Schroders

September 2020

Schroder Real Return CPI Plus 5% Fund Wholesale Class

Quarterly Report

Total return %

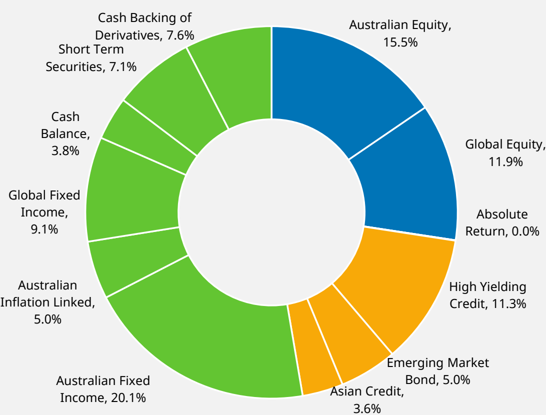
	1 mth	3 mths	1 yr	3 yrs p.a.	5 yrs p.a.	Inception p.a.
Schroder Real Return CPI Plus 5% Fund (pre-fee)*	-0.30	0.69	1.01	3.93	4.62	6.29
Schroder Real Return CPI Plus 5% Fund (post-fee)*	-0.38	0.46	0.10	3.01	3.69	5.34
Distribution^	0.00	0.00	3.38	3.48	4.00	4.27
Growth^^	-0.38	0.46	-3.28	-0.47	-0.31	1.07

Portfolio inception 01/07/2010

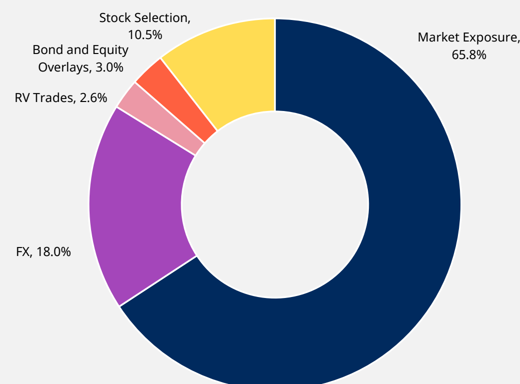
*Performance may be impacted by changes in the buy/sell spread over the period.

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

Asset allocation - Capital Weights



Asset allocation - Risk Weights



RBA CPI Trimmed Mean* as at 30 June 2020

3 months	-0.15%
1 year	1.22%
3 years. p.a.	1.48%
5 years. p.a.	1.96%
Since Inception	1.98%

*The RBA CPI Trimmed mean returns are published quarterly by the ABS. Historical returns may be subject to revisions.

^ Represents distributions as a proportion of total net return

^^ Price to price return excluding distribution reinvestments

Portfolio refers to the Schroder Real Return CPI Plus 5% Fund Wholesale Class

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

Numbers may not total to 100 due to rounding

* Inception date of the Schroder Real Return CPI Plus 5% Strategy is 1 October 2008, as represented by the Schroder Real Return CPI Plus 5% Fund - Professional Class

Fund objective

To deliver an investment return of 5.0% p.a. before fees above Australian inflation over rolling 3 year periods. Inflation is defined as the RBA's Trimmed Mean, as published by the Australian Bureau of Statistics.

Portfolio review

The Schroder Real Return CPI Plus 5% Fund ("Fund") returned -0.38% (post-fees) in September, taking the quarter and rolling one-year return to 0.46% and 0.10% (post-fees) respectively. While the 1-year return is below our target of real 5%, this compares to a fall of -10.2% in the ASX 200 over the same period. Volatility and downside risk remain low and consistent with the Fund's objectives.

Largest contributors

FX was the largest positive contributor in September, adding roughly 0.4% to overall portfolio returns, with a rebound in the USD helping to drive FX returns. Duration also added 0.1% to returns, while our S&P 500 options also made a moderate positive contribution. Over the quarter, the main positive drivers of returns were split across Equities, Credit and Duration. Within Equities, Global Equities were the primary positive contributor adding 0.4% to returns, while in Duration, our AUD holdings were the largest contributor adding 0.2% to returns.

Largest detractors

The main detractor to returns in September was Equities, as a pullback in risk markets saw Equities weigh down portfolio returns by -0.7%. Within the Equities figure, a large part of this detraction coming from Australian Equities which underperformed Global Equities. Credit spreads were a more moderate detractor over the month, taking -0.2% off returns. Over the quarter, the primary detractor was FX with USD weakness being the primary driver, which impacted overall portfolio returns by -0.6%. Stock selection in both Australian and Global Equities was another detractor as value stocks underperformed growth stocks, while our S&P 500 put options were also a small drag on returns.

Market Review

It's easy to get distracted in the current environment. Covid-19 case counts globally ebb and flow as does the political rhetoric around vaccinations and cures, the US political "circus" rolls on and will only intensify in the lead up to the November poll, the delivery and appropriateness of the various fiscal support packages (including the Australian budget) are under scrutiny and geo-political tensions remain elevated.

Behind this list lie some extremely important bigger picture issues that will materially impact the path forward for markets.

With economic Armageddon averted through rapid and aggressive fiscal and monetary policy responses as the pandemic unfolded earlier in the year, the focus has shifted to the realities of recovery and both credit and equity markets have responded reflecting a more optimistic future in prices. The optimistic view is that 2021 will bring a successful vaccine and vaccination roll-out, and against a backdrop of significant and ongoing fiscal and monetary support, economies will roar back to life in the "new" normal economy. However, despite the proclamations of President Trump, this is far from assured and the outlook for 2021 remains uncertain. The optimistic scenario may play out, but it's entirely possible that despite the ongoing support from policymakers, the private sector does not match up, or that the stop-start characteristics of 2020 carry forward.

While few would argue that the fiscal and monetary life support for the economy is not welcome and/or needed, it is a double-edged sword from an investor's point of view.

Firstly, record-low interest rates are helpful for borrowers both in terms of "encouraging" credit growth and reducing the cost of debt, but for savers, interest rates and returns from interest bearing investments have collapsed. Increasing capital values as interest rates have declined simply reflects a pull-forward of future returns but returns from these investments going forward will be very low for some time.

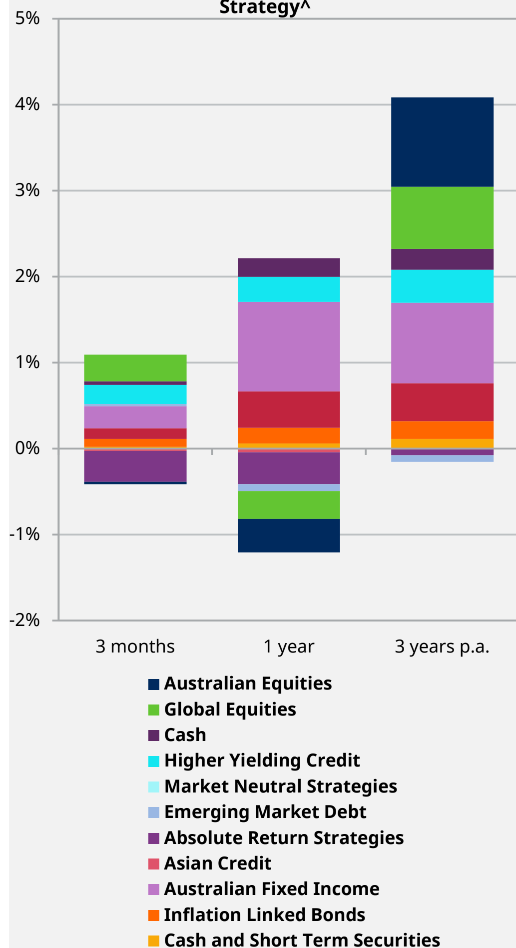
Secondly, while government debt levels in Australia are low by global standards it's the burgeoning global debt load that effectively keep rates low for an extended period (supply and demand doesn't really work in the sovereign debt market). This means that we need to get accustomed to negligible returns from cash and shorter dated low risk debt investments for an extended period. More variability at the longer end of curves is possible given the combined stimulus could trigger some inflation (particularly if the economy gains some underlying momentum in 2021) but this won't help those with money in the bank.

The implications for equities are mixed. The bullish argument for equities is two-fold. Stimulus measures have and will continue to inject liquidity into the economy and while private demand remains subdued this is flowing into financial markets and asset prices (not goods prices). With rates so low, equities generally offer higher yields (income) and the potential (indeed the assumption) of growth. At what point this argument collapses is difficult to tell but with risk free rates close to 0% it could run for a while.

Schroder Real Return CPI Plus 5% Fund Wholesale Class

Quarterly Report September 2020

Performance



Fund details

APIR code	SCH0047AU
Fund size (AUD)	$1,754,746,015
Redemption unit price	$1.1127
Fund inception date	July-2010
Buy / sell spread	0.20%/0.20%
Management costs	0.90%
Minimum initial investment	$20,000
Distribution frequency	Normally twice yearly - June and December

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

^Strategy relates to the Schroder Real Return CPI Plus 5% Professional Class

Market Review continued

The more bearish (although I'd suggest "balanced") argument is that absolute valuations particularly in certain sectors like technology in the US are very extended suggesting that much of the potential recovery is now discounted and the onus has shifted back to corporates to deliver even better earnings growth to drive further gains. The alternative is a broader rotation away from these "growth" sectors towards the parts of the market that are fundamentally more solid but at much better valuations. At present, markets are grappling with these competing perspectives (as are we).

The key idea behind a diversified investment portfolio is to avoid the need to bet on a particular outcome but to balance risks to align with investor objectives under uncertainty. We have no better insight to the likelihood of a Covid-19 vaccine than the average punter.

To this end, I'd summarise our key positions as follows:

- we are cautious but not bearish on risk position, largely due to liquidity and policy support and the fact that in equities the extremes of valuation are concentrated and not uniform;
- within equities, we are biasing toward the more attractive segments of the market like Australian equities and value to growth as a style bias;
- where possible we aim to find high quality "carry" in preference to cash – albeit they are becoming scarcer;
- we are looking for and making investments in areas where there is a structural and underinvested risk premia (like Commercial Real Estate lending) and other selective alternative investments;
- we are diversifying away from broader corporate risk in developed economies and into markets like Asian credit and US securitized debt which provide high quality exposure to the US consumer; and
- we have a preference for safe-haven currencies (USD and JPY) as risk hedges, albeit maintaining some sovereign duration exposure despite very low yields.

Market Outlook

Equity

Equities weakened during September as a resurgence of Covid-19 cases in Europe and the inability of Democrats and Republicans in the US to come to an agreement on a fiscal package weighed on investor sentiment. With Biden's chances of winning the US election increasing over the last few weeks according to betting markets, investors are weighing up what a potential Biden victory may imply for Equity markets, as the proposed tax hikes will be a drag on corporate earnings. This will at least be partially offset by increased fiscal expenditure, should it pass through Congress. The other factor that will impact markets is the upcoming US Q3 earnings season which kicks off from mid-October, with consensus expectations for a continued recovery in earnings per share, albeit still down almost 20% from 2019 levels in absolute terms.

With the pullback in Equity markets stalling the run that we've see in mega cap US tech stocks, this allowed Global Value stocks to outperform Growth stocks during the month. However, over the 12 months to September, Value stocks have still underperformed Growth stocks by over 38%.

While we remain cautious on Equity markets given the extended valuations and uncertainty around the upcoming US selection, we have used the pullback in September to add about 2% to our Equities exposure taking the overall allocation to 27.5%. We also sold some out of the money S&P 500 Put Options, which allows us to collect a premium while the CBOE Volatility Index (VIX) is still trading at a relatively high level of around 30. This should enable us to effectively buy back into the market should the S&P 500 fall to the 3000 mark.

Fixed Income

Australian bonds were one of the standout performers during September, as both shorter and long end yields moved lower on the back of a speech by RBA deputy governor Guy Debelle flagging the potential for the RBA to provide further easing. Bond markets are now anticipating a further rate cut to 10 bps and potentially further quantitative easing. Global bond yields also rallied through September, albeit to a smaller extent than Australia. Credit and emerging market debt spreads widened over the month in conjunction with the pullback in equity markets.

Over the month we made a few changes to our fixed income positions, though overall portfolio duration remains at 1.75 years. We added moderately to our credit exposure, spread out across investment grade, high yield and securitised, in order to seek some additional yield. Additionally, we added a US 5s30s steepener given the concerns around a steeper US curve.

Currency

The USD recovered some of its losses over the last few months, as a broader sell-off in risk assets resulted in safe haven currencies like the USD and JPY outperforming. We have flagged that a possible rebound in the USD was possible given the accumulation of short speculative positions, however our medium term view is for the USD to continue to weaken as it remains overvalued against other developed market currencies (with the exception of the AUD), while the Fed's accommodative stance is also likely to be supportive of a weaker dollar.

Discontinuation of the London Interbank Offered Rate

This notification is to inform you of the changes that will arise due to the discontinuation of the London Interbank Offered Rate (and other similar rates) by the end of December 2021 and its impact on our funds. For more details, please refer to our policies & notices page on our website www.schroders.com.au

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Investment style

Our approach to inflation plus (or real return) investing is to choose the portfolio that has the highest probability of achieving the required return objective over the investment horizon with the least expected variability around this objective. The Fund employs an objective based asset allocation framework in which both asset market risk premium, and consequently, the asset allocation of the portfolio are constantly reviewed. The portfolio will reflect those assets that in combination are most closely aligned to the delivery of the objective.

Investment in the Schroder Real Return CPI Plus 5% Fund Wholesale Class ("the Portfolio") may be made on an application formaccompanying the current Product Disclosure Statement, available from the Manager, Schroder Investment Management Australia Limited (ABN 22 000 443 274 AFSL 226473) ("Schroders").This Report is intended solely for the information of the person to whom it is provided by Schroders. It should not be relied on by any person for the purposes of making investment decisions. Total returns are calculated using exit price to exit price, after fees and expenses, and assuming reinvestment of income. Gross returns are calculated using exit price to exit price and are gross of fees and expenses. The repayment of capital and performance of the Funds is not guaranteed by Schroders or any company in the Schroders Group. Past performance is not a reliable indicator of future performance. Unless otherwise stated the source for all graphs and tables contained inthis report is Schroders. Opinions constitute our judgment at the time of issue and are subject to change. This report does not contain and is not to be taken as containing any financial product advice or financial product recommendation. For security reasons telephone calls may be recorded.

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