Quarterly report

Schroder Global Recovery Fund - Wholesale Class

March 2020

Total return %

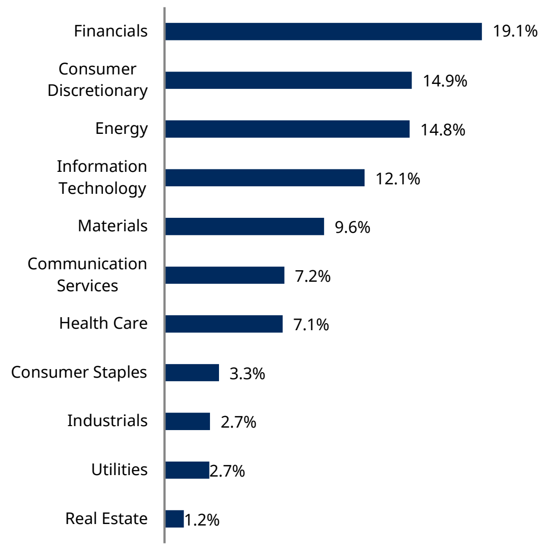
	1 mth	3 mths	1 yr	Inception pa
Schroder Global Recovery Fund (post-fee)	-18.73	-27.20	-18.61	-3.08
MSCI World Index NR	-8.60	-9.33	4.00	10.65
Relative performance (post-fee)	**-10.13**	**-17.88**	**-22.61**	**-13.73**
Schroder Global Recovery Fund (pre-fee)	-18.66	-27.03	-17.81	-2.13

Inception date of the Schroder Global Recovery Fund is August 2017
Past performance is not a reliable indicator of future performance
Please refer to www.schroders.com for post-tax returns

Top 10 portfolio holdings

Stock	Portfolio weight	MSCI World
Sanofi Sa	4.95	0.28
Anglo American Plc	4.39	0.05
Hp Inc	4.04	0.07
Eni	3.96	0.07
South32 Ltd	3.67	0.02
Standard Chartered Plc	3.44	0.04
Morrison(Wm.)Supermarkets Plc	3.26	0.02
Royal Bank Of Scotland Group Plc	3.17	0.02
Barclays Plc	3.14	0.06
Hyundai Mobis Ltd	2.98	--

Portfolio positioning as at 31 March 2020



Unless otherwise stated figures are as at March 2020
Benchmark is the MSCI World Index NR
Please note numbers may not total 100 due to rounding

Portfolio review

The MSCI World Index fell by 9.33%, while the Schroder Global Recovery Fund (post-fee) fell by 27.2%, underperforming by 17.88% for the quarter.

Our usual approach when looking at performance over the quarter is to provide clients with a paragraph on some of the names that feature at the top and bottom of our performance attribution. While we have included some stock-specific comments further below, it would be remiss of us not to comment on the general nature of the aggressive sell-off we have seen in the last month of the quarter, as it provides useful context to our stock-specific commentary.

While the sell-off has been dramatic, it has also been one-dimensional. Any sector with a cyclical bent (i.e. sensitive to the economic cycle) has seen considerably greater drawdowns; companies in sectors such as oil & gas, travel & leisure, autos and financials have been affected most. To put it another way, the market has, so far, focused on short-term earnings risk. Our portfolio owns a number of companies with greater cyclical exposure because these companies' valuations were attractive in a world of hard choices (coming into this crisis, valuations were high in many areas of the market). This context should help clients understand what has driven performance so far in this downturn.

Our positions in the financial sector detracted significantly, including **Royal Bank of Scotland**, **Barclays** and **Standard Chartered**. The banks have seen aggressive sell-offs as the market has become even more pessimistic around near-term profitability owing to central bank rate cuts as well as regulator-mandated suspensions on capital distributions. The impact of both policy actions on near-term earnings for banks will be substantial, as cash is hoarded and net interest margins get squeezed further. We continue to believe the long-term opportunities in these names is significant, owing to the valuations on offer. However, the investment opportunity set is wildly different from the start of the quarter, and the opportunity set has started to broaden out; as such we have marginally reduced some our positions in this sector.

Prior to the current Covid-19 crisis these banking positions had become a meaningful part of the portfolio. The reality is that in a market where relative valuations became hugely distorted, banks and insurers made up a large portion of the opportunity set for deep value investors. To be clear, we remain of the view that these are extremely attractive investments on a 3-5 year view, but now the breadth of opportunity is wider, we can increase the portfolio's diversification, without compromising our very high standards with regard to either balance sheet risk or valuation. This was not an opportunity afforded to us six weeks ago. We are making this shift judiciously, cognisant of extreme volatility, so have been selling those names that have fared better on up days, and adding to positions elsewhere on down days.

For the first time in many years, we are having to sell cheap stocks, to buy stocks that are even cheaper. While this psychologically difficult, this is exactly what our bespoke risk/reward framework – using risk scores, fair values and required upsides – is designed to do.

Another major detractor to performance was **Centrica**. Centrica had a good fourth quarter last year, but had given most of that up before the market drawdown began, and proceeded to fall a further 40% by quarter-end. Centrica's 2019 reported results confirmed the tough trends the business flagged last year, particularly in the consumer business where the lower UK default tariff cap weighed on results. Operating profits and net debt were in line with target ranges, and the dividend confirmed its rebased level (which has subsequently been cut in the coronavirus-related downturn). Exceptional items of £1.1 billion included impairments of £500 million to its exploration and production assets and £370 million to its nuclear investment, both of which are up for sale. While the results disappointed the market, they were in line with our expectations. The business is clearly going through a very difficult turnaround and while 2020 does not signal a year of recovery, we know from experience that turnarounds can take time. The multiple being applied to Centrica today is very low. Centrica has been hit by numerous negative events, and just a small dose of mean reversion can improve profits and allow for a reassessment of an appropriate multiple. More broadly, one obvious impact from the coronavirus crisis is that companies have been forced to speed up decision-making. For example, at Centrica, the chairperson (who was ill) stepped down with immediate effect, the CEO left with immediate effect and the financial director stepped up to be interim CEO. This increased pace of execution should be to the benefit of long-term shareholders.

Commentary continued

On the positive side, **Sanofi** performed well as healthcare behaved more defensively. This is one area where we have trimmed positions in favour of better opportunities elsewhere with more compelling risk/return profiles. Food retailer **Morrison Supermarkets** also sat near the top of our positive attribution.

Portfolio activity

For the last three years, we have been laser-focused on balance sheet strength. This is not because we forecasted the arrival of a global pandemic, but because risk appetites in the market were too high and valuations didn't compensate us for risk of an unknowable future. We believe that no -one ever knows what risks are coming, and so we always test our balance sheets versus very poor expectations. Every company we are invested in has been stress -tested, and we believe our clients are more than compensated for any risk by the upside on offer.

Some businesses, which we have avoided, have balance sheets that require a continuation of good news. A macroeconomic wobble (of an unknowable length) may prove terminal for some of them. The stock market has not differentiated in the short -term – which is what we've seen in previous market panics – but longer-term there is a difference. Strong balance sheet companies will survive. Weak ones may not, or equity holders may be subject to significant dilution. Either way , balance sheet strength combined with low valuations is vital to limiting the longer-term impact on portfolios. This means our portfolios should be better protected than most, and we are confident that the vast majority of the companies in portfolios have a significantly better liquidity and solvency profile than the average stock in the market.
We believe that this is an environment that requires calm heads and dispassionate decision making. That's what our stock pick ing and portfolio construction processes are designed to do, and is what we are executing today.

We have taken advantage of stocks that have held up well to rebalance portfolios into companies with even more attractive ris k/reward profiles. This has involved trimming some of the larger positions, such as US computing stalwart **Cisco**, to add to some of those, generally outside the top ten holdings in portfolios, that have been beaten-up but have strong balance sheets.

We initiated a position in **TGS-Nopec**, a Norwegian listed provider of subsurface surveys for the oil and gas industry. It also provides data processing services and maintains a large library of seismic and other data for offshore and onshore locations across the globe. The company's principal asset is its ' client library' of seismic data, which sits on the balance sheet as a large intangible asset. TGS would be affected by a potential downturn in exploration & production investment but w e see it as occupying an attractive niche within the industry. We also note the net cash balance sheet and historic focus on shareholder returns.

We established a position in tyre-manufacturer **Continental**. The market is nervous about a potential downturn in the auto market and the structural threat of the shift to electric vehicles (EVs). However, we note that Continental's balance sheet is among the strongest in the sector and its record of cash generation is impressive. In terms of the threat from EVs, this could impact Continental's Powertrain division but this is a relatively small part of group earnings.

We have initiated a position in Japanese healthcare business **Miraca**. It sells diagnostic testing machines and also provides outsourced laboratory testing & sterilisation services to Japanese hospitals. We see it as a good quality business with high return on invested capital and a good record of cash conve rsion. Profitability has declined in the last couple of years as it has invested in order to expand into adjacent testing areas (such as food and cosmetics testing). Management expe cts this to be an area of growth and future profits. However, we do not see the valuation as stretched even if this return to higher profitability does not materialise. Miraca al so consistently returns excess cash to shareholders with a 5% dividend yield.

We built a new position in European broadcaster **RTL Group**. RTL has leading free-to-air TV market shares in a number of European countries as well has stakes in France's M6 and Spain's Atresmedia. It owns content provider Fremantle and also produces content designed for YouTube. The market has had con cerns over pressure on TV advertising revenues, but around 25% of sales come from content production. RTL has a strong balance sheet with low levels of debt. The shares had been weak in 2019 due to a soft German TV advertising market, which seems unsurprising given the German economy has been weak in the past 12 months. We think the marke t is assuming a 30-40% decline in TV advertising profits, which seems overly harsh.

We have bought **Tiger Brands**, a South African business specialising in branded consumer staples and grain products. The business has a net-cash balance sheet, outstanding market position, high returns on capital and yet trades on a lowly valuation.

Russian business **Alrosa**, one of the world's largest diamond miners, is another new addition to the portfolio. A mixture of weak demand for natural diamonds, with some issues in China and India, together with the emergence of a threat from synthetic diamonds goes some way to explaining the share price weakness (through the market's lens). However, given it's history of strong cash-conversion and low valuation, we believe that we are well-compensated by the upside on offer for these risks.

We bought **Citizen Watch** in Q1. The company trades below tangible book value, has a very strong balance sheet and yields >4%. An argument could be made for the holding on the income basis alone. However, with the recent correction, its valuation offers compelling upside. Its recent decision to cut i ts dividend is perhaps overly cautious given its strong cash position, but likely more representative of conservative Japanese governance.

We also initiated a small position in **Tapestry**, owner of the Kate Spade and Coach luxury fashion brands. The share price has seen a dramatic decline in recent weeks and we think it now looks attractive in a recovery scenario. Clearly the current lockdowns are putting pressure on retailers of non -essential goods but we feel Tapestry's balance sheet is sufficiently robust to weather this.

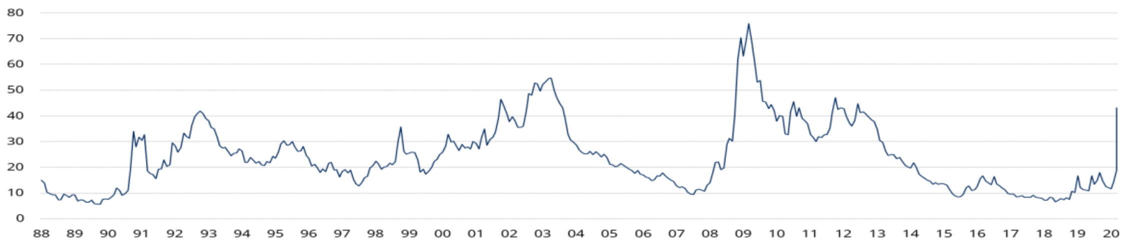
Outlook

A very human tragedy is unfolding across the world as a result of the Covid -19 pandemic. While the world grapples with this crisis, it remains our job to do the best we can by those who choose to entrust their money to us. Equity markets have been extremely volatile as investors react to the latest news-flow and assess the impact of the pandemic on end-consumer demand and companies. The speed of market movements have made it difficult for investors to accurately reflect the i mpact on companies, and therefore to make sensible pricing decisions. As such, there are many pricing anomalies where prices have moved far further than fair values, a nd similarly some prices which have not moved enough to reflect the new reality. Up to this point, the market's focus has largely been on short -term profitability, and has not yet focused or distinguished between companies with differing balance sheet strength. This pattern is similar to what we've seen in previous panics, but longer -term there is a difference and the market will almost inevitably discriminate in due course.

An indiscriminate sell-off is opportunity for discerning investors

There is an old expression that holds: "You make most of your money in a bear market – you just don't realise it at the time." If its meaning is not totally clear on first reading, the below chart starts to drill to the heart of its message.

Percentage of global stocks falling 50% from their seven year high



Source: Societe Generale. 1 January 1988 to 19 March 2020

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Key features

The benefits of investing in the Fund include:

Unconstrained: The Fund is completely benchmark unaware with a focus on stocks that will deliver absolute returns over the long term

Contrarian: The Fund adopts a disciplined value driven approach

Bottom up: The investment team has a strong focus on micro analysis, not macro, using skills in company analysis and valuation

Low turnover: A thoughtful, patient, investment style, targeting long-term value creation.

Fund objective

The fund's investment objective is to provide capital growth and to outperform the MSCI World Index.

Fund details

APIR code	SCH0095AU
mFund code	SCH45
Fund size (AUD)	$1,058,720.71
Redemption unit price	$0.8894
Fund inception date	18-Aug-17
Strategy inception date	09-Oct-13
Buy / sell spread	0.30%/0.15%
Management costs	0.98% ICR
Minimum investment	$20,000.00
Distribution guidance	1.4% p.a. (Under AMIT)
Distribution frequency	Typically June and December

Unless otherwise stated figures are as at March 2020
Benchmark is the MSCI World AUD (NR)

Outlook & strategy continued

Running from the start of 1988 to the middle of last month, the chart shows the percentage of global stocks that have fallen 50% from their seven-year high.

Value investing strives to take emotions out of the investment equation, enabling us to operate in markets gripped by investor euphoria and panic. In many respects, not least the near-vertical line on the right-hand side, this chart is a reflection of the latter and, while it does not say much about the magnitude of the potential opportunity, it says quite a lot about its breadth.

The sheer volume and number of stocks that have been beaten down in recent weeks demonstrates just how indiscriminate the market is being at present. Still to find its feet when it comes to differentiating between balance sheets, sectors and valuation, it is simply marking almost everything down. As such, while the above chart can be seen as reflecting panic, it is also a reflection of the opportunity set for value investors.

At most we buy perhaps one in 10 of all the stocks we analyse. In a strongly rising market, such as at the tail-end of a bull run, that can make life very difficult. As such, with value appearing in fewer and fewer sectors, our portfolios had become concentrated and turnover very low. The kind of market we are witnessing today, on the other hand, where there has been a broad-ranging and indiscriminate sell-off, is one we can – in a considered and discerning way – find more compelling opportunities for our clients.

Diversifying portfolio risk

The broad-based nature of the current sell-off means there is more opportunity to diversify out the risk in a portfolio than there was at the start of the year. Predictably cyclical-type businesses, such as airlines, are suffering in these markets – but so are traditionally more stable stocks, such as utilities.

At this point, it is worth stressing that, in Recovery portfolios, we will continue to be 'the investor of last resort'. It is what we do and where we are offered the most attractive returns. For example, in the Global Recovery Fund's sister portfolio, the UK Recovery Fund, which celebrates it's 50th anniversary this year, In the downturn brought on by the 2008/09 global financial crisis, we participated in rescue rights issues in the likes of Dixons, Inchcape and Taylor Wimpey and went on to make our investors many multiples of that original capital.

These were decent businesses with the wrong balance sheet at the wrong time but, we concluded, they were survivors and we should support them when no-one else would. Today, investors are generally not yet being compensated for taking that level of balance sheet or solvency risk but, while we wait for such opportunities, we can still pick up good companies at compelling prices and diversify the risk within our portfolios.

How will cyclical businesses fare in a downturn?

Irrespective of how it is defined, a recession is likely, which means that the profits for cyclical companies are likely to come under pressure. That does not, however, mean that share prices will inevitably decline. It is the stock market's job to look through cyclical issues to see how the company may fare on the other side. The share price movements have already been severe, and in many cases already price in a significant economic contraction. For companies where the balance sheets are marginal, whether a recession is accurately priced in will depend on the size and shape of the downturn. However, for those companies where balance sheets are sound, we can be confident that, on the balance of probabilities, the odds of success are more favourable today than they were in the past and can begin to move forward prudently.

Many of the cyclicals we have been holding have already been discounting a much more negative economic scenario (which is one of the reasons we hold them). A major focus of our recent balance sheet work was to understand the robustness of the companies we hold if things turn out to be even worse than the market has been discounting. We are comfortable that the companies we own, whilst not immune to the effects of an economic rout, are well placed to weather the coming storm, allowing us to profit from future recovery.

Anglo American is a case in point. It is a business that will no doubt be meaningfully affected by an economic maelstrom, but it has learned its lesson from the last downturn and now scores extremely well across the multiple balance sheet stress tests that we put all of our businesses through. Not only do we believe Anglo American will survive what's to come, but by virtue of its strong capital position, it may well be able to benefit by buying back its stock at hugely discounted levels. For example, we believe today this business could tender close to 30% of its shares in issue without putting the balance sheet in any peril. There is positive time arbitrage in many of the cyclicals we hold and we believe patience (and some bravery in buying more when attractive opportunities present themselves) will be rewarded.

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