latest solution put forward. So to again say that November was dominated by macro events would somehow imply that the prior 10 months were not, however it is hard to escape the investment reality that is shown in the performance of equities everywhere during the month and year to date. We are now the better part of 20% lower on the Small Ords than where we began the year, and it has yet to be seen how long asset prices rise in response to the co-ordinated global liquidity moves by central banks on November 30.

The problem, as it stands, is not Sub Prime. Or a European debt crises. Or the Congressional Supercommittee. Or Wall St (occupied or not). These are the symptoms. The problem is that in most western countries we spend more than we earn. We can try and make these problems go away through accounting and financial engineering but without addressing their root cause, we wake up again and again with the same unresolved issue. As a group western economies have been overspending their productive value add, and turning to politicians, economists and central bankers to find new theories that justify this as sustainable. We have done this for so long that there is a sense we have forgotten the root cause of our problems.

Of course in November none of this was solved. There was some talk about a group of European bureaucrats changing some laws and creating some new complex debt super structure that was going to solve the problem for good. Except they didn't, and even if they did the problem would not be solved – but the market would be happier because so long as we all pretend this is the solution we can go on with the game. Even a six year old knows there is no downside in believing in Santa in the short term.

There is a good chance that at some point in the next few years the global economy faces a 21st century Roosevelt New Deal to address the problem at its root cause. Meaning economic change, enacted by government and enshrined in law that changes the way western economies function and how GDP is divided. This could be significant and nothing should be considered "off the table". Retirement age, corporate tax rates, personal income and capital gains taxes, behavioural taxes (consumption, vice etc), tariffs and subsidies and regulation of all sorts are likely – and demographics will make all of this trickier than it may be otherwise. These changes will at an individual level create perceived winners and losers (in the context of everyone having to be net worse off to balance the books) and as such the politics and influence of how we change and who bears the brunt of it will be a very contentious topic. This may be years away, and who knows maybe something unforeseen will indeed create the painless path to prosperity we seem to have set ourselves up to require at this point. Our approach is better to be prepared for a less robust economic outcome, and be pleasantly surprised if we escape this scenario.

1 The 'Portfolio' is the Schroder Australian Smaller Companies Fund

2 Benchmark is the S&P/ASX Small Ordinaries Accumulation Index

Unless otherwise stated all figures are as at the end of November 2011
Please note numbers may not total 100 due to rounding

*Turnover = ½(Purchases + Sales - ∑Cashinflows + ∑Cashoutflows) / ½(Market Value(T0)+ Market Value(T1) - ∑Cashflows)

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Commentary continued

There are a couple of ways of dealing with this world view – as individuals, companies and in our case as investors. One solution is buy a farm, stock up on baked beans and ammunition and await the apocalypse. Alternatively we can look at what is wrong with the current model, what a new model looks like, adopt that model today and wait until the market comes to us. Ironically, the new model is the model that has worked basically forever. The current model is about getting paid, maximising short term margins, exploiting rent seeking opportunities, application of leverage and using accounting to make perception triumph economic reality. The new model is about adding value. Free markets and capitalism when left to their own devices have never had a problem with discerning between the levels of value people and companies provide in the long run. Governments however have a few thousand years of track record, so we can be sure it is “skill” and not luck, demonstrating a completely woeful ability to discern between what is value adding and what perhaps in the short term is just popular and likely to result in (re)election.

Focusing on value adding possession of a rare and valued skill such as a surgeon, or making a unique product that people value such as Apple are good proxies) also circumvents issues of the monetary system and arguments about fractional reserve banking, central banking and gold standards. If we press reset on the world, my guess is that being one of twenty brain surgeons in Australia may be considered more valuable than one of three thousand fund managers.

Our investment philosophy and the construction of the small companies portfolio is a reflection of the value adding belief. Companies that can sustain a competitive advantage through one of two primary means – being low cost or by differentiating from their competitors – are what we invest in.

Contributors:

Dominos Pizza Enterprises (DMP.AX, +12.0%): It was only four months ago that Collins Foods Limited IPO’d at A$2.50 and was pitched as the “value” way of investing in fast food franchising in Australia. Sidestepping the whole debate around the 100% private equity sell down, massive prospectus downgrades three months after listing and a capital loss of 50% in three months, what was interesting to us through the process is the difference between this prospect and our current investment in DMP. As is the case with all IPOs, the vendor and their agents focused the market on how cheap the stock was being sold (P/E ratio) and perhaps less on what risks and long term value is attached to the business. Put really simply, DMP management through their strategic position of the Dominos brand against Pizza Hut, development of online ordering technologies and execution of this in conjunction with their franchisees do something which is difficult and valuable. They have also invested in new territories in Europe and the value of this in five years time will be the value they bring to it. Collins Foods on the other hand, as the franchisee for KFC in Qld (80% of firm value), gives investors the opportunity to build and staff KFC outlets. The other business (Sizzler, 20% of firm value) could be classified as difficult, but not particularly valuable – at least in the eyes of the consumer and they are who counts. On the same day that Collins cited tough trading conditions and lower than forecast profits, Dominos announced that they would likely deliver a result at the upper end of expectations, largely accounting for the performance of the stock during the month.

Other contributors included Resolute Mining (o/w, +17.7%), RCR Tomlinson (o/w, +15.5%) and Dulux group (o/w, +7.8%).

Detractors:

Fletcher Building: (FBU.NZ, -11.9%): The downgrades in the housing related sectors continue, with Fletcher Building updating the market in October to the trading conditions in the September quarter. FBU highlighted “In Australia, the significant downturn in residential consents and continued weak approval levels in commercial construction” as a key driver of weaker than expected profit performance, and continues similar comments from other participants in exposed to domestic non-infrastructure construction activity in the past months. The share price continued to trade down on these downgrades in November.

Other detractors included Beach Energy (u/w, +19.5%), Flinders Mines (u/w, +80.7%) and Medusa Mining (o/w, -13.5%).

Schroder Australian Smaller Companies Fund

Monthly Report
November 2011

Fund objective

To outperform the S&P/ASX Small Ordinaries Accumulation Index after fees over the medium to long term by investing in a broad range of smaller companies from Australia and New Zealand.

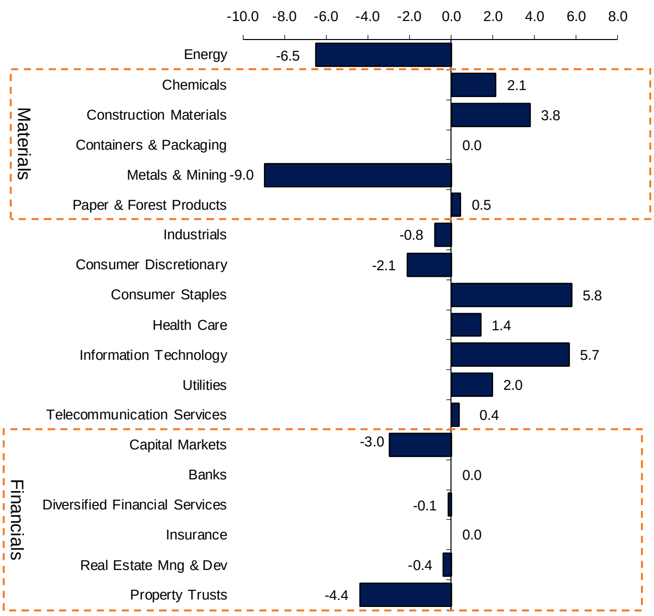
Investment style

Schroders is a bottom-up, fundamental, active growth manager of Australian equities, with an emphasis on stocks that are able to grow shareholder value in the long term.

Fund details

APIR code	SCH0036AU
Fund size (AUD)	$33,166,339
Redemption unit price	0.5962
Fund inception date	December 2007
Buy / sell spread	0.60%/0.60%
Minimum investment	$50,000
Distribution frequency	Normally twice yearly - June and Dec
Management costs (p.a.)	1.10% pa plus performance fee of 20.5% pa of net outperformance

Sector exposure versus the benchmark %



Unless otherwise stated all figures are as at the end of November 2011
Benchmark is the S&P/ASX Small Ordinaries Accumulation Index

Commentary Continued

Outlook

As we have previously highlighted, Australia in general, and many small caps in particular are more leveraged to the health of the Chinese economy than that of the marginal southern European economies. There continues to be evidence that the Chinese economy is slowing, with the latest PMI data in November indicating contraction in four of the five components. This is interesting from a small cap market perspective as despite continued evidence that China is slowing, and continued evidence that developed market growth is likely to surprise on the downside, small resource stocks have actually performed in line with small industrials since June 30 this year. But we continue to search for companies that add value and can sustain a competitive advantage that we can purchase at prices that provide solid investment returns – and we doubt these will be private equity sourced and wrapped and delivered to us by investment banks like the Santa Claus of IPO alpha generation.

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