

Schroder Dynamic Inflation Strategy

Strategy Overview

Summary

Schroders Dynamic Inflation Strategy seeks to provide a hedge against the effects of rising inflation on traditional assets such as equities and bonds allowing the investor to protect total portfolio returns.

Firm highlights

- Schroders manages approximately \$328.7 billion in assets worldwide
- Asset management is our sole business
- Over 340 portfolio managers and analysts globally
- Dedicated to proprietary research – fundamental and quantitative
- Truly global reach: 32 offices in 25 countries

Team highlights

- Team based approach with portfolio managers drawing on the expertise and experience available within Risk Management, Economics, Multi-Manager and Structured Investment teams
- Multi-Asset Solutions team comprises of approximately 60 investment professionals globally
- Team manages assets of \$56 billion globally
- Access to Schroders global network of investment professional

Key features

Portfolios are constructed around the principles of:

- Diverse asset allocation across inflation sensitive assets
- Innovative inflation hedging strategies
- Active management driven by a thorough understanding of the drivers behind the inflation environment

The portfolio's strategic choice of assets have been selected to provide protection from the three broad drivers of inflation:

- A **cyclical** component – the expected level of demand in the US economy relative to output drives input costs and short-term pricing pressures
- A **structural** component – the monetary regime and shifts in global trade, production and exchange rates between emerging and developed markets result in changes in long-term external pricing pressures
- A **shock** component – a high weighting of volatile commodities in the inflation baskets can cause sudden spikes in price levels

Investment objective

The portfolio is designed to outperform traditional asset classes in an elevated or rising inflation environment and will aim to deliver a return of CPI +5% net of fees over the market cycle.

All data and statistics as of June 30, 2011

Schroder Investment Management North America Inc.
875 Third Avenue, 22nd floor, New York, NY 10022-6225
(212) 641-3800 www.schroders.com/us



Schroders

Investment philosophy

Our Dynamic Inflation Strategy is founded and managed based on three core beliefs:

- **Diversification** — Use of a broad range of inflation related assets that are sensitive to different inflationary pressures as we move through the cycle. In aggregate this portfolio when combined with traditional assets such as equities and bonds should provide a smoother path of return.
- **Understanding the inflation environment** — A focus on global inflationary trends to identify where pressures are building in the framework of structural, cyclical and shock components
- **Dynamic asset allocation** — A flexible yet disciplined approach to actively managing the mix of assets in the portfolio. We combined an understanding of the inflationary drivers and a bottom up assessment of the opportunity with risk based portfolio construction to actively manage the portfolio with conviction.

Investment process

The Dynamic Inflation Strategy Portfolio is managed based on an understanding of the impact of global drivers on domestic inflation. Inflation (as measured by CPI) is a lagging indicator and prices tend to move in response to demand and supply shifts that occur well in advance of the statistics. Nonetheless we believe that inflation has momentum and inflation trends are likely to persist for some time. The process follows three stages:

- **Top down** — Identifying the structural, cyclical and shock inflationary pressures over the next 12-18 months.
- **Bottom up** — Assessing how these themes will impact each of the underlying asset classes in the opportunity set. The portfolio would be managed in line with the views of the Global Asset Allocation Committee (GAAC) which meets and sets out recommended positions based primarily on a qualitative assessment of the environment but supported by proprietary quantitative models that assess the macro, valuation and sentiment biases across assets. Six members of the Multi-Asset team including the fund manager of this portfolio comprise the GAAC.
- **Implementation** — The portfolio is invested using internal and external strategies, active and passive approaches. We also assess both synthetic and physical investment. The Schroder Multi-Asset team is independent of the wider Group and can therefore take an objective view of the best approach.

To assist us in understanding the risks in the portfolio we have developed a sophisticated and proprietary risk management and portfolio construction software tool that was developed in-house and is managed by a team in Multi-Asset.

Portfolio construction and management

We have designed this strategy based on our strength as an independent multi asset team without bias to a particular asset class. We have considered the problem objectively and developed a solution which offers a sensible addition to a traditional equity and bond portfolio.

We will continue to investigate a range of alternative assets classes or themes which will provide effective inflation exposure. We will express these through off benchmark positions where appropriate.

How we allocate

Our medium term allocation decision, across all portfolios, is based on the point we are in the economic cycle. Our cycle model is based on the output gap which directly relates to inflation.

When the economy is producing above its trend level of output it has a positive output gap, the economy is overusing the resources available to it and this tends to result in prices being bid up and inflation rising. The opposite is true when output is below trend and the economy has a negative output gap.

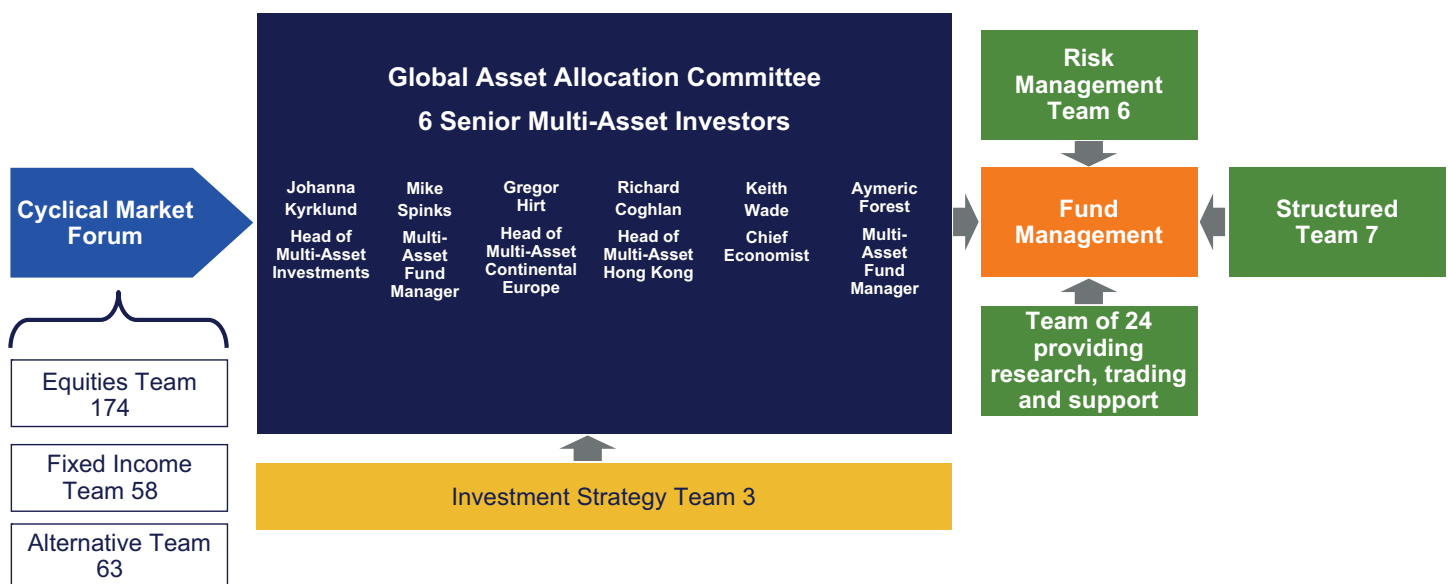
There are 4 phases of the output gap led inflation cycle:

1. Slowdown phase/Stagflation, when the output gap is positive, the rate of inflation is still rising but the rate of growth is slowing. During this phase risk assets perform poorly but commodities and TIPS tend to perform well. This phase of the cycle is often associated with fears of stagflation with growth weak and inflation high brining back fears of a return to the 1970s.
2. Recession phase, when the output gap is negative, the rate of inflation is falling and growth is below trend, assets with good fundamental growth prospects tend to perform well in this phase of the cycle so our allocation would shift in favor of EMD.
3. Recovery phase, output gap negative, inflation is still falling but the economy is growing, this is a good environment for equities and towards the end of this phase property.
4. Expansion phase/Demand Pull inflation, the output gap is positive, inflation and growth are rising in tandem, commodities and property tend to perform. During this phase of the cycle inflation can be described as demand pull and a prolonged period of this type of inflation would be analogous with what occurred in the 1960s.

The cyclical rotation of assets will be a key driver of the asset allocation alpha. The benchmark aware approach ensure that we maintain the structural exposure to inflation linked assets ensuring a level of protection against an inflation shock which may occur at any point in the cycle.

Team structure

Access to Schrodgers' global integrated network of investment experts provides key inputs to asset allocation to take advantage of inefficiencies and market dislocations.



Risk management

Our objective is to ensure that the portfolio has a diversified range of exposures to the various asset classes. As well as ensuring that the portfolio is invested across numerous positions, we make use of sophisticated risk analysis to assess and quantify different types of risks to which the strategy is exposed. Our core risk management system is a suite of three Schroder Multi-Asset Risk Technology (SMART) tools with each performing a different but important role in the management and monitoring of portfolio risk, as outlined below.

1. **A portfolio construction tool:** It provides portfolio managers with the means to design portfolio strategies with particular return and risk characteristics against a variety of benchmarks. One of the key benefits of SMART is its flexibility.
2. **SMARTVaR:** Any portfolio created within SMART can be analysed in SMARTVaR which provides VaR reporting at different confidence levels (90% - 99.5%) over different time horizons and performs CVaR – based risk budgeting. Asset class assumptions can be stress-tested within SMARTVaR by stressing, for example, the correlation matrix. Portfolios can be modified to analyse the effect of changing the portfolio structure.
3. **SMART Trader:** Enables us to assess factor risks in portfolios such as equity, fixed income, small cap, commodities, credit and the US dollar. Although the strategy has a high degree of flexibility, diversification is paramount in managing overall risk. We have therefore set ranges on the net exposure to each asset class to ensure the portfolio is broadly diversified at all times and that no one asset class contributes excessively to total portfolio risk.

Why Schrodgers for Dynamic Inflation

- Experienced team of investment professionals supported by the global resources of Schrodgers
- Portfolio diversified across broad spectrum of growth opportunities
- Our Multi-Asset Growth portfolios exploit three sources of return
- Utilizes the full range of Schrodgers' expertise and external opportunities

Risks

All investments, domestic and foreign, involve risks including the risk of possible loss of principal. The market value of a portfolio may decline as a result of a number of factors, including adverse economic and market conditions, prospects of stocks in the portfolio, changing interest rates, and real or perceived adverse competitive industry conditions. Investing overseas involves special risks including among others, risks related to political or economic instability, foreign currency (such as exchange, valuation, and fluctuation) risk, market entry or exit restrictions, illiquidity and taxation. Emerging markets pose greater risks than investments in developed markets. Investments in small- and medium-capitalization companies may involve a higher degree of risk and volatility than investments in larger, more established companies. All investments involve risks including the risk of possible loss of principal. The market value of a portfolio may decline as a result of a number of factors, including interest rate risk, credit risk, inflation/deflation risk, currency risk, mortgage and asset-backed securities risk, U.S. Government securities risk, foreign investment risk and derivatives risk.

Important Information

Schrodgers plc

Schrodgers is a global asset management company with \$328.7 billion under management as of June 30, 2011. Our clients are major financial institutions including banks and insurance companies, public and private pension funds, endowments and foundations, high net worth individuals, financial intermediaries and retail investors. Our aim is to apply our specialist asset management skills in serving the needs of our clients worldwide and in delivering value to our shareholders. With one of the largest networks of offices of any dedicated asset management company and over 340 portfolio managers and analysts covering the world's investment markets, we offer our clients a comprehensive range of products and services.

Further information about Schrodgers can be found at www.schrodgers.com/us

Disclaimer

This document does not constitute an offer to sell or any solicitation of any offer to buy securities or any other instrument described in this document. The information and opinions contained in this document have been obtained from sources we consider to be reliable. No responsibility can be accepted for errors of facts obtained from third parties. Reliance should not be placed on the views and information in the document when taking individual investment and/or strategic decisions. Schrodgers has expressed its own views and opinions in this document and these may change. There is no guarantee that any forecast will be realized, and opinions may change.

Past performance is not necessarily a guide to future performance. The value of investments can go down as well as up and is not guaranteed.

Diversification does not assure a profit or protect against loss in a declining market.

Schroder Investment Management North America Inc. ("SIMNA Inc.") is an investment advisor registered with the U.S. SEC. It provides asset management products and services to clients in the U.S. and Canada including Schroder Capital Funds (Delaware), Schroder Series Trust and Schroder Global Series Trust, investment companies registered with the SEC (the "Schroder Funds".) Shares of the Schroder Funds are distributed by Schroder Fund Advisors LLC, a member of the FINRA. SIMNA Inc. and Schroder Fund Advisors LLC. are indirect, wholly-owned subsidiaries of Schrodgers plc, a UK public company with shares listed on the London Stock Exchange.