

## Quarterly Fund Update

## Schroder Alternative Solutions\* Commodity Fund

## Fund Overview

Schroders aims to give investors a diversified exposure to commodities primarily through commodity futures. Although index unconstrained, this is an enhanced beta product with the return objectives of outperforming the average of the four main commodity indices, with lower volatility.

## Cumulative returns to 30 June 2010

US\$ %	3 months	6 months	1 year	2 years	3 years
Schroder AS Commodity Fund*	-6.82	-10.20	-2.54	-40.44	-10.34
Average of all 4 Indices	-7.09	-9.81	0.59	-50.30	-22.42
S&P GSCI TR	-10.41	-11.21	-5.43	-61.87	-32.90
RJ CRB TR	-5.39	-8.72	3.55	-43.71	-14.97
DJ AIG Commodity TR	-4.81	-9.60	2.75	-45.63	-23.03
Rogers Int. Commodity TR	-7.80	-9.89	1.44	-48.40	-18.97

Source: Schroders; Bloomberg; JP Morgan; Reuters/Jefferies; S&P Goldman Sachs; Dow Jones UBS; Diapason

US\$ %	Since Inception **			€uro Hedged %	Since Inception **		
	Cumulative Perf	Volatility	Sharpe Ratio		Cumulative Perf	Volatility	Sharpe Ratio
SAS Commodity Fund*	12.13	20.36	0.10	SAS Commodity Fund*	3.10	20.65	0.00
Average of all 4 Indices	-18.19	22.94	-0.18	Average of all 4 Indices	-19.05	22.89	-0.20
S&P GSCI TR	-39.92	27.82	-0.32	S&P GSCI TR	-40.53	27.78	-0.34
RJ CRB TR	-8.12	21.40	-0.09	RJ CRB TR	-9.05	21.34	-0.12
DJ AIG Commodity TR	-15.10	20.54	-0.19	DJ AIG Commodity TR	-15.96	20.47	-0.21
Rogers Int. Commodity TR	-6.82	23.45	-0.05	Rogers Int. Commodity TR	-7.76	23.38	-0.07

GBP Hedged %	Since Inception **		
	Cumulative Perf	Volatility	Sharpe Ratio
SAS Commodity Fund*	9.30	20.68	0.01
Average of all 4 Indices	-15.12	22.89	-0.20
S&P GSCI TR	-37.65	27.79	-0.34
RJ CRB TR	-4.68	21.35	-0.12
DJ AIG Commodity TR	-11.90	20.48	-0.21
Rogers Int. Commodity TR	-3.31	23.39	-0.07

Source: Schroders; Bloomberg; JP Morgan; Reuters/Jefferies; S&P Goldman Sachs; Dow Jones UBS; Diapason

\* All tables above are shown as A Shares Net  
\*\* 31 October 2005

## Review

The end of June marked the second consecutive quarter of negative returns, and the worst period for the asset class since prices reached their nadir during the early months of 2009. In common with equities, commodity markets across the globe also experienced meaningful declines; the average of the four main commodities was down by 7.1% for the quarter. The predominant drivers of this negative performance emerged from the top down global macro picture; concerns over the debt dynamics of the peripheral nations in Europe, the longer-term viability of the European Union itself, fears of a double dip recession in Europe and the United States, and doubts about the future sustainability of Chinese growth. Government bonds (especially those of the United States and Germany), which were perceived as having safe haven status, performed well.

\* Schroder Alternative Solutions is referred to as Schroder AS throughout this document.



For the most part, those markets which have been considered most sensitive to the expectations for buoyant growth during the last 18 months were the ones which were hit hardest during the quarter. The combination of falling prices and negative returns from the cost of carry of futures positions meant that markets which delivered positive returns during the quarter were few and far between; only seven out of the 30 largest markets ended the quarter higher. The best performers were coffee (18.1%), gold (12.6%), natural gas (11.0%) and silver (7.6%), while at the other end of the scale, base metals such as zinc and nickel registered negative returns of 24.6% and 18.9% respectively. Performance by sector were: precious metals 4.6%, agriculture -1.8%, energy -11.3% and industrial metals -17.6%.

After a positive month during April, the fund began to adopt a defensive position during the early part of May by scaling out of energy and metals positions and into precious metals and cash. Exposure to agricultural markets remained relatively constant throughout the quarter. Overall, the fund did not see much relative benefit to this change of positioning as June ushered in a corrective bounce across risk assets. However, this strength, which was proven to be relatively short-lived by price action at month end, was not the catalyst for any change of view.

## Investment Outlook

### Global

- There appears to be little that could reinvigorate global financial markets in the foreseeable future, as the key sources of the recent economic recovery have already been exhausted. Moreover the deleveraging of the private sector in key economies has not yet shown any sign of abating, as evidenced by the relentless and broadening slowdown in monetary and credit aggregates. There seems to be real evidence that the “shock and awe” bailouts of the last eighteen months are now subject to the law of diminishing marginal returns; there is much to suggest that deflationary forces are stronger than is widely acknowledged.
- For the last several years, commodities have been driven by supply constraints, the rapid evolution of demand in emerging economies and the weakening of the dollar. Given recent developments it is possible that a different environment for commodity investing is now evolving. New themes may include (i) much greater governmental regulation and taxation on production resulting in cost-push inflation, (ii) low growth in the developing world due to high debt burdens and deleveraging, (iii) a transition for China as it addresses over investment and attempts reorient the economy towards consumption, (iv) the consideration of certain commodities as viable alternatives to fiat money. It seems probable that a period of weakness, which may be severe, lies directly ahead for the asset class.

### Energy

- Four themes are likely to shape investment policy in energy markets during the next quarter: (i) levels of inventory and the associated cost of carry, (ii) emerging market demand, (iii) the health of the US economy and levels of gasoline demand, and (iv) the negative impact of the Deepwater Horizon accident on the energy industry in the United States. While there have been improvements in demand, spare capacity and inventories are ample; a fact which seems consistent with the high levels of contango in the term structure witnessed in recent months. If higher prices are likely, global demand growth will need to exceed the most optimistic expectations, OPEC will need to reduce production, and an active hurricane season would be needed. Prices will be flat at best and returns negative during Q3.
- The natural gas industry appears stuck in a state of oversupply as producers continue to drill wells in shale plays to meet the “use it or lose it” conditions of leases they hold on production acreage; simultaneously industrial demand appears to be stalling. Much will depend on seasonal factors during the next several months, which if supportive, may prove the catalyst for a substantial rally. However, until more supportive evidence emerges, prospects for the gas market look neutral at very best.

### Metals

- Prospects for base metals during the next quarter will depend on China, a sustained draw down in commercial and exchange inventories, and a supportive environment for risk assets. Our expectations for all three sources of support during the next quarter are muted, on the basis that (i) Chinese authorities will impose whatever administrative measures are necessary to cool the property market, (ii) prices are still encouraging producers to supply metal, (iii) that risk appetite will decrease as demand stalls in the OECD and (iv) inventories of all metals are at elevated levels. Caution is warranted across these markets during Q3.
- Year to date, gold and silver have been amongst the best performers in the asset class, as well as registering new highs against many currencies from all regions of the world. Thus far, there is little evidence to suggest that the sustained strength which has been witnessed in recent times is about to dissipate; inflows into ETFs continue at a rapid pace, purchases by central banks in emerging economies will continue, and the viability of fiat currencies in the light of high debt levels is being questioned.

## Agriculture

- Grains and oilseeds markets are poised to rebound significantly during the summer months, as a result of weather concerns in the northern hemisphere and a firm import demand from China and India. Corn and soybean oil prices should lead this movement. A seasonal correction is expected during the autumn months. New lows are likely for the oilseeds due to long term negative fundamentals.
- In the softs, cocoa prices are expected to reach new highs in July. The coffee markets should demonstrate the strongest performance amongst the agricultural markets. Sugar prices could reach new lows in the summer on negative fundamentals and continuous funds selling.
- Meats markets are expected to trend lower on herd liquidations (live cattle and hogs) and fund selling.
- Barring any weather concerns in the US Delta and Texas, we expect cotton prices to head lower in the coming months. A slowdown in Chinese import demand could be the trigger of significant correction.

## Equities

- Similar to previous quarter, we believe that the only subsectors that offer value at this point are precious metals and agricultural equities. In the case of precious metals, we note that the equities are trading at a low P/NAV compared to history; this is most surprising in light of the fact that the gold price is at a record high. Our view is reinforced by the fact that companies have been able to keep costs stable. Given our view on a recovery if grains prices, we believe agricultural names also look attractively valued. Where bulk and base metal prices are concerned, they do not look particularly cheap at current spot prices in view of our outlook for the underlying commodities.

## Chart Analysis

- During the last quarter, many markets appear to have been forming an important top after the large rally from the lows of early 2009. Price action has been overlapping, momentum has been slowing, and prices have failed at key retracement levels and moving averages across many markets. In addition, there is clear evidence that where strength has occurred, it has taken place on low volumes and declining open interest; this applies to major markets such as oil and copper. As such, a steep and largely unexpected decline may be about to unfold in many markets. Gold and silver are the exceptions to this conclusion.
- A temporary bottom seems to have formed in June in both the grains and oilseeds markets' charts. A seasonal rebound, or "summer rally", should now follow but will fade in the middle of the summer. The chart pattern looks extremely bullish for coffee markets. On the contrary, the bearish trend looks intact for sugar prices. The broadening formation observed in cotton prices heralds an imminent trend reversal. A significant correction should follow.

## Sentiment Analysis

- There have been further adjustments in global growth expectations this past quarter, but not enough pessimism has been built in to be able to predict a sustainable improvement going forward. Hence little market positioning adjustments have taken place so far and in particular commodity allocations remain stable, making the latter vulnerable to further downward moves in growth expectations.
- The Consensus Forecast Model has provided strong signals this past quarter, indicating a break away from the consolidation patterns of previous months. It has given a broadly negative signal for energy, with the exception of natural gas. The model remains broadly positive for precious metals while turning negative for base metals.
- Finally, the model remains positive for cotton and has recently turned positive for coffee, while remaining negative for sugar and cocoa, and continuing so for soybeans, corn and wheat as well. On the latter group of grains, either a sharp price reversal is about to take place (an extraordinary strong divergence from price to forecast is currently visible), or an important downward adjustment in expectations will be required to observe a sustainable recovery in these assets.

## Quantitative Analysis

- The majority of the oilseeds markets still exhibit a negative score. The "grains" score declines QoQ from neutral to bearish (mainly due to upward revisions of the global rice planting estimate). Vegetable oils, meats, meals and cotton markets scores are neutral. Meals and cotton scores move QoQ from the bullish category to the neutral one. Soybean oil, rice, oats and beef scores are still bullish, even if their scores tend to decline QoQ. The highest scores remain orange juice, sugar and coffee.

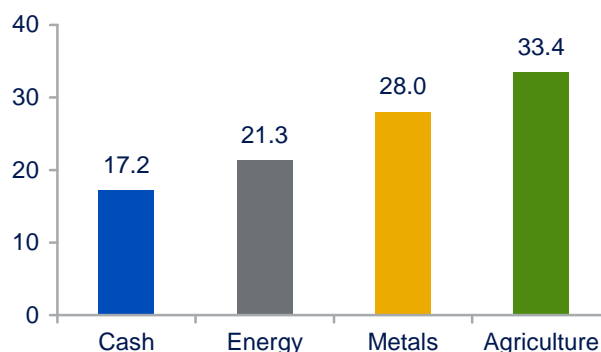
- In the metals, the lead and aluminium scores are still very negative. The copper score is neutral and the lowest since 2007. We note that the “demand score” is the lowest since 1997, which is bearish for prices. At the opposite end of the scale, zinc exhibits the highest score amongst the base metals.

Rob Howell / Rodolphe Roche / Paula Bujia / Abdallah Guezour / Guillermo Besaccia – 29 June 2010

**Top 5 Holdings as at 30 June 2010**

	%
Crude Oil	19.1
Gold	16.4
Coffee	6.3
Corn	5.4
Wheat	5.3

**Sector Allocation as at 30 June 2010 %**



Source: Schroders (for top 5 holdings and sector allocation)

<b>Fund information</b>	<b>Fund manager</b>	Robert Howell
	<b>Managed fund since</b>	31 October 2005
	<b>TER (A shares)</b>	Est. 2.01%
	<b>Launch date</b>	31 October 2005
	<b>Fund size</b>	US\$4,975 million
Source: Schroders	<b>No. of holdings</b>	65

**Risk Warning:** Indirect investment in commodities and/or real estate may cause the fund to face market risk from the value of the underlying asset together with geopolitical, supply, currency exchange rate and interest rate risks.

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