Schroder Absolute Return Income (Managed Fund)

An active ETF designed to boost income while preserving capital

Chi-X code: PAYS

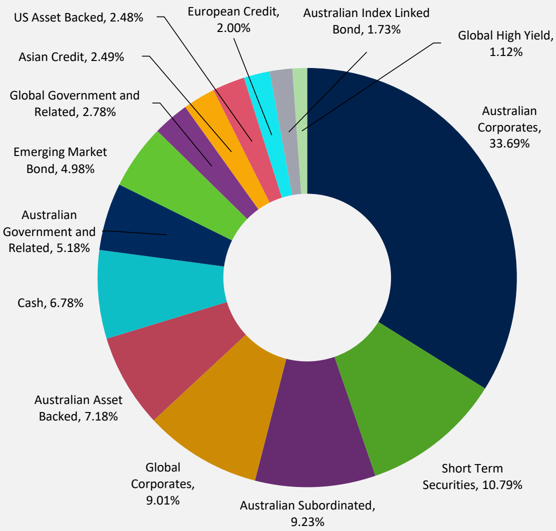
Monthly Report - August 2020

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

Total return %	1 mth	3 mths	6 mths	Inception p.a.
Schroder Absolute Return Income (Managed Fund) (post-fee)	0.00	1.53	0.18	1.53
RBA Cash Rate	0.02	0.06	0.12	0.34
Relative performance (post-fee)	**-0.02**	**1.46**	**0.05**	**1.19**

Portfolio inception 19/11/2019, 0 years and 9 months

Asset allocation %



Portfolio statistics

Duration	2.08 yrs
Yield to maturity	1.82%
Average credit rating	A-
Number of securities	2563

*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 2020

*Benchmark is the RBA Cash Rate

Market review

With a stabilisation in COVID-19 cases, further progress towards a vaccine and a strong Q2 earnings season in US and Europe relative to consensus expectations, equity markets continued to perform strongly through August. The S&P 500 reached an all time high during August, but there is some concern that this rally has been narrow with performance being driven by mega cap tech and consumer stocks. In the US macroeconomic signals in the form of ISMs, labour market data and housing data all remained strong, while the Fed announced its shift in policy towards inflation targeting. This could keep shorter end yields lower for longer but could result in steeper curves and a backup in longer end yields as investors price in the possibility of higher inflation. On the political front, Trump regained some momentum in the polls, with betting odds now split evenly between Trump and Biden for the upcoming election. Globally, we also saw strong PMI prints in both China and Europe.

Global equities returned 6.4% in local currency terms in August being led by US tech stocks, while Japan was another strong performer. The Australian market underperformed with a return of 2.8%, continuing its recent underperformance relative to the US. Longer end government bond yields moved higher in the month, with Australian 10Y government bond yields rising by 0.17% to end the month at 0.98%, while in the US 10Y government bond yields rose by 0.18% to finish at 0.70%. Bond yields also increased in Germany and Japan by 0.13% and 0.03% respectively. With front end yields relatively stable, this change in longer end yields has resulted in steeper curves across most markets. Credit spreads also continued to tighten during the month, though at a slower pace than we saw in previous months. Elsewhere, the US dollar continued to weaken, while commodities (with the exception of gold) continued to do well.

Portfolio review

The Schroder Absolute Return Income (Managed Fund) delivered a return that was flat over the month.

Credit was a key contributor over the month both in terms of "carry" from coupons but also as spreads continued to compress. Central bank support and government stimulus continue to buoy risk assets as they seemingly look through the negative economic news.

Duration was a detractor to portfolio performance as bonds yield rose over the month. Hence the long duration position we hold as a key diversifier subtracted from overall performance. Currency positioning also detracted from the portfolio. The ongoing strength of the AUD against the USD and Yen were the main drivers.

Outlook and strategy

The current market dynamics continue to be dominated by the liquidity story. The fiscal response from governments around the globe has ensured that cheap and readily available credit continues to wash through markets. The income shock to the consumer from the pandemic has been alleviated, in part at least, by government stimulus packages. As a result of this seemingly abundant liquidity, the market continues to look through the current poor fundamentals and push risk assets higher. The question is how long can this last.

This divergence between fundamentals and pricing can be seen in many markets. One example is the current dynamic in the US investment grade credit market. The yield on the index has recently hit an all-time low whilst the duration is at an all-time high (and have longer average maturities) and the average quality of the index continues to fall as leverage rises. This is occurring at a time where there has been a rapid growth in the market size whilst the underlying stress is rising and the fundamentals, especially around corporate earnings, continue to deteriorate.

Schroders

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^	-0.01	1.51	0.19	1.56	3.25	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

Very low cash rates and various price distortions in many government and some corporate bond markets appears to be hindering price discovery and suppressing volatility which is arguably lulling the market into a false sense of comfort. That is not to say that all assets are problematic. There will be winners and losers over time, and this is where both the opportunities and risks of the current market environment present themselves. What it does reinforce to us is the mantra we carried into the crisis - that is to remain defensive, diversified, active, and liquid.

This is reflected in different ways through our portfolio positioning. Defensive posturing can be seen given our credit exposures are predominantly to investment-grade rated bonds. With lower chances of default and lower volatility than lower quality and higher risk markets, these are an important source of high-quality income.

Our active approach is seen both in bottom up stock selection and top down asset allocation. The bottom up the stock selection process across our global exposures is key particularly given the current environment. Our analysts research and identify the credit assets that are appropriate on a risk reward basis thereby looking to avoid the default and capital impact, which will help with picking the winners and avoiding the losers. From the top down our active approach controls not only the total risk in the portfolio but where we take that risk. Our active approach has seen us add to overall credit since March and broaden the composition. This has allowed us to participate in the credit rally.

Diversification is achieved across credit, rates and currency markets. In the credit space we have a core of Australian investment grade credit. We also hold exposures to AAA-rated residential mortgage backed securities as a source of high-quality yield. We also hold Australian hybrids that provide a subordination risk premium by being down the capital structure.

We hold some US investment grade credit but have recently reduced this exposure given the market dynamics as mentioned above. Our US securitised credit exposures provide diversification from corporate credit via holdings biased to higher quality securitised segments that have subordinated that helps protect capital. Holdings in the Schroder ISF Asian Credit Opportunities Fund aims to improve diversification but also allows access to additional yield via the higher term structure in these markets. Our emerging market debt absolute return exposures provide risk managed exposure to emerging markets in both local and hard currency bonds. We have also added exposure to the Schroder ISF Global Credit Income Short Duration Fund which adds to the European credit exposures.

Diversification is also through duration, and we retain a long duration position of close to 1.9 years. This is predominantly split between Australia and the US. Duration can still play a role in portfolios although its effectiveness is challenged in an environment of low rates and yield curve control. We hold duration for some carry but also to provide some downside risk in the more extreme scenarios in a risk off phrase.

This is also supplemented by currency management. We believe currency can continue to provide downside risk management benefits to the portfolio. Holding duration combined with currency we believe remains an effective method of maintaining downside risk protection. Another portfolio level insurance policy.

Liquidity is reflected in several ways. Firstly physical cash remains at elevated levels at close to 20%. Secondly the higher quality assets tend to be more liquid. Thirdly we have a natural maturity profile of the bonds in the portfolio.

Overall, we remain alert to both risks and opportunities as we seek to deliver income and manage downside volatility.

Schroder Absolute Return Income (Managed Fund)

Monthly Report
August 2020

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

The benefits of investing in the Fund include the following:

– **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)	$27,187,701
Redemption unit price	$9.8834
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%
AUSGRID FINANCE PTY LTD 3.75 30-OCT-2024 (SECURED)	1.7%
TREASURY NOTE 2.625 15-FEB-2029	1.5%
BHP BILLITON FINANCE (USA) LTD T2 6.75 19-OCT-2075 Reg-S (SUB)	1.4%
TREASURY NOTE 1.75 15-NOV-2029	1.3%
SYDNEY AIRPORT FINANCE COMPANY PTY 3.625 28-APR-2026 Reg-S (SECURED)	1.1%
MACQUARIE BANK LTD 3.9 15-JAN-2026 Reg-S (SENIOR)	1.0%
BBI (DBCT) FINANCE PTY LTD 0.39 09-JUN-2021 (SECURED)	1.0%
BRISBANE AIRPORT CORPORATION PTY L 3.9 24-APR-2025 Reg-S (SECURED)	0.9%
SCENTRE GROUP TRUST 1 3.5 12-FEB-2025 Reg-S (SENIOR)	0.9%
Total	**12.5%**

Maturity Profile %

	Portfolio
0-3 Years	33.5
3-5 Years	20.4
5-7 Years	15.3
7-10 Years	13.9
10-15 Years	5.1
15+ Years	11.8

Security profile %

	Portfolio
Fixed rate	67.2
Floating rate	30.0
Other	2.7

Regional exposure %

	Portfolio
Australia	56.2
USA	33.9
Europe ex UK	5.7
UK	1.6
Asia inc Japan ex EM	0.0
Emerging Markets	2.5

Holdings by composite broad credit rating %

	Portfolio
AAA	13.7
AA	5.0
A	21.2
BBB	42.9
Below BBB	8.2
Cash and Equivalents	6.9
Not Rated	2.1

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.

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

Figures may not total 100 due to rounding

Regional exposure is expressed by currency pre-hedging

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