Schroder Absolute Return Income (Managed Fund)

An active ETF designed to boost income while preserving capital

Chi-X code: PAYS

Monthly Report - August 2021

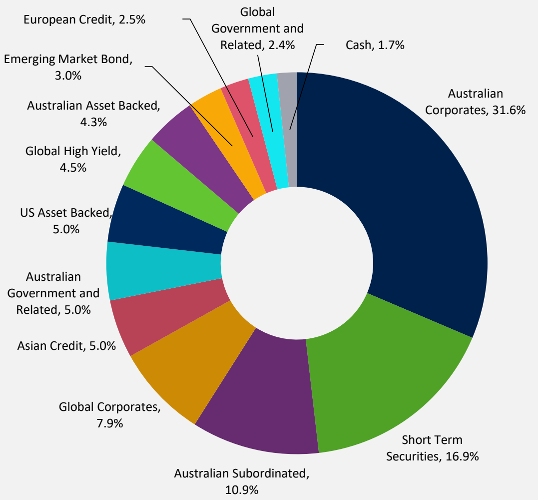
For more information about the Fund visit www.schroders.com.au/pays

Total return %	1 mth	3 mths	6 mths	1 yr	Inception p.a.
Schroder Absolute Return Income (Managed Fund) (post-fee)	0.19	0.45	0.79	2.54	2.28
RBA Cash Rate	0.01	0.03	0.05	0.13	0.26
Relative performance (post-fee)	**0.18**	**0.42**	**0.74**	**2.41**	**2.02**

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

Portfolio inception 19/11/2019, 1 years and 9 months

Asset allocation %



Portfolio statistics

Duration	0.27 yrs
Yield to maturity	1.44%
Average credit rating	A-
Number of securities	2810

*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 Aug 2021

*Benchmark is the RBA Cash Rate

Market review

US Fed Chair Jerome Powell's speech at Jackson Hole provided guidance around potential QE tapering at the end of this year or early next year, but reiterated expectations for the Fed Funds rate to remain accommodative for the foreseeable future. Powell also maintained the Fed's view around inflation being transitory. The August release of CPI data showed headline inflation remaining elevated, but some of the drivers of the uplift in core inflation, such as used cars, have eased somewhat. The Australian reporting season saw a large portion of companies beating expectations, however forward guidance is more uncertain, and earnings expectations have eased somewhat, given the impact of lockdowns. The RBA has moved ahead with a cautious tapering of its QE program, reducing bond purchases to $4 billion a week, but has pushed back a further review that was planned for November until next year.

Developed market (DM) equities continued to perform strongly, with DM global equities returning 2.7% in local currency terms during August, while the Australian market had a return of 2.5%. Emerging markets underperformed in the first part of the month on lingering concerns around Chinese regulation, before finishing the month strongly, rallying 2.6% for the month in US dollar (USD) terms. Growth stocks outperformed value, with the technology sector performing strongly. Global bonds had a lacklustre month, with US 10 year yields rising by 0.09% to end the month at 1.31%, while Australian 10 year yields fell by 0.02% to finish at 1.16%. Longer dated bond yields increased by 0.12% in Germany, but were more stable in Japan, rising by 0.01%. Credit spreads were generally unchanged in both Australian and global investment grade, as well as high yield, while emerging market debt spreads moved tighter at the margin.

Portfolio review

The Schroder Absolute Return Income (Managed Fund) delivered 0.19% (post fees) over the month and 2.54% (post fees) over one year, which was 2.41% (post fees) above the RBA cash rate over 12 months.

Credit markets retraced part of the weakness from last month to post a positive contribution to the overall portfolio. Given current credit spread levels, we believe that we are largely in a carry phase with limited expectations for further capital gains. The higher yield earned from the portfolio's credit holdings is a key source of return.

In terms of duration, the contribution to returns was essentially flat over the month. We hold low levels of interest rate sensitivity in the portfolio and as such the drift higher in bond yields of the major markets had little impact on the portfolio. In addition, we have positioned for US inflation-linked securities at the 5 year part of the curve to underperform longer maturities – and this made a small positive contribution to the portfolio. Foreign currency exposures also provided some benefit over the month.

Outlook and strategy

In Australia the lockdowns continue, although the path out appears to be becoming clearer. As we move towards the goal of reopening the plan hinges on achieving certain vaccination levels in the population. Meeting certain thresholds allows for relaxation of restrictions as we have seen in other countries. Living with COVID is the strategy going forward, as the elimination of more infectious variants appears to be unachievable.

Key issues in global markets continue to revolve around inflation risks and the timing of Federal Reserve tapering of asset purchases and potential interest rate increases. During the month the US Federal Reserve economic symposium in Jackson Hole was a key focus. Chairman Powell stuck to the script, indicating the goal of "substantial further progress" had been met on the inflation mandate, but not on employment. That said, he noted "clear progress" in labour markets had been made and that the Federal Open Market Committee's (FOMC's) economic outlook is consistent with curtailing asset purchases "later this year". This would imply a strong signal about tapering in the months to come.

Post-fee performance of the underlying Schroder Absolute Return Income Fund, offered by Schroders as a Unit Trust

	1 mth	3 mths	6 mths	1 yr	3 yrs p.a.	mFund Code
Schroder Absolute Return Income Fund - Wholesale Class^	0.19	0.46	0.79	2.54	3.10	SCH55

^The fund on offer is unlisted. An application into this fund may be made through an application form attached with the PDS, which is available on our website at www.schroders.com.au. The management fee for the Schroder Absolute Return Income Fund (Wholesale Class) is 0.54%.

Outlook and strategy continued

Inflation remains a key risk to markets, although Powell reiterated he viewed current price pressures as transitory and that inflation should go back "to levels consistent with [the Fed's] goal of inflation averaging 2 percent over time". Powell concluded by stating that "if the economy evolved broadly as anticipated, it could be appropriate to start reducing the pace of asset purchases this year." He explicitly separated the decision to taper from the timing of the first rate hike, which has been telegraphed to be a long way off – especially given economic data appears to have peaked and COVID risks linger.

The muted reaction from financial markets following Jackson Hole reveals that investors are prepared for a tapering announcement before year-end and suggests that a reduction in bond purchases will not derail markets (as has occurred in the past). The weaker-than-expected non-farm payrolls following Jackson Hole supports a pushing out of tapering of asset purchases. An announcement is likely to come at the November or December FOMC meeting, but the Fed is likely to favour a cautious approach. Any policy surprise would be around a faster-than-expected pace of tapering or an earlier-than-anticipated rate hike which appears unlikely in the near term.

So what does it mean for investors seeking income? Cash rates are expected to stay close to zero in the near-term meaning investors that are seeking income continue to face challenges. Credit risk premium is compressed, and duration-based assets are likely to come under pressure if there is a policy surprise or strong payrolls emerge.

Our view is that investors should remain cautious considering that equities are at or close to all-time highs, credit spreads are at multi-decade lows, and the path of duration-based assets is somewhat uncertain. We do believe that from this starting point many markets look fully valued. Alongside inflation, other factors – including China-US tensions, a growth scare or withdrawal of liquidity – can cause market to reprice and volatility to spike. Ultimately, this is important across different interest rate, credit and FX markets – as well as the relativities between them.

From a portfolio perspective we made some minor adjustments. In terms of currency exposures, we exited the long EUR and GBP positions. These were originally implemented to back the European reopening trade given the faster vaccine roll out and associated loosening of restrictions. Given the pace of vaccine roll out in Australia and the plan to reopen, the relativities have largely played out. We have retained the long USD and JPY positions to act as hedges against risk asset weakness.

Credit position was largely unchanged. We did increase our Asian credit exposures marginally. Asian credit has come under pressure recently largely due to a regulatory crackdown in China in a number of sectors. From a valuation perspective Asian credit is by far and away the most attractive. US securitised credit continues to look reasonable value. We are cautious on US high yield valuations and are watching for any potential catalyst to cause spreads widen. With very little room for further spread compression we are looking to earn the interest rate carry at this stage.

Duration positioning was largely unchanged. We hold low levels of duration at the total portfolio level. Of this we have a long position in Australia. We are short duration in the US on the view that upward pressure on bond yields is likely if we see structural inflation risk rise or the Fed adjusts its narrative around tapering. We have also retained our short exposure to inflation-linked securities in the US at the 5 year part of the curve.

Overall, with credit risk premiums compressed, the Schroder Absolute Return Income Fund remains defensively positioned with an investment grade average rating. Reflecting this positioning, we are carrying low interest rate sensitivity and our foreign currency positions have been reduced. We remain liquid but importantly active and alert to opportunities as markets move forward.

Schroder Absolute Return Income (Managed Fund)

Fund Objective

To outperform the RBA Cash Rate after fees over the medium term while aiming to avoid negative returns over any rolling 12-month period.

Key Features

– **Reliable monthly income:** Predictable and stable monthly income assists investors with planning their retirement income needs.
– **Global diversification:** Provides diversification across broad global fixed income markets with flexibility to respond to changing market conditions.
– **Strong risk management:** Actively managed to provide strong risk management, helping to avoid losses and preserve capital, should markets fall.
– **Competitively priced:** Competitive management fee of 0.54% p.a.
– **Easily accessed via one trade:** Contact your broker, financial planner or invest via your online trading account using the Chi-X code: **PAYS**.
– **Brought to you by Schroders:** A leader in fixed income, with an experienced local team backed by specialists in 12 locations around the world.

Fund details

Chi-X Code:	PAYS
Fund size (AUD)	$57,818,723
Redemption unit price	$9.8340
Fund inception date	November-2019
Management costs	0.54%
Distribution frequency	Monthly

Top ten holdings %

	Portfolio
AUSNET SERVICES HOLDINGS PTY LTD 3.1247 06-OCT-2080 Reg-S (SUB)	1.5%
TREASURY NOTE 1.75 15-NOV-2029	1.2%
TREASURY NOTE 2.625 15-FEB-2029	1.2%
SCENTRE GROUP TRUST 2 5.125 24-SEP-2080 Reg-S (SUB)	1.1%
SANTOS FINANCE LTD. 4.125 14-SEP-2027 Reg-S (SENIOR)	1.0%
BRISBANE AIRPORT CORPORATION PTY L 3.9 24-APR-2025 Reg-S (SECURED)	1.0%
QPH FINANCE CO PTY LTD 2.85 29-JAN-2031 (SECURED)	0.9%
WCX M4 FINCO PTY LTD 3.15 31-MAR-2031 Reg-S (SECURED)	0.8%
AMPOL LTD 3.6104 09-DEC-2080 Reg-S (SUB)	0.7%
LONSDALE FINANCE PTY LTD 2.45 20-NOV-2026 Reg-S (SECURED)	0.7%
Total	**10.2%**

Maturity Profile %

	Portfolio
0-3 Years	36.7
3-5 Years	20.0
5-7 Years	13.1
7-10 Years	18.0
10-15 Years	2.5
15+ Years	9.5

Security profile %

	Portfolio
Fixed rate	64.3
Floating rate	33.5
Other	2.2

Regional exposure %

	Portfolio
Australia	59.4
USA	30.3
Europe ex UK	5.9
UK	2.2
Asia inc Japan ex EM	0.3
Emerging Markets	1.8

Holdings by composite broad credit rating %

	Portfolio
AAA	9.6
AA	5.2
A	10.7
BBB	46.2
Below BBB	10.3
Cash and Equivalents	17.0
Not Rated	1.0

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Figures may not total 100 due to rounding

Regional exposure is expressed by currency pre-hedging

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Contact www.schroders.com.au
E-mail: web.queries@computershare.com.au

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

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