Schroder Absolute Return Income (Managed Fund)

An active ETF designed to boost income while preserving capital

Chi-X code: PAYS

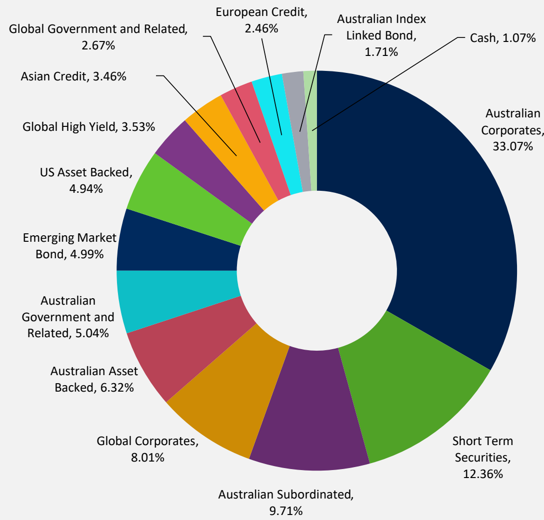
Quarterly Report - December 2020

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	1.56	2.54	3.07	2.94
RBA Cash Rate	0.01	0.04	0.10	0.31	0.35
Relative performance (post-fee)					

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

Asset allocation %



Portfolio statistics

Duration	1.72 yrs
Yield to maturity	1.60%
Average credit rating	A-
Number of securities	2792

*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 Dec 2020

*Benchmark is the RBA Cash Rate

Market review

The global rollout of a number of COVID-19 vaccines and a strong outlook for earnings in 2021 pushed equity markets higher through the month. However, it was not all positive news as case numbers continued to surge in the US and Europe, and the emergence of a more contagious strain out of the UK and South Africa, have resulted in harsh lockdowns and could delay the recovery. Meanwhile an outbreak in Sydney also resulted in localised lockdowns. On the political front, Trump continued to mount unsuccessful legal challenges in an attempt to overturn the US election, while the Georgia runoff vote allowed the Democrats to effectively take control of the senate – which is likely to result in increased fiscal stimulus as well as the potential for corporate tax hikes. Elsewhere, the UK and EU managed to reach a Brexit agreement on trade and a number of other issues. In terms of macroeconomic data, global manufacturing indicators remain strong, however with lockdowns coming in to place in Europe and parts of the US, a number of shorter-term indicators have begun to turn more negative. Locally, Australia reported a strong Q3 GDP growth rate of 3.3%, which was above expectations, while business confidence also strengthened.

Global equities returned 3.6% in local currency terms during December, while the Australian market underperformed producing a return of 1.2% for the month. Over the quarter, both Australian and global equities performed very strongly with returns of 13.7% and 12.3% respectively. Emerging markets were the standout performer by region, returning 19.7% in USD terms over the fourth quarter. Government bond yields continued to rise over the month on the prospect of higher inflation rates, with Australian bond yields increasing by 0.07% to end the month at 0.97%, while US bond yields also increased by 0.07% to end the month at 0.91%. Bond yields in Germany and Japan defied this trend and were broadly flat for the month. Credit spreads also continued to tighten across the board, most notably in high yield (HY), where they have now tightened by over 150 basis points through the fourth quarter. Within commodities, iron ore was a strong performer and gained approximately 25% in December in response to Chinese demand. This was one factor which help support the Australian Dollar which appreciated by 4.7% in the month.

Portfolio review

The Schroder Absolute Return Income (Managed Fund) returned 1.56% (after fees) in the December quarter. This closed out a strong yearly performance of 3.07%, or 0.31% (after fees) above the RBA cash rate.

The Fund's performance over the quarter was driven by our allocations to credit, which performed strongly on hopes of economic recovery and further fiscal stimulus in the US. Our currency exposures to the US dollar (USD) and Japanese Yen (JPY) are deliberately anti-cyclical in order to provide a hedge, and these acted as a small offset. Meanwhile, our duration exposures detracted a little as yields begin to drift a little higher.

We remain constructively allocated to credit securities but have reduced interest rate exposure over recent months. Through the quarter we increased our allocations to emerging market debt and Asian credit and marginally reduced higher quality developed market exposure. We also reduced the portfolio's total duration position following the positive vaccine news in November.

Outlook and strategy

Our Christmas wish for a peaceful month for markets broadly played out in December, though who knows what 2021 will bring? Even though there appears to be a strong consensus that the sailing will be smooth this year, as global economic recovery is underpinned by vaccine rollout and maintenance of strong policy support. We are cautious that the consensus is too narrow.

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	1.57	2.52	3.08	3.42	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

2020 taught us that we need to be extremely flexible in our approach to the outlook, incorporating real time data and policy developments in our assessments. People and economies showed a remarkable ability to adapt to challenging conditions, while policymakers continued to push new boundaries.

Our central outlook for the next 6 to 12 months is similar to consensus: we expect the vaccine rollout and improved mobility to drive economic recovery alongside strong policy support, and for low yields to continue to drive a search for returns. However, we nonetheless need to ensure that our portfolios are prepared for a range of possible market outcomes, particularly as the risks around them shift.

Most of the risks we are contemplating are policy-related. Last year showed just how powerful policy has been in supporting economies and markets. While the income support schemes have been successful in allowing businesses to remain solvent and consumers to build a savings buffer, balance sheets remain fragile. Therefore, early removal of policy support could be damaging. On the other hand, policy support could eventually be too much of a good thing for markets. Markets have been conditioned to believe that central bankers will be accommodative ad infinitum. It is ironically an environment of stronger growth – along with higher inflation, and concern about monetary policy tightening – that could be the worst scenario for both riskier and risk-free assets.

The COVID shock accelerated the shift to arguably a new policy era, including near-zero rates and coordinated monetary and fiscal policy easing. Going forward, policy-makers' willingness and effectiveness in managing the transition risks for economies and markets will be crucial.

Although yields are low and there are considerable risks to the outlook, there is plenty of scope to use fixed income effectively to generate income and help manage portfolio risk. We are focusing on positioning for quality income generation across a broad opportunity set, keeping portfolios well diversified and being flexible to both capture opportunities and manage risk. We are also adapting by accessing more low risk alpha opportunities with returns from the broad market probably reasonably limited, and by adopting a more targeted approach to risk management.

We continue to believe that credit allocations form part of the solution for investors in a low yield world. The breadth of the diverse credit universe provides opportunity both to deliver the income return investors are craving, but also to help manage the risks. However, although corporate fundamentals are improving as economies recover, the risks for investors have shifted as spreads have now tightened into expensive territory. As a result, we need to be active in the way we manage both our allocations and our security selection.

Consequently, we are trimming our aggregate exposure at the margin, in order to protect against downside, while focusing exposure to the assets and sectors we believe have the best potential to participate in the upside of economic recovery. High yield, Asian and emerging market debt at the asset class level are attractive prospects, as are transport and property at a sectoral level. We have been increasing our US securitised credit exposures funded from reduced exposure in lower yielding Australian mortgages, and are also looking to looking to trim our position in US investment grade corporates as the duration or interest rate risk of this market continues to increase. We are retaining our Australian investment grade credit holdings, as they offer high quality and stability to the portfolio, and our hybrid exposures which continue to provide a good source of income via subordination risk premia.

We are also being more targeted in our approach to duration management, attempting to balance the diversification benefit that duration adds to the portfolio, against the risk of an adverse move higher in yields from a low starting point. Our view is that yields are likely to gradually shift higher over the next year, but not materially so. The risk, however, is for a more outsized move, against which the cost of hedging is low. As a result, we have been reducing portfolio duration, and particularly have been reducing exposure to US treasuries.

We are also continuing to employ some foreign currency exposure to add additional diversification. We have small long positions in safe haven currencies such as the USD and JPY. We do have some longer term concerns around a potentially weaker US dollar given its large fiscal and trade deficits, however we expect a long USD position to continue to provide a valuable hedge in most risk-off episodes.

Overall, we remain very active, with a liquid and highly diversified portfolio designed to deliver an income stream from the defensive portion of a client's portfolio.

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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)	$31,061,621
Redemption unit price	$9.9551
Fund inception date	November-2019
Management costs	0.54%
Distribution frequency	Monthly

Top ten holdings %

	Portfolio
AUSTRALIA COMMONWEALTH OF (GOVERN 2.0 21-AUG-2035 Reg-S	1.7%
TREASURY NOTE 2.625 15-FEB-2029	1.4%
TREASURY NOTE 1.75 15-NOV-2029	1.3%
AUSGRID FINANCE PTY LTD 3.75 30-OCT-2024 (SECURED)	1.1%
BRISBANE AIRPORT CORPORATION PTY L 3.9 24-APR-2025 Reg-S (SECURED)	1.0%
SYDNEY AIRPORT FINANCE COMPANY PTY 3.625 28-APR-2026 Reg-S (SECURED)	0.9%
QPH FINANCE CO PTY LTD 2.85 29-JAN-2031 (SECURED)	0.9%
SANTOS FINANCE LTD. 4.125 14-SEP-2027 Reg-S (SENIOR)	0.9%
LONSDALE FINANCE PTY LTD 2.45 20-NOV-2026 Reg-S (SECURED)	0.8%
SCENTRE GROUP TRUST 2 5.125 24-SEP-2080 Reg-S (SUB)	0.8%
Total	**10.8%**

Maturity Profile %

	Portfolio
0-3 Years	35.2
3-5 Years	18.7
5-7 Years	15.6
7-10 Years	14.7
10-15 Years	5.5
15+ Years	10.2

Security profile %

	Portfolio
Fixed rate	64.7
Floating rate	31.2
Other	4.1

Regional exposure %

	Portfolio
Australia	57.7
USA	32.2
Europe ex UK	5.3
UK	2.0
Asia inc Japan ex EM	0.1
Emerging Markets	2.7

Holdings by composite broad credit rating %

	Portfolio
AAA	12.3
AA	6.3
A	18.8
BBB	43.3
Below BBB	9.3
Cash and Equivalents	6.9
Not Rated	3.2

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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