Schroders

May 2019

Schroder Absolute Return Income Fund Professional Class

Monthly Report

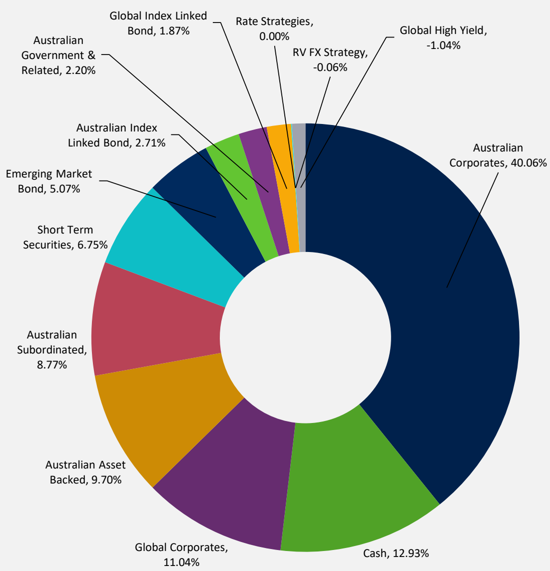
Total return %

	1 mth	3 mths	1 yr	3 yrs p.a.	5 yrs p.a.	10 yrs p.a.*
Schroder Absolute Return Income Fund (pre-fee)	0.56	1.87	4.76	4.50	3.92	6.87
RBA Cash Rate	0.12	0.37	1.50	1.51	1.78	2.74
Relative performance (pre-fee)	**0.44**	**1.50**	**3.26**	**2.99**	**2.14**	**4.13**
Schroder Absolute Return Income Fund (post-fee)	0.52	1.73	4.19	3.94	3.36	6.30
*Distribution return^*	*0.29*	*0.86*	*3.49*	*4.34*	*4.72*	*5.13*
*Growth return^^*	*0.23*	*0.86*	*0.70*	*-0.40*	*-1.37*	*1.17*

Portfolio inception 24/06/2002, 16 years and 11 months

Past performance is not a reliable indicator of future performance. Returns over 12 months are annualised.

Asset allocation %



Portfolio statistics

Duration	1.45 yrs
Yield to maturity	2.66%
Average credit rating	BBB+
Number of securities	1511

*Please note numbers may not total 100 due to rounding

*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 2019

*Benchmark is the RBA Cash Rate

^ Represents distributions as a proportion of total net return

^^ Price to price return excluding distribution reinvestments

Market review

The re-escalation of trade tensions and signs of slowing global growth were the key themes driving markets in May. Instead of the expected resolution of trade talks between the US and China, May saw the re-escalation of the dispute. On May 5 US President Trump tweeted that the tariff on $200bn Chinese goods would rise from 10% to 25% and that he was looking at placing a 25% tariff on currently untaxed imports. In retaliation, China announced an increase in tariff rates on US goods. President Trump added to the uncertainty again at the end of the month by announcing a 5% tariff on imported goods from Mexico to pressure Mexico to strengthen its border security. Data released in May suggested that global growth continued to deteriorate, with the lagged effect of the trade dispute continuing to weigh on the global economy. In Australia, the return of the Coalition Government boosted business sentiment, as well as indications from the Reserve Bank of Australia's Governor that the cash rate was likely to be lowered in June.

Global equities fell sharply in May returning -6.2% in local currency, while the Australian market was a rare oasis posting a positive return of 1.7%. Chinese equity markets suffered the worst performance, falling 13.5%, given the re-escalation of the trade dispute. Global government bond yields fell in May, with 10-year yields in the US falling by 0.38% to end the month at 2.12%. 10-year yields also fell in other markets, falling by 0.22% in Germany and 0.05% in Japan. In Australia, 10-year yields followed a similar pattern, falling by 0.33% to end the month at 1.46%. Credit markets, particularly high yield credit, had a weak month in May.

Portfolio review

The Schroder Absolute Return Income Fund returned 0.56% (pre fees) over the month of May and delivered 4.76% (pre fees) over 12 months exceeding the RBA cash rate by 0.44% (pre fees) and 3.26% (pre fees) respectively.

With the market moving into a risk off mode we had a widening in credit risk premium across markets. This was relatively moderate in investment grade markets however in the sub- investment grade market it was more pronounced as is to be expected in the lower quality segments. Our portfolio is essentially investment grade and having removed our US high yield exposure some months ago the portfolio was relatively insulated.

In term of interest rates our long Australian duration position contributed to performance with bonds rallying as the market moved to price in the probability of interest rates cuts. Softness in the local economy and a weaker housing market prompted the market moves and for the RBA to actually cut rates in early June. Our exposure to inflation-linked bonds was also contributed as inflation expectations lifted a little. Our currency positioning via the long Yen exposure contributed to performance as market volatility lifted.

Overall our positioning remains reasonably defensive given where we see valuations. We are positioned to generate defensive income and await the repricing of risk to increase exposure to markets.

Outlook and strategy

The 24-hour news cycle provides a never-ending deluge of information and distraction. Trade wars, Brexit, global growth concerns and the list goes on. The challenge ultimately is to cut through the noise and focus on those thing that drive portfolio outcomes. In the case of the Absolute Return Income Fund the portfolio outcome we focus on is to deliver income but also importantly manage downside risk.

At the core of our process is valuations, where we look across the full opportunity set to determine those assets where we see the best value. Valuations ultimately drive outcomes and hence are key. Imbedded in this approach is active management. Adjusting portfolio exposures over time with changing valuations allows us to capture opportunities as they present themselves. Managing downside risk is also important in ensuring aggregate portfolio risk is at its intended level, as well as in the desired assets and that the portfolio is adequately diversified.

Outlook and strategy continued

With this approach in mind our valuation models and our outlook on the economic cycle leads us to remain defensively positioned. Risk assets appear fully priced and we are late in the cycle. We see the risk of a US recession as more of a medium term issue although we do believe risky assets will have periods of price adjustment and bouts of volatility as markets focus on potential headwinds including potentially weaker economic growth and liquidity withdrawal. With the Fed having signaled its "patient" stance and the RBA cutting interest rates at the beginning of June it is clear central banks are concerned about the path ahead of us.

As such our credit allocations remain focused on investment grade which has low levels of default risk. With this we are able to generate yield whilst minimising the risk to capital from default. In May we adjusted some portfolio exposures. We implemented a small reduction both in the US investment grade position and in our EMD exposure, while also adding to AAA- rated RMBS. This served to reduce total risk at the margin whilst maintaining yield. We have retained our hybrid exposures but prefer the wholesale Tier 2 issuance given their current levels.

We will continue to look to add assets opportunistically but are prepared to be patient. We continue to largely avoid the lower quality end of the credit market where we think risk is truly mispriced. Leveraged loans looks to be one asset class that will face challenges going forward. High leverage, declining profits and covenant-lite issuance mean it remains susceptible to a slowing economy and/or a reduction in global liquidity. To this end we are avoiding sub-investment grade exposures weather they it be in bond or loan format.

In interest rates we have retained a long duration position in Australia given the risks around the softening domestic economy and the weakness around the housing market. We did trim this position over the month as we took some profits on the rally in bonds as the market prices in greater changes of RBA cutting rates. In the US we added duration and having previously been short we have established a small long position consistent with the view that the Fed is more likely to look to stimulate the economy should we see continued weakness. We also retain some inflation protection. Whilst inflation has been largely discounted by the market we view this as a relatively cheap way to provide some protection should we see an inflation shock in the future.

In currency terms we continue to see benefit in holding long USD and long Yen positions versus the AUD. These currency exposures provide additional downside protection in risk off periods and complement our duration positions. We added to the long USD position during May as a way of adding more downside risk protection into the portfolio.

Overall we remain focused on the higher quality segments of credit and have reduced risk at the margin. We have been extending our duration exposures and added to our our currency exposures to manage risks. Importantly we remain liquid and able to take advantage of future volatility to position the portfolio more constructively.

Schroder Absolute Return Income Fund - Professional Class

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Fund Objective
To outperform the RBA Cash Rate after fees over the medium term.

Key Features
- Actively managed absolute return debt strategy offering income, risk control and liquidity

- Flexible and diversified, with the capability to invest across the fixed income universe, unconstrained by a benchmark

- Greater focus on reducing losses with risk objective of avoiding negative returns over rolling 12 month periods

- Proven investment approach that aims to ensure we are in the right assets at the right time, with a focus on risk management

- Stable and experienced local team with a long track record in absolute return investing, with access to Schroders' global investment resources

Fund details

APIR code	SCH0024AU
Fund size (AUD)	$92,147,383
Redemption unit price	$0.9901
Fund inception date	June-2002
Buy / sell spread	0.20%/0.20%
Management costs	0.54%
Minimum initial investment	$500,000
Distribution frequency	Monthly

Top ten holdings %

	Portfolio
AUSTRALIA (COMMONWEALTH OF) 0.75 21-NOV-2027 Reg-S	2.7%
AUSGRID FINANCE PTY LTD 3.75 30-OCT-2024 (SECURED)	2.0%
TREASURY (CPI) NOTE 0.25 15-JAN-2025	1.9%
ALE DIRECT PROPERTY TRUST 5.0 20-AUG-2020 Reg-S (SENIOR)	1.3%
MACQUARIE GROUP LTD 3.25 15-DEC-2022 Reg-S (SENIOR)	1.2%
COMMONWEALTH BANK OF AUSTRALIA 2.3578 25-APR-2023 (SENIOR)	1.1%
BBI (DBCT) FINANCE PTY LTD 2.16 09-JUN-2021 (SECURED)	0.9%
CHORUS LTD 1.125 18-OCT-2023 Reg-S (SENIOR)	0.9%
APT PIPELINES LTD 4.2 23-MAR-2025 Reg-S (SENIOR)	0.9%
IDOLT-11-1-A1 2.6 17-JUN-2042	0.8%
Total	**13.7%**

Maturity Profile %

	Portfolio
0-3 Years	37.5
3-5 Years	21.5
5-7 Years	16.8
7-10 Years	11.8
10-15 Years	1.0
15+ Years	11.3

Security profile %

	Portfolio
Fixed rate	68.4
Floating rate	31.9
Other	-0.4

Regional exposure %

	Portfolio
Australia	63.1
USA	27.5
Europe ex UK	5.1
UK	1.4
Asia inc Japan ex EM	0.0
Emerging Markets	2.9

Holdings by composite broad credit rating %

	Portfolio
AAA	15.6
AA	10.0
A	9.8
BBB	40.4
Below BBB	4.1
Cash and Equivalents	19.5
Not Rated	0.6

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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Regional exposure is expressed by currency pre-hedging

Contact
www.schroders.com.au
E-mail: info.au@schroders.com
Schroder Investment Management Australia Limited
ABN 22 000 443 274 Australian Financial Services Licence 226473
Level 20 Angel Place, 123 Pitt Street, Sydney NSW 2000
Phone: 1300 136 471 Fax: (02) 9231 1119

Schroders