Schroders

May 2020

Schroder Fixed Income Fund Wholesale Class

Monthly Report

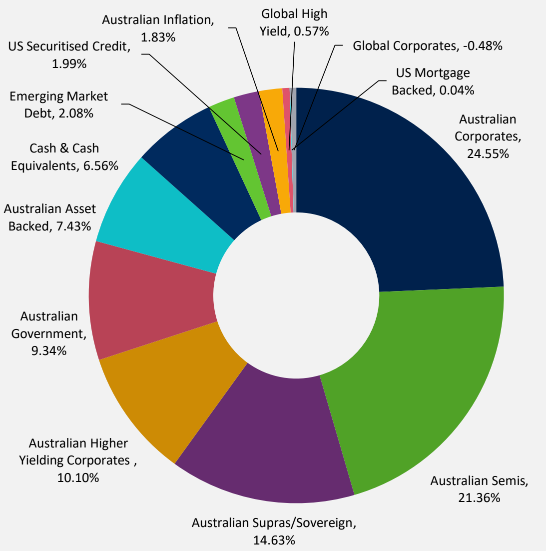
Total return %

	1 mth	3 mths	1 yr	3 yrs p.a.	5 yrs p.a.	10 yrs p.a.
Schroder Fixed Income Fund (post-fee)**	0.89	-0.46	4.45	4.73	4.00	5.32
Bloomberg AusBond Composite 0+Yr Index	0.29	0.00	4.94	5.15	4.52	5.71
Relative performance (post-fee)	**0.60**	**-0.46**	**-0.49**	**-0.42**	**-0.52**	**-0.39**
Schroder Fixed Income Fund (pre-fee)	0.93	-0.33	4.97	5.26	4.52	5.85
*Distribution return^*	*0.00*	*0.50*	*2.08*	*2.51*	*3.15*	*4.38*
*Growth return^^*	*0.89*	*-0.96*	*2.37*	*2.23*	*0.85*	*0.94*

Portfolio inception 25/02/2004, 16 years and 3 months

Past performance is not a reliable indicator of future performance

Asset allocation %



Portfolio statistics

	Portfolio*	Benchmark
Duration	6.32 yrs	5.80 yrs
Spread Duration	3.55 yrs	2.20 yrs
Yield to maturity	1.70%	0.87%
Current yield	3.02%	3.05%
Average Credit Rating	AA-	AA+
Number of securities	2069	657

Market review

Economic data suggests that for almost all countries the second quarter of 2020 will see depression-like falls, as social distancing and lockdowns significantly depressed economic activity. However, markets appear to have focused on the success of global containment measures that have seen infection rates fall in many countries and the extraordinary actions of central banks and governments to attempt to cushion the blow to the global economy. Also, many countries have begun to successfully reopen their economies which appears to have increased optimism. In May, China announced new security laws for Hong Kong which saw the US question Hong Kong's special trade status and raised the risk of another round of rising geopolitical tensions. In Australia the states and territories announced major relaxations in social distancing rules and a correction of accounting errors around the JobKeeper package saw its cost fall from the originally announced $130bn to $70bn.

Global equities returned 4.8% in local currency terms, while the Australian market posted a 4.4% return over the month. Global bond yields remain anchored to low levels, on the back of near-term deflationary forces and central bank QE programs. Government bond yields in Australia and the US were flat in the month, with Australian 10-year government bond yields falling 0.01% to 0.89%, and US yields rising 0.01% to 0.65%. Credit markets, like equities, were well bid in May with global spreads tightening over the month. Higher beta plays like emerging market debt and high yield corporate bonds performed strongly.

Portfolio review

In May the Schroder Fixed Income Fund returned 0.89% (after fees), considerably ahead of the benchmark. This takes the 12 month return to 4.45% (after fees).

Our credit allocations provided the largest contribution to return in the month, as spreads narrowed materially. Australian corporates participated in this rally after diverging from global credit in April. Our rates positions contributed marginally with curves steepening and inflation expectations bouncing a little from low levels.

Over the month we further allocated to credit, moderately increasing exposures in Australian investment grade, global investment grade and US securitised assets. In rates we've positioned for the yield curve to steepen, and while focusing mainly on Australia and the US, have reintroduced positions in the UK and Europe.

Outlook and strategy

At the time of writing, US stock markets are up almost 45% since the March lows, which is the greatest 50-day rally ever seen by the US market. Markets are rallying hard as a number of positive drivers appear to have come together: a fast and sizeable policy response, the containment of the medical emergency in many western economies, and early data suggesting the rebound in activity might be sharper than initially feared.

Back in March, with cash rates at zero and credit spreads at their widest, we identified that the best opportunities in fixed income were in credit. This was reinforced by the actions of central banks. By moving to control the yield curve, central banks limited the active opportunity in rates, while at the same time the provision of solvency support and direct market purchases reduced downside potential in credit.

As a result, we positioned our portfolios to capture this rebound, though have been surprised by its speed. Short positioning by fund managers in risky assets appears to have been part of the cause – caught on the wrong side, managers have had to painfully cover, or even chase returns in unloved places (such as value equities or high yield credit which lagged the early part of the rally).

It's a funny thing to say, but markets seem to be cheering that the COVID-19 crisis looks likely to deliver 'only' a recession, rather than the depression many were fearing. Fundamentally things still look pretty bad – unemployment rates are in double digits in the US and Europe, earnings have slumped and dividends have been cut, defaults are rising, business and consumer sentiment is poor, and inflation is weak. However, at least in the short term, the marginal change matters a lot for markets and things are looking better than they were a month ago. In addition, markets seem very confident that central bankers have (once again) minimised many of the risks.

**Returns in May and for longer timeframes that include the May month are impacted by the changes in the sell-side spread we imposed on the Fund. These changes reflect the fluctuating transaction costs associated with the varying levels of market liquidity and is intended to preserve fairness amongst unitholders.

*The 'Portfolio' is the Schroder Fixed Income Fund - Wholesale Class

*The Portfolio may have a sizeable exposure to securities, including cash instruments, issued by each of the four major Australian banks.

*Unless otherwise stated figures are as at the end of May 2020

^ Represents distributions as a proportion of total net return

^^ Price to price return excluding distribution reinvestments

*Benchmark is the Bloomberg AusBond Composite 0+Yr Index

*Please note numbers may not total 100 due to rounding

Outlook and strategy continued

However, the uncertainty in evaluating the current environment is considerable: it's a medical emergency that is both new to health specialists and for which there is still no effective vaccine; policymakers, business leaders and society in general have had to adapt on the fly; the rapid changes regarding restrictions, working arrangements and policy measures have required investors to analyse new datasets in a more timely fashion to understand their impacts; the disruption to industries has been large and the dispersion of winners and losers is wide; and the collapse to zero of cash rates in virtually all developed countries alongside a very aggressive expansion of fiscal policy represents a significant policy shift. And of course, there are likely to be longer run effects too: on the pace/direction of globalisation, on government spending priorities, on the level of government involvement in the economy, on technology and working arrangements, and on future inflation, to name a few. Markets appear to be putting aside many of these uncertainties at the moment.

Investing is all about making the best decisions possible given the inherent uncertainty of markets. Our robust investment framework, and the research that underpins it, helps us make better decisions, and we are continually enhancing it to both improve our existing methods, and adapt our methods as the investing environment changes.

As mentioned earlier, we've reoriented our portfolios considerably to embrace the new set of opportunities. Beginning in late March, we've deallocated from government and quasi-government bonds and allocated to credit across a spectrum of assets. This has meaningfully shifted our active risk away from rates, towards credit. It has also appreciably improved the portfolio's income generating potential and arguably its diversification (at least with respect to the sovereign-dominated benchmark). However, given the uncertainties described above, we are not at 'full risk', and would describe our credit allocation as about 75% through its range.

In rates our core view is that yields are likely to stay anchored at low levels, courtesy of both weak economies and ongoing dovish policy implementation by central bankers. While we think rates volatility, and hence opportunity, is likely to be low, we're looking to maximise the opportunity including by researching in detail the new demand / supply environment we are in, as buying by central banks to implement quantitative easing trades off against increased supply by governments. We're also mindful of continually assessing the ongoing viability of the low rates, low volatility view. Our preference remains to be a little long duration in both Australia and the US, with a bias for curve steepeners. More recently we've been encouraged by policy developments in Europe, including both the steps towards debt mutualisation with the Eurozone, and the commitment by Germany to (finally) expand fiscal policy meaningfully, and have taken small short duration positions there.

In credit, our view has been that the value presented by the sharp spread widening seen in March more than offsets the COVID-induced deterioration in fundamentals as earnings decline, balance sheets become further stretched and ultimately some defaults materialise. As such, over the last two months we have lifted our hedges on Australian investment grade credit, closed our short in global high yield, and allocated to global investment grade, Australian higher yielding corporates, and US securitised credit, while holding our allocations steady in Australian mortgages and emerging market debt. Overall our preference remains for Australian credit, though we are looking to diversify in areas that provide a different exposure to traditional developed market corporate exposure. The recent sharp narrowing of credit spreads makes us more circumspect on the credit opportunity from here, and it may be that we use this opportunity to trim and rebalance.

Overall, the portfolio is well positioned to both capture the opportunities and navigate the risks ahead.

Schroder Fixed Income Fund - Wholesale Class

Monthly Report
May 2020

Fund Objective
To outperform the Bloomberg AusBond Composite 0+Yr after fees over the medium term.

Investment style
Our broad fixed income philosophy is underpinned by 3 key ideas:

– Fixed income is typically held for defensive purposes. These include liquidity, capital preservation, liability management and to diversify equity risk.

– Investors should utilise the breadth of the fixed income universe to improve risk / return outcomes (as opposed to closely tracking arbitrary benchmarks).

– Volatility is not risk; we view losing money and not delivering on objectives as our core risk.

These key investment beliefs are encapsulated in our Schroder Fixed Income Fund, a Core-Plus strategy which combines a low active risk 'Core' and 'Plus' strategies where opportunities to add value is present. The Portfolio utilises the breadth of the opportunity set and combines asset allocation, country selection, credit risk management, stock selection, and duration/yield curve management in a combination that aims to outperform the benchmark Bloomberg AusBond Composite 0+Yr Index over the medium term whilst ensuring it remains a true defensive strategy.

Fund details

APIR code	SCH0028AU
Fund size (AUD)	$2,354,410,931
Redemption unit price	$1.1790
Fund inception date	February-2004
Buy / sell spread	0.12%/0.22%
Management costs	0.50%
Minimum initial investment	$20,000
Distribution frequency	Normally quarterly

Top ten holdings %

	Portfolio
QUEENSLAND TREASURY CORPORATION GOVTGUAR 3.25 21-JUL-2026	2.9%
INTERNATIONAL BANK FOR RECONSTRUCT 2.8 13-JAN-2021 (SENIOR)	2.1%
AUSTRALIA (COMMONWEALTH OF) 2.25 21-MAY-2028 Reg-S	2.0%
NEW SOUTH WALES TREASURY CORP NONDMUNI 5.0 20-AUG-2024	1.9%
NEW SOUTH WALES TREASURY CORP NONDMUNI 2.75 20-NOV-2025	1.7%
AUSTRALIA (COMMONWEALTH OF) 3.25 21-JUN-2039 Reg-S	1.7%
QUEENSLAND TREASURY CORPORATION GOVTGUAR 3.25 21-JUL-2028	1.5%
AUSTRALIA (COMMONWEALTH OF) 2.75 21-NOV-2027 Reg-S	1.5%
AUSTRALIA (COMMONWEALTH OF) 3.75 21-APR-2037 Reg-S	1.4%
AUSGRID FINANCE PTY LTD 3.75 30-OCT-2024 (SECURED)	1.4%
Total	**18.2%**

Maturity Profile %

	Portfolio	Benchmark
0-3 Years	29.1	26.1
3-5 Years	25.1	17.9
5-7 Years	16.6	14.6
7-10 Years	15.0	26.5
10-15 Years	3.7	9.1
15+ Years	10.5	5.8

Security profile %

	Portfolio	Benchmark
Fixed rate	82.1	100.0
Floating rate	17.6	0.0
Other	0.3	0.0

Regional exposure %

	Portfolio	Benchmark
Australia	79.0	100.0
USA	17.4	0.0
Europe ex UK	1.7	0.0
UK	0.8	0.0
Asia inc Japan ex EM	0.0	0.0
Emerging Markets	1.1	0.0

Holdings by composite broad credit rating %

	Portfolio	Benchmark
AAA	41.6	75.9
AA	14.3	16.7
A	10.9	4.3
BBB	27.4	3.0
Below BBB	2.8	0.0
Cash and Equivalents	2.8	0.0
Not Rated	0.2	0.0

Credit ratings are scales by which the future relative creditworthiness of a security is measured and express an opinion about the vulnerability of default. Credit ratings may be issued by an independent credit rating agency, or represent internal ratings prepared by Schroders. A change in a published credit rating can impact the price and liquidity of the security(ies) being re-rated.

Investors should not rely on credit ratings in making investment decisions or view them as assurances of credit quality or the likelihood of default. The ratings issued included in the monthly report are intended to be used by wholesale investors as a guide only and should not be relied on by retail investors when making a decision to buy, hold or sell any securities or make any other investment decisions.

Unless otherwise stated figures are as at the end of May 2020

Figures may not total 100 due to rounding

Regional exposure is expressed by currency pre-hedging

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