Schroders
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.

US$ %	Apr 2011	YTD 2011	2010	2009	2008	2007	Since Inception**		
							Cumulative Performance	Volatility	Sharpe Ratio
Schroder AS Commodity Fund*	**3.38**	**12.20**	**15.36**	**34.03**	**-35.29**	**34.73**	**58.40**	**19.46**	**0.43**
Average of all 4 Indices	**3.50**	**12.23**	**15.63**	**20.57**	**-39.65**	**25.19**	**12.23**	**22.26**	**0.15**
S&P GSCI TR	4.41	16.49	9.03	13.48	-46.49	32.67	-14.07	26.68	-0.05
RJ CRB TR	3.10	11.39	17.60	23.65	-35.04	22.15	31.85	20.88	0.25
DJ UBS Commodity TR	3.46	8.06	16.83	18.91	-35.65	16.23	18.57	20.09	0.15
Rogers Int. Commodity TR	3.04	13.07	19.01	26.23	-41.35	30.01	39.14	22.79	0.29

€uro Hedged %	Apr 2011	YTD 2011	2010	2009	2008	2007	Since Inception**		
							Cumulative Performance	Volatility	Sharpe Ratio
Schroder AS Commodity Fund*	**3.36**	**12.47**	**14.30**	**32.13**	**-36.66**	**32.48**	**45.43**	**19.76**	**0.33**
Average of all 4 Indices	**3.59**	**12.52**	**16.11**	**21.26**	**-38.67**	**23.97**	**17.12**	**22.24**	**0.13**
S&P GSCI TR	4.49	16.79	9.47	14.07	-45.59	31.38	-14.48	26.67	-0.06
RJ CRB TR	3.18	11.67	18.08	24.28	-33.95	20.96	31.22	20.86	0.23
DJ UBS Commodity TR	3.54	8.34	17.31	19.52	-34.57	15.10	18.00	20.05	0.13
Rogers Int. Commodity TR	3.12	13.36	19.50	26.88	-40.36	28.74	38.47	22.79	0.29

GBP Hedged %	Apr 2011	YTD 2011	2010	2009	2008	2007	Since Inception**		
							Cumulative Performance	Volatility	Sharpe Ratio
Schroder AS Commodity Fund*	**3.36**	**12.50**	**14.86**	**31.34**	**-36.16**	**34.78**	**54.57**	**19.77**	**0.34**
Average of all 4 Indices	**3.55**	**12.41**	**16.05**	**21.16**	**-38.02**	**26.07**	**22.60**	**22.22**	**0.13**
S&P GSCI TR	4.46	16.67	9.41	14.04	-45.04	33.61	-10.49	26.65	-.0.06
RJ CRB TR	3.14	11.57	18.02	24.25	-33.30	23.02	37.29	20.84	0.23
DJ UBS Commodity TR	3.51	8.24	17.25	19.48	-33.92	17.06	23.49	20.03	0.13
Rogers Int. Commodity TR	3.09	13.25	19.44	26.84	-39.76	30.93	44.90	22.74	0.27

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

* A Share Class Net ** Inception 31 October 2005

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

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Review

By certain measures, the month of April witnessed a remarkable eighth consecutive month of positive returns in the asset class. Returns by sector were as follows: precious metals 12.7%, energy 6.7%, base metals 0.7% and agriculture -2.0%. The best performing markets on the month were silver (28.2%), cocoa (14.8%), coffee (13.3%) and gasoline (10.5%), while at the opposite end of the scale lurked lumber (-22%), sugar (-11.7%), cotton (-10.7%) and lead (-7.5%). Fund returns gross of fees were 3.9% relative to a composite benchmark return of 3.5%. There were no major changes of policy throughout the month, as cash levels in the fund were maintained at minimal levels in the expectation of higher prices across all sectors. Although we have less conviction now than we had earlier in the year, we are still of the view, despite recent volatility, that prices are still likely to have an upward bias during the next several months.

Energy

Throughout April, three themes dominated energy markets.

Firstly, the continued unrest in the MENA region. The stalemate in Libya and ongoing social unrest in Syria continued to underline the extent to which geopolitical uncertainty has the potential to further reduce available spare productive capacity, particularly in OPEC where available capacity is now a little less than four million barrels per day.

Secondly, the debate about where the tipping point for demand lies, particularly for consumers in the Western world who have little capacity to bear significantly higher energy prices for extended periods of time. In addition, the issue of elasticity of demand in the Far East, where consumers are still somewhat insulated from rising prices in the world markets as a result of subsidies from their governments, emerged once more. For the last several years, this kind of data has been the holy grail of energy analysts the world over, as the destruction or rationing of demand due to high prices is virtually impossible to prove empirically while it is occurring. During 2008, the conclusive evidence from the EIA and other bodies on the rationing which was happening during the first half wasn't available until later on in the year, far too late for it to be of any use. However, the major news story during the month was the assertion by Goldman Sachs that they believed in "nascent signs of oil demand destruction in the US" and recommended that clients begin to exit commodity positions. This was quickly countered by Morgan Stanley and Barclays, who, unsurprisingly, disagreed.

Monthly demand numbers released from the EIA showed that gasoline demand in the US during the month of February (8.6 million barrels per day) was flat on the year, and approximately 2% below the levels seen in 2008-2009. However, gasoline and product inventories in North America are also lower (as are OECD inventories generally) so that fact that demand is not up materially on the year is not necessarily a bearish sign. In summary, we found little evidence that the supply demand situation in the US, or indeed elsewhere, had materially changed during the course of the month. We still maintain the view that if there are surprises in the US during the driving season this summer, they will be to the upside.

Finally, and a theme which was also highly pertinent in precious metals markets, the open question of how the interaction between commodity prices, inflation expectations, currencies and central bank policy should be considered. Given the 25 basis point rate rise from the ECB on 7 April (and a reasonable probability that another rise of the same magnitude will occur in June or July) and the well telegraphed end to the Federal Reserve's U$600 billion "quantitative easing" by the end of June, it is a reasonable assumption that policy makers are now embarking upon the path towards normalisation of monetary policy, no matter how glacial the pace. However, implicit in these deliberations is the ideological debate of headline versus core rates of inflation. In other words, how much do energy and food prices matter anyway? If you're seeing double digit percentage increases in your energy and grocery bills, then most consumers will say they matter a great deal. Going forward, it seems obvious that if policy makers disregard food and energy for too much longer, it will matter little what the academic arguments are for their chosen metric, as inflation expectations will be destabilised more than they are already, sparking a wage-price spiral from Mr and Mrs Public, who are seeing discernible changes in their standards of living.

Unsurprisingly, this line of thought leads us back, once again, to the one of our longer-term secular theories on the potential for commodity prices to influence monetary policy. For many years, we had believed that the bond market was the “vigilante” which would likely rein in the range and scope of the unconventional policies employed by the Fed and other central banks during the past decade, but it seems increasingly unlikely to happen these days. Money has been chasing “real yields” against a background of negative real rates, meaning that bond investors have been searching for returns in emerging markets and credit in the belief that, once rates begin to normalise, they will sell before any major bear market begins and certainly well before their peers. At the same time, elevated levels of inflation expectations and rising commodity prices have focussed the minds of investors on the influence, or lack thereof, of markets such as crude oil, gold and corn on official policy deliberations. Our sense is that commodities, and perhaps oil and gold most of all, will increasingly be looked upon as the “circuit breakers” in the near future, but at what price, it is virtually impossible to know.

Metals

The story of the month was unquestionably silver. In an asset class where wild swings are relatively commonplace, the sheer force of the move upwards throughout the month was noteworthy; the intraday low of 36.41 on 1 April to the high of 49.79 on 25 April constituted a rise of just over 34% in 17 trading sessions. For the most part, we believe that this says much more about the state of markets generally rather than about silver specifically, at least in the short-term. In other words, there was no discernible change in any of the underlying fundamentals for the metal, all of which remain positive, and no specific news items which would have justified such a rise. In fact, many of our indicators (aggregate open interest, traded volume and MarketVane sentiment) signalled that it was time to reduce our position by 50% on 18 April. It remains to be seen whether our position should be closed out altogether during the next several weeks if the correction which began at month-end continues.

To be clear, we remain bullish on the metal, and our conclusion from last October’s report, stated immediately below, remains valid.

“Silver’s status as a precious metal, which has been questioned in the past, now seems established and will likely grow in importance during the next several years….On the demand side, fabrication is unlikely to surprise to the upside during the next several years, and it is more likely that the price will be influenced most strongly by the future path of investment demand which should be expected to rise sharply as demand for real assets rises at the expense of fiat currencies.”

If there is one lesson from this month’s price action, it is that silver has ably demonstrated the capacity for explosive upside potential in precious metals when momentum gathers against a positive fundamental backdrop. It would be unwise to dismiss the action of the last several weeks as a purely speculative movement in a volatile and thin market (although undoubtedly some of these conditions were present), and perhaps more fruitful to consider what may yet unfold in the gold market in the future.

Speaking of which, gold performed well during April. The spot market rose 9.2% on the month, delivering its best performance since November 2009, but as ever, it was overshadowed by something else. This observation builds, we think, on the paragraph above in the sense that we have yet to experience the kind of parabolic rise in gold which has been witnessed in just about every other market in the asset class; oil, silver, corn, copper, wheat, sugar, tin, lead – all of these markets and several more besides have had their asymptotic day in the sun, but the one that has not has been gold. It grinds away, month after month, slowly garnering attention and April was more of the same.

Finally, base metals. While there is no immediate cause for concern about the way that Chinese policymakers are successfully engineering a soft landing in their economy, base metals markets have become addicted to sharp rises in Chinese consumption month-on-month, and quarter-on-quarter, during the past several years. Moves to tighten credit conditions, as evidenced by four increases in lending and deposit rates since last October, coupled with rising inventories of metal and a marginally less supportive global macro environment (i.e. normalisation in monetary policy) have meant that even the most positively inclined metals investor is struggling to argue the case for significantly higher prices from current levels, especially in view of the fact that broad measures of industrial metals have risen almost 50% since the lows of last June. In short, we continued to be cautious on base metals markets throughout the month, and where our overall metals allocation is concerned, we are far more positively disposed towards precious markets.

Agriculture

Recent price movements seen on the corn markets this last month have been extreme. Firstly, prices rose strongly at the beginning of April, following the release of the USDA's planting intentions and quarterly stocks reports (which showed a lower than expected corn planted area in 2011 and very low old crop inventories). Severe planting delays, coupled with expectations of adverse weather conditions in the US this spring, continued to support prices in the following days. Secondly, the market fell strongly in the last sessions of the month on profit taking and expectations of an acceleration in the planting pace during May. We continue to think that the long term fundamentals are very supportive for this market and increased slightly our allocations in this product as a result. The wheat markets closed the month sharply down, on fund selling and expectations of a resumption of Black sea exports in the coming months. The export restrictions seemed to ease somewhat in the Ukraine, which could increase competition with the US ports quicker than previously expected. We note that the severe planting delays in the north of the US continued to support the spring wheat quality prices however.

Oilseeds prices finished the month on a negative tone. Long term fundamentals (namely extremely low old crop soybean stocks in the US and expectations of lower oilseeds planting areas in 2011) remain very supportive but some concerns about the Chinese import pace of soybean, which appears to slow, seemed to be sufficient to temporally stop the established bullish trend. The weather conditions during both the planting and growing stages (i.e. the coming spring and summer months) will be the main driver of these markets. We left unchanged our positions in this sector in the last month. This sub-sector still represents the second largest allocation in the agriculture fund.

The meats markets closed the month of April strongly down. The movement seen in the live cattle market appears mainly seasonal by nature. The strong placements since the beginning of this year into feedlots, owing to the poor grazing conditions in the south of the US (notably Texas), as well as fears that domestic per-capita consumption could slightly suffer from high gasoline prices and the possibility that we could see more beef on storage verse a year ago, were also seen as bearish factors for this market. The lean hog prices followed the movement despite high cut-out prices and better domestic and export demands. We left unchanged our positions during the month of April. This sub-sector still represents the smallest allocation in the agriculture fund.

In the softs sector, the coffee markets showed strong performances in April. From a fundamental point of view, it is difficult to explain this rally given the fact that the long term bullish factors are now well known, and that we did not note any fresh bullish news during the past month. Thus, this market seemed to be mainly supported by large speculative buying. We believe that the expected record “off-year” in Arabica production in Brazil, which will soon be harvested, should weigh on prices in time. The sugar market fell strongly on forecasts of a record large Thai sugarcane crop, the beginning of the crush season in Brazil and the resumption of exports from India (the first large shipment since 2007 and the introduction of the export ban on sugar). Regarding the cocoa market, prices rebounded modestly after the massive selloff which occurred in March. The evolutions of the cocoa markets in New York and London have been mainly driven by the political crisis in Ivory Coast during the last month, and we think that it will continue to be the case in the medium term. Uncertainties about the conditions of their infrastructure (notably roads and ports) could support the market in the near term. In terms of positioning, we slightly decreased sugar positions and increased the coffee allocation.

Cotton prices fell in April on concerns about the Chinese import pace (some shipments have been cancelled recently), as well as expectations of large crops in the coming seasons in the main exporting countries and fund profit taking. The supportive near term fundamentals (notably the extremely low global and US old crop stocks, the already serious planting delays in the US and the overly dry weather in Texas) have seemed to be mostly ignored by market participants this month. We significantly reduced our cotton positions during the month. The materials sub-sector represents the fourth largest allocation in the agriculture fund.

Commodity Equities

April was a muted month for commodity related equities versus the underlying commodities, almost without exception.

The most notorious underperformance was precious metals equities, with the NYSE Gold Bugs Index up only 3% verses the gold and silver prices' increases of 9% and 27% respectively. We believe the reasons for the divergence are:

Expectations of cost increases – with the oil price up 20% year to date, together with other consumables (i.e. explosives, steel), cost are expected to rise by 15% to 20% this year. After 2009 and 2010, when costs were quite contained, 2011 could be the year when cost increases outpace the increase in the gold price, resulting in margin compression and jeopardizing the earnings leverage to the metal price (as was the case in 2007 and 2008).

Lack of production growth and declining grades of ore – this is particularly a problem for the large companies that represent the bulk of the weightings in gold equity indices. Due to this factor, such companies feel they need to make acquisitions, which might not end up actually adding value (as was the case with Barrick's expensive acquisition of a copper company, risking its gold premium multiple, in our opinion).

The implications for the above are that: i) we might need to see the gold price rise by a comfortable 20% before we see gold equities outperforming as a group (year to date up 9%); and ii) the leverage will have to come from production and reserves growth, as well as/or improvements in ore grades or certain special situations (companies neglected by the market, turnaround stories, change of management, etc).

In order not to lose perspective, even with a 20% increase the average cash cost for the industry would be $670/oz, plus sustaining capital cost of $160/oz implies $830/oz for the industry, leaving a cash margin of $700 at the current spot price. A point we have made in the past is that this strong cash generation would allow the gold companies to pay a higher dividend yield than the current meagre 1%. We thought Newmont's recent decision to link its dividend policy to the gold price was quite clever and attractive.

A similar case could be made for base metal companies. Overall, while over the last few years one could buy low quality names that provided the highest leverage, now selectivity is key. We are therefore, favouring companies with growth, grade improvements and turnaround stories. Also, under a scenario where costs are soaring, royalty companies are become interesting investments.

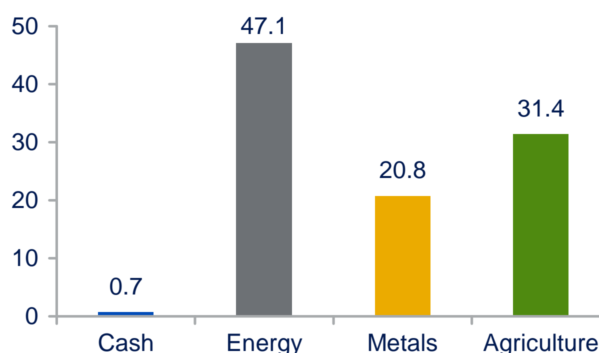
Asset Allocation as at 29 April 2011

Top 5 Holdings as at 29 April 2011

WTI Oil	17.0
Brent Oil	9.1
Gold	7.2
Gasoline	7.2
Corn	6.4

Source: Schroders

Sector Allocation as at 29 April 2011 %



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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