

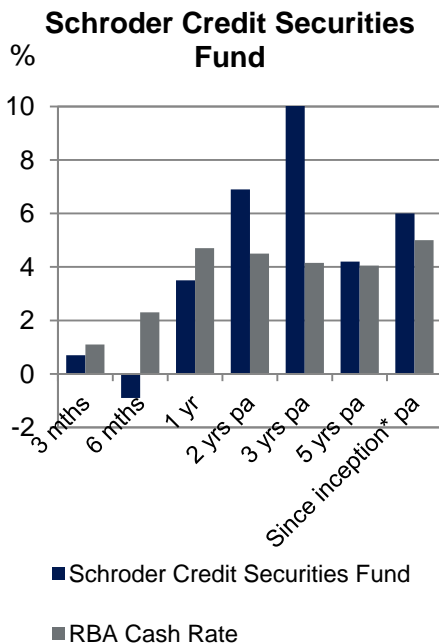
Schroders Fund Focus

Schroder Credit Securities Fund



Mihkel Kase, Portfolio Manager - Fixed Income, talks about the Fund and views on domestic and global credit markets and the portfolio positioning.

Performance to 30 November 2011 net of fees



* August 2002

The sovereign debt crisis in Europe is severely impacting investment markets around the world. How is it specifically affecting credit markets?

The uncertainty surrounding the European economy, the future course of outcomes in Europe and the health of the European banking sector means episodic market dislocation is highly likely. This has been reflected in ongoing market volatility and has kept credit spreads at elevated levels. That said, valuations across the credit curve favour credit based assets.

As an investment house, does Schroders have a positive view on credit?

Yes it does. When we look at investment markets around the world, credit looks attractive from both a valuation and a quality perspective. Corporate health is solid overall and valuations are well above breakeven levels. Across our fixed income and multi-asset portfolios in Australia, a key position is the exposure to credit based assets.

Credit markets around the world have experienced a rough ride in the past few years. What reasons can you give my clients for investing now?

An argument can be made suggesting corporate debt may be a winner from the current machinations and concerns about global sovereign debt. The current crisis is not about corporate leverage – in fact corporates are in good shape, valuations are reasonable and yield will remain a key driver of investment decisions for many investors. Hence credit is an asset class with valuation support that can provide yield and diversification to client portfolios.

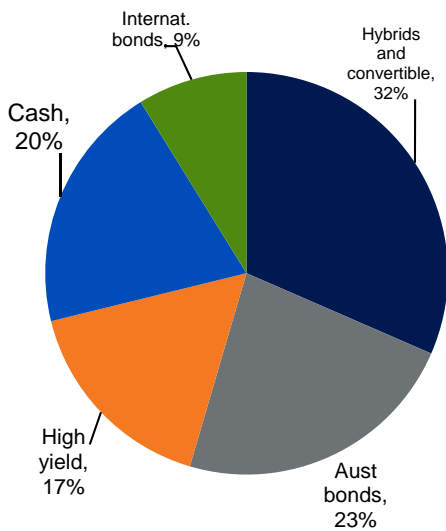
From which part of my clients' portfolios should I fund an investment in Credit?

In our recent article "Rediscovering Credit" we considered this from the perspective of a broadly diversified portfolio. It is important because the breadth of the credit opportunity set means very different outcomes can be achieved from the use of different parts of the credit universe. The critical question to address is what role credit is expected to play in the portfolio. The answer will largely determine whether the credit allocation should be funded through a reduction in the growth/equity allocation of the portfolio or through a reduction in the portfolio's true defensive exposure, or both. The more aggressive the return objective and the lower the quality / further down the capital structure the credit investment the more appropriate it is to be funded from equities. Alternatively more defensive strategies can be funded from the defensive side.

The Schroder Credit Securities Fund has successfully avoided any defaulting investments. How do you select investments for the portfolio?

Our approach to credit stock selection is based on fundamental credit research. We don't outsource our credit views, instead we have a large credit capability domestically and offshore which focuses on analysing credits and avoiding companies that won't be able to pay their debts as

Asset allocation as at 30 November 2011



Source: Schroders

and when they fall due. The focus is on identifying companies that have strong underlying cash flows, have sound business models and are priced to reflect the risk of the issuer. This research approach and our active management style give us the best chance to avoid taking exposure to companies that are likely to default.

How has credit issuance in the Australian market been impacted? What is your assessment of value in recent issues?

The GFC has to some extent reduced credit issuance in the Australian market. Firstly the significant amount of equity issued during the crisis has reduced the demand for companies to issue debt. Secondly, volatility in markets and wide credit spreads has reduced the desire of companies to issue debt into the market. That said we have seen a couple of recent issues we thought were good value. The Woolworths issued hybrid was one we found to be attractive in terms of issuer quality and price that we have recently added to the portfolio.

It looks like Australian interest rates will come back further in the new year. How will it impact the Fund's yield?

Given a portion of the portfolio is invested in floating rate credit this could potentially reduce the overall yield to maturity. However even if we do see cash rates come down further the overall yield levels will remain attractive in our view given credit spreads remain at elevated levels.

What risks do you see for the assets in the portfolio?

The two key risks are issuer default and price volatility. Firstly, the risk of default we view as relatively low as corporate health is sound at the moment, leverage has come down and interest coverage is sound. This combined with our approach to fundamental credit research should allow us to manage the default risk in the portfolio. The second risk is ongoing price volatility driven by continued global uncertainty. That said, we believe we are getting compensated for the risk of volatility through current credit spreads.

How is the Fund currently positioned?

As can be seen from the pie chart above left the Fund is currently diversified across a range of sectors with a cash holding of 20%. The cash component is intended to ensure sufficient liquidity in the Fund and also enables us to take up any opportunities in the market such as the recent Woolworths deal. We have 23% in Australian corporate credit, 31.5% in Australian hybrid securities, 16.6% in high yield and 8.8% in global investment grade bonds. Overall the quality split is investment grade 78.1% and sub-investment grade 21.9%.

Investment in the Schroder Credit Securities Fund may be made on an application form in the Product Disclosure Statement dated 1 February 2011 which is available from Schroder Investment Management Australia Limited, ABN 22 000 443 274, AFS Licence 226473 ("Schroders"). Opinions, estimates and projections in this report constitute the current judgement of the author as of the date of this report. They do not necessarily reflect the opinions of Schroders or any member of the Schroders Group and are subject to change without notice. In preparing this document, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources or which was otherwise reviewed by us. Schroders does not give any warranty as to the accuracy, reliability or completeness of information which is contained in this article. Except insofar as liability under any statute cannot be excluded, Schroders and its directors, employees, consultants or any company in the Schroders Group do not accept any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in this article or for any resulting loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of this article or any other person. This document does not contain, and should not be relied on as containing any investment, accounting, legal or tax advice. Past performance is not a reliable indicator of future performance. Unless otherwise stated the source for all graphs and tables contained in this document is Schroders. For security purposes telephone calls may be taped.