Schroders

January 2019

Schroder Fixed Income Fund - Wholesale Class

Monthly Report

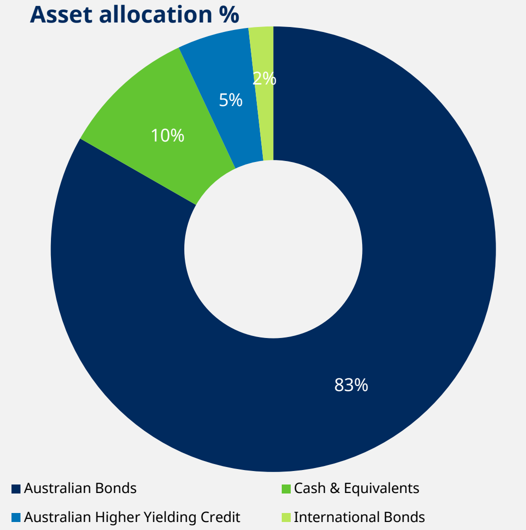
Total return %

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)	0.59	2.04	4.57	3.14	3.68	5.11
Bloomberg AusBond Composite 0+Yr Index	0.64	2.40	5.49	3.50	4.58	5.11
Relative performance (post-fee)	**-0.05**	**-0.36**	**-0.92**	**-0.36**	**-0.90**	**0.00**
Schroder Fixed Income Fund (pre-fee)	0.64	2.17	5.09	3.66	4.20	5.64
*Distribution return^*	*0.00*	*0.51*	*2.08*	*3.22*	*3.66*	*5.02*
*Growth return^^*	*0.59*	*1.53*	*2.48*	*-0.08*	*0.02*	*0.09*

Portfolio inception 25/02/2004, 14 years and 11 months

Past performance is not a reliable indicator of future performance

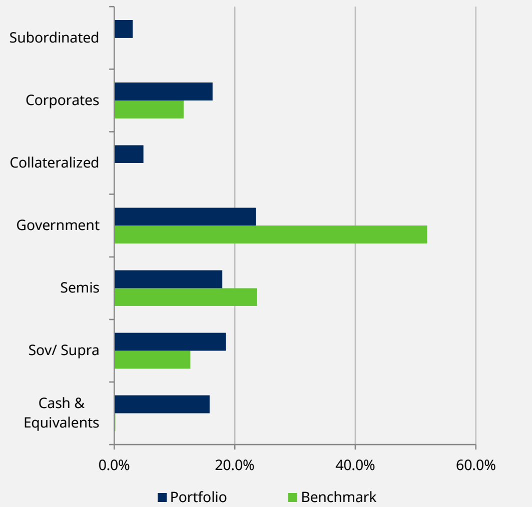
Asset allocation %



Portfolio statistics

Portfolio statistics	Portfolio*	Benchmark
Duration	5.09 yrs	5.21 yrs
Credit spread duration	2.15 yrs	1.99 yrs
Yield to maturity	2.43%	2.28%
Current yield	3.32%	3.69%
Average Credit Rating	AA-	AA
Number of securities	791	659

Sector exposure



*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 Jan 2019

*Benchmark is the Bloomberg AusBond Composite 0+Yr Index

*Please note numbers may not total 100 due to rounding

^ Represents distributions as a proportion of total net return

^^ Price to price return excluding distribution reinvestments

Market review

Markets were subject to cross currents in January but chose to focus on the positives. The main positive over the month was the pivot by the US Federal Reserve (Fed), which went from expecting to provide further rises in the cash rate, to indicating a pause in higher rates - highlighting they will hold for as long as necessary. This was driven by a significant downgrade in the outlook for the US economy. Also, the restarting of trade talks between the US and China was a positive news story over the month. On the negative side was the US government shutdown and signs of a slowdown in global growth. A disagreement between President Trump and the House Democrats on funding for a border wall saw to a partial shutdown of the US Federal government continue in January, this lasted for a record 35 days before a temporary agreement saw federal employees back at work. Weaker economic data, particularly from China and Europe, pointed a softening in global growth.

Global equities rose strongly in January, returning 7% in local currency terms, with emerging market and US equity leading the pack. The Australian market underperformed in January seeing a more modest 4% rise. Government bond yields continued to fall, in line with the more dovish Fed, with 10 year yields moving lower during the month by 0.05%, to end it at 2.63%. Australian 10 year yields moved 0.08% lower to end the month at 2.24%, while German yields fell by 0.09% while Japanese bond yields were unchanged. Credit markets took the lead from equity markets, with January seeing spreads over government bonds narrow significantly.

Portfolio review

The Schroder Fixed Income strategy returned 0.59% (after fees) over January, just behind the benchmark's return. With portfolio duration close to neutral now, our yield curve and inflation exposures added value, however our underweight to global higher yield credit offset these gains as risk appetite recovered rapidly. Over a year the strategy's 4.57% (after fees) has slipped below the benchmark's 5.49%. Through most of 2018 we were cautiously positioned in both interest rate and credit exposures, however the recent market volatility created some opportunity to set the portfolio more constructively. Having bought considerable duration in the December quarter, interest rate exposures were largely maintained in January. We added credit exposure in December and early January, though with markets rebounding so sharply have now shifted some of our exposure from lower to higher quality.

Outlook and strategy

In our last report we noted that an obvious circuit-breaker to the market turmoil of the December quarter would be a more dovish central bank shift. This was delivered in commentary by Fed chair Powell in the early part of January and reaffirmed at the FOMC's late month meeting. Alongside this, we considered that both the US/global growth deceleration apparent in recent months and the unlikeliness of a material near-term reacceleration should see rates somewhat rangebound, but that credit offered a relatively appealing opportunity after recent weakness.

The post-GFC economic cycle has been more muted than previously, and therefore more dependent on policy for marginal change. In turn markets have become heavily dependent on policy, both because of the higher economic dependency on policy, as well as because of the direct implementation of policy via markets (eg central banks buying bonds). The bounce in market sentiment that has occurred year-to-date is therefore unsurprising, but now that the dovish shift has been delivered, and markets have recovered some of their nerve, the question is: "what now?"

Firstly, valuations of riskier assets, having moved closer to fair during December, are now back in expensive territory. To some degree a more dovish central bank environment supports this – the pace of stimulus withdrawal slows, policy certainty increases, market volatility falls.

Secondly, it's too early to declare the economic cycle over. While late last year markets shifted from worrying about higher inflation to worrying about lower growth, actually we think they should be worrying about both – with respect to the US at least, we think we are in the late stage of the cycle where both inflation rises and growth slows, a generally unfavourable cocktail for markets. Although we have downshifted our view on both US growth and inflation over the past six months, we still see the US economy travelling through this late stage for some time – our models are still saying recession is more than 12 months away – and perhaps the Fed pause can allow the US cycle to extend. Alongside this, corporate fundamentals are weakening, but not yet especially problematic.

Outlook and strategy continued

Beyond the US, the global economy has been weakening for some time. It's clear that China's slowdown has been a key driver – stronger policy stimulus and an easing of the trade war appear required to arrest this. Locally, the ongoing housing correction, concern around global developments, and persistent low inflation have seen the RBA join the dovish chorus this week.

Thirdly, it would seem that the bounce in market sentiment needs to be validated by an improvement in economic data to be sustained. We think the downward trends in global manufacturing and trade data will take some time to arrest so don't expect this to occur in the near term.

We bought about a year of duration in the December quarter. This leaves us a little overweight Australian interest rate risk, neutral in the US and short in Europe, where value remains poorest. In addition to the country positions we have largely kept in place both yield curve flatteners and inflation linked exposures, and look for moderate repricing in each. While our expectation is for a range trading rates environment in the near term, we expect to be adding considerably more duration to the portfolio on opportunity through 2019, as the US economic cycle ages further.

We're happy to hold higher quality credit for carry, and although we might add on near-term weakness, we are not expecting to build up a very significant credit holding at this point given the stage of the US cycle. Our preference remains for Australian investment grade corporates, and against global high yield. Although we added a little exposure to each during the Q4 weakness, our most recent changes have been to add Australian IG but reduce US HY. We retain an effective short position in the latter.

Schroder Fixed Income Fund - Wholesale Class

Monthly Report
January 2019

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)	$2,162,647,314
Redemption unit price	$1.1029
Fund inception date	February-2004
Buy / sell spread	0.12%/0.12%
Management costs	0.50%
Minimum initial investment	$20,000
Distribution frequency	Normally quarterly

Top ten holdings %

	Portfolio
US Treasury Infl (Tii) 0.2500 15/01/2025	4.1%
Australian Government 2.7500 21/04/2024 Series 137	3.3%
QLD Treasury Corp 3.2500 21/07/2026 Series Regs	2.7%
Australian Government 4.2500 21/04/2026 Series 142	2.6%
International Bank For Reconstruction and Development 2.8000 13/	2.2%
Australian Government 3.7500 21/04/2037 Series Regs	1.9%
Australian Government 3.2500 21/04/2025 Series 139	1.8%
NSW Treasury Corp Index Link 2.7500 20/11/2025 Series Cib1	1.8%
Australia (Government Of) 4.7500 21/04/2027 Series 136	1.7%
Australian Government 4.5000 21/04/2033 Series 140	1.7%
Total	**23.8%**

Maturity Profile %

	Portfolio	Benchmark
0-3 Years	40.2	29.7
3-5 Years	19.8	17.5
5-7 Years	19.6	13.8
7-10 Years	11.1	25.1
10-15 Years	5.3	9.2
15+ Years	4.0	4.7

Security profile %

	Portfolio	Benchmark
Fixed rate	79.2	99.8
Floating rate	20.7	0.2
Other	0.1	0.0

Regional exposure %

	Portfolio	Benchmark
Australia	91.6	100.0
USA	7.7	0.0
Europe ex UK	0.6	0.0
UK	0.2	0.0
Asia inc Japan ex EM	0.0	0.0
Emerging Markets	0.0	0.0

Holdings by composite broad credit rating %

	Portfolio	Benchmark
AAA	51.1	73.3
AA	18.7	19.6
A	5.1	4.2
BBB	12.1	3.0
Below BBB	-0.9	0.0
Cash and Equivalents	15.6	0.0
Not Rated	-1.6	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.

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Figures may not total 100 due to rounding

Regional exposure is expressed by currency pre-hedging

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