Schroder Asian Income
Monthly Fund Update

Fund Performance

As at 31 October 2016, in SGD

	1 month	Year to date	1 Year	3 Years (p.a.)	Since launch* (p.a.)
Schroder Asian Income Fund (Bid-Bid) (%)	-0.9	8.0	7.3	5.9	8.4
Schroder Asian Income Fund (Offer-Bid) (%)	-5.8	2.6	1.9	4.1	7.3

Source: MorningStar, SGD, net dividends reinvested. The fund is benchmark unconstrained.

*Launch date is 24 October 2011.

Market Overview

Asia ex Japan equities fell back in October as worries over an impending interest rate rise by the US Federal Reserve and continuing concerns surrounding Chinese growth. Chinese equities delivered negative returns over the month as yuan depreciation, a step up in property curbs and tightening liquidity all weighed on sentiment. Meanwhile, Hong Kong stocks fell as Southbound flows via the Stock Connect scheme with the Mainland Chinese market, which had driven the market higher over the previous months, dried up amid waning buying interest. Over in Taiwan, the market gained as strong demand for the new iPhone 7 buoyed the island's technology stocks. In Korea, stocks fell on the back of a deepening governance crisis that has hit President Park Geun-hye. In ASEAN, Thailand and the Philippines both saw their markets fall with the former declining on news of the death of King Bhumibol Adulyadej – the world's longest-serving monarch. Indonesia's market finished flat.

Asian USD credits declined in USD terms in October as the 10-year US Treasury yield rose by more than 20 bps. Investment grade bonds underperformed high yield credits, which are less sensitive to base yields. In addition, the weak trade data of China, tighter house purchasing policies of top-tier cities in China and heavy supply weighed on the market. Elsewhere, Indonesia sovereigns and quasi-sovereigns underperformed. Local currency bonds also fell as USD strengthened against most Asian currencies amid higher interest rate expectation.

Over the month, the Singapore dollar depreciated by 2% against the US dollar.

Performance Commentary

In October, the Fund fell by -0.9% bringing the year to date return to 8.0%.

The equity portfolio fell by 1.1% in SGD, underperforming the broad market. Within the equity portfolio, all markets fell with high yield stocks in Australia and Singapore being the noticeable underperformers in anticipation of higher interest rates after a strong rally earlier this year. In Singapore, REITs gave back some previous gains mainly due to the rise in government bond yields. Australia REITs, utilities and telecoms were also down as investors rotated out of the defensive "bond proxy" holdings in light of bonds' sell-off. The Australia 10-year bond yield rose by 40bps as the central bank refrained from further easing amid favourable growth and inflation data. On the other hand, Australia financials managed to deliver positive returns on better economic growth outlook. In Hong Kong, REITs and telecoms were not spared from the fall albeit at a relatively moderate rate. In contrast, financials rallied on the evidence of continuous stabilisation of China's economy, while one of the bank holdings did particularly well on a potential divestment with profit gains.

The fixed income portfolio also fell slightly. High yield credits outperformed investment grade bonds, which are more sensitive to rising yields. Indonesian sovereign bonds detracted the most given the long duration position. Furthermore, S&P also stated that it is not ready to recommend an upgrade to Indonesia's sovereign credit rating mainly due to the rising non-performing loans in the banking sector. In China, the property sector was resilient despite of the tightening of funding channel onshore, while industrials performed strongly as the PMI rose further in October.

Elsewhere, the global allocation gained slightly and outperformed the Asian markets. In risk management, currency hedges on AUD detracted value as AUD appreciated against SGD, which was however offset by reduction of hedge on USD. Both duration hedge and equity hedge also ended the month flat.

Asset Allocation Strategy and Outlook

In October, we maintained the physical allocation to Asia equity, Asia fixed income and the global assets at 57%, 33% and 6% respectively. Over the month, we rolled forward the Singapore futures and added further to Hong Kong put options to replace the options on Australian equities. The net equity exposure remained at 53%. In terms of fixed income, we sold 10-year bond futures to reduce the overall portfolio duration given rising government bond yields.

In currencies, there was no change to the Fund's currency hedging strategy, as we keep our hedges on the AUD, CNH, THB and TWD in the portfolio. The overall exposure to USD & HKD remained at 24% and the exposure to SGD remained at 56%.

With the surprising victory of Donald Trump in the US presidential election, global markets quickly moved on from the “risk-off” sentiment to identifying “winners” and “losers”, which resulted in a strong divergence between different asset classes and sectors. To a very large extent these market movements after Trump being elected were based on investors' speculation on the implementation of all the policies that he promised during his campaign, such as tax-cuts, infrastructure projects, and trade tariffs. However, we believe that it is premature to tell how much of these policies are going to be actually implemented, and uncertainty is the only certain thing in the near term. We believe this volatile environment could present some opportunities for investors to take advantage of oversold assets, such as emerging markets, which economies might become more competitive due to the weakness in their currencies in the near term.

One of the key risks to the income strategy is rising bond yields, which are triggered by the fear of higher inflation as a result of Trump's fiscal stimulus measures. In the near-term, it is likely that yields could continue to rise further given the expected tighter monetary conditions and higher inflation expectation. However, we would also remind our investors that the long-term forces that support income strategy, such as deleveraging and aging population, are still in place irrespective of what Trump is going to do. As a result, we are likely to see long-term money from pension funds and insurance companies to start buying when yields reach a certain level, which would put a cap on long-term bond yields.

Therefore, over short-term, it is important for investors to manage their interest rate risks in the portfolio, but investors can look to re-enter the market once the selling pressure tapers off which could allow them to capture a better entry point with higher yields. In our fund, our risk management measures such as currency and duration hedges should help investors ride through this period with less volatility and the increase in yields mean the assets now provide better valuation and the potential for a higher payout in the coming quarters.

Equity Strategy and Outlook

Over the month in the equity portfolio we added to a few bank names in Hong Kong, China and Australia, as the recent steepening of bond yield curves could benefit banks' profits through higher interest margin. We increased exposure to a Taiwan tech name which offers relatively high dividend yield of 6% with the potential for growth surprises from new Apple devices and the potential increase in the payout ratio from the current level. Elsewhere, we added to a Chinese telecom name on attractive valuation as market reacted negatively towards below-consensus earnings result. We believe investors over-reacted and the sell-off presented a good entry point. We remain comfortable with the company given its leadership position in the Chinese 4G market with strong top line growth and stable profit margin. On the other hand, we reduced our holdings in some Singapore REITs which rallied over the past few months and have become less attractive from a valuation point of view.

We remain cautious on overall equities. Within the equity portfolio, we are rotating some of the exposures in the highest yield sensitive sector into sectors which could benefit from higher interest rates such as banks. Short-term speaking, the defensive holdings such as utilities and telecoms are likely to be under pressure, but over the longer-term, we believe the structural demand for income (as mentioned in previous paragraph) means that these dividend stocks could come back as bond yield stabilises. As mentioned above, we believe a lot of the market actions are speculation based. While the divergence could continue in the short-term, we expect the trends to converge at some point as investors get to know more details about Trump's policies.

Fixed Income Strategy and Outlook

In October, we participated in the new issue of a Chinese consumer company with attractive yield of above 5% with stable cash flow. We also bought a new issue of an Australian bank with majority of assets in more stable residential mortgages and consumer loans. Elsewhere, we invested in the new issue of an Indonesia property name with yield of above 6%, which will benefit from the country's improving macroeconomic outlook and relaxation of mortgage policy. We took profit on selective Chinese property names, which are more vulnerable to the tightening of funding channel onshore and the restrictions on property purchase in the tier-1 and tier-2 cities.

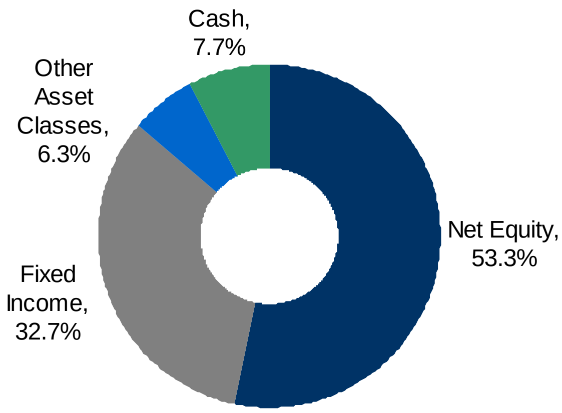
Near term, the risk of fixed income is skewed toward downside as the inflation expectation is higher thanks to the potential policies of President-elect Trump. The Federal Reserve is also expected to raise rate in December. Having said that, we should not forget that the structural forces of low inflation, such as deleveraging and aging population, remain in place. In addition, the existing monetary stimulus from central banks around the world, including Bank of Japan, European Central Bank, etc. is also likely to remain unchanged in the near future. In Asia, bonds held up relatively well with strong technical support, but we have started to see some slight deterioration in terms of fundamentals. Post US election, we have added a few credit default swaps on Korea, Indonesia, China and also broad investment grade to hedge against the risk of widening spreads over base yield. Overall, the CDS covers about 15% of the fixed income portfolio.

With wider spread and higher base yields, overall bond valuations have become more attractive after recent correction and the default rates remain close to historic lows. We continue to prefer high quality investment grade corporates which have stable leverage and ample liquidity on their balance sheets. And we will continue to diversify our holdings in peripheral Asian countries such as Australia and middle-east to maintain both the quality and the yield of the portfolio. Duration wise, we increased the duration hedge and the portfolio duration was reduced from 1.8 to 1.6 years.

Fund Positioning

As at 31 October 2016, net of hedges

Asset Allocation Breakdown



Source: Schroders

Portfolio Statistics

	Asian equities	Asian bonds
No. of Holdings	77	216
Gross Yield	5.8%	4.2%
Average Credit Rating	NA	BBB
Average Duration	NA	4.8 yrs

	Credit rating (%)
Investment Grade	62.2
BB	12.8
Non Rated	18.2
Below BB	6.7

Source: Schroders

Geographical Breakdown

	Equities	Fixed Income	Total
Hong Kong	13.8	4.3	18.1
Singapore	13.2	1.1	14.3
Australia	14.0	3.4	17.4
China	3.4	8.9	12.3
India	0.0	4.7	4.7
Thailand	4.3	0.1	4.4
Indonesia	1.5	5.0	6.5
Korea	1.1	1.3	2.4
Taiwan	2.7	0.6	3.4
Japan	0.9	0.0	0.9
Others	1.8	3.3	5.1
Global	-	-	6.3
Cash & Cash Equivalents	-	-	7.7
Hedges	-3.3	-	-3.3
Total	53.3	32.7	100.0

Source: Schroders

Sector Breakdown

	Equities	Fixed Income	Total
Financial	29.1	10.6	39.7
Communications	14.6	2.9	17.5
Utilities	9.7	2.7	12.4
Energy	0.0	4.5	4.5
Government	-	4.3	4.3
Industrial	1.4	3.1	4.5
Basic Materials	-	2.3	2.3
Consumer, Cyclical	0.3	0.9	1.2
Consumer, Non-cyclical	0.0	0.7	0.7
Diversified	-	0.7	0.7
Technology	0.8	0.0	0.8
Others	0.7	-	0.7
Global	-	-	6.3
Cash & Cash Equivalents	-	-	7.7
Hedges	-3.3	-	-3.3
Total	53.3	32.7	100.0

Top 5 Holdings

Equities

Securities	%
HK Electric Investments & HKE	2.0
LINK REIT	2.0
HKT Trust and HKT Limited	1.9
Mapletree Commercial Trust	1.8
National Australia Bank	1.8

Fixed Income

Securities	%
CNOOC 3.5% 05/05/2025	0.6
India Government Bond 7.16% 20/05/2023	0.6
Proven Honour Capital 4.1250 06/05/2026	0.5
Indonesian Government Bond 7.0% 15/05/2022	0.5
Perusahaan Gas Negara Persero 5.125% 16/05/2024	0.5

Source: Bloomberg, Schroders
For illustrative purpose only. It does not represent any recommendation to invest in or divest of the above mentioned securities.

Dividend payout calendar – SGD Class

Month	Record date	Payment date	Dividend per unit	Total payout in %
May-16	31-May-16	16-Jun-16	0.004883	0.4375%
Jun-16	30-Jun-16	19-Jul-16	0.004935	0.4375%
Jul-16	29-Jul-16	17-Aug-16	0.005084	0.4375%
Aug-16	31-Aug-16	19-Sep-16	0.005079	0.4375%
Sep-16	30-Sep-16	18-Oct-16	0.004817	0.4167%
Oct-16	31-Oct-16	16-Nov-16	0.004754	0.4167%

Dividend payout calendar – AUD-Hedged Class

Month	Record date	Payment date	Dividend per unit	Total payout in %
May-16	31-May-16	16-Jun-16	0.005281	0.5208%
Jun-16	30-Jun-16	19-Jul-16	0.005333	0.5208%
Jul-16	29-Jul-16	17-Aug-16	0.005055	0.4792%
Aug-16	31-Aug-16	19-Sep-16	0.005270	0.5000%
Sep-16	30-Sep-16	18-Oct-16	0.005245	0.5000%
Oct-16	31-Oct-16	16-Nov-16	0.005180	0.5000%

Dividend payout calendar – USD-Hedged Class

Month	Record date	Payment date	Dividend per unit	Total payout in %
May-16	31-May-16	16-Jun-16	0.003717	0.3958%
Jun-16	30-Jun-16	19-Jul-16	0.003756	0.3958%
Jul-16	29-Jul-16	17-Aug-16	0.003867	0.3958%
Aug-16	31-Aug-16	19-Sep-16	0.004071	0.4167%
Sep-16	30-Sep-16	18-Oct-16	0.004054	0.4167%
Oct-16	31-Oct-16	16-Nov-16	0.004000	0.4167%

* Distributions of Schroder Asian Income will be declared on a monthly basis. The distributions are not guaranteed and might be changed at the Manager's discretion in accordance with the Trust Deed. Ordinarily, they will be reviewed annually. In the event of income and realised gains being less than the intended distribution, distributions will be made from capital, subject to trustee approval. Investors should be aware that the distributions may exceed the income and realised gains of the each fund at times and lead to a reduction of the amount originally invested, depending on the date of initial investment.

Important Information

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