Schroders

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Schroder GAIA Paulson Merger Arbitrage

Quarterly Fund Update

Third Quarter 2017

Portfolio characteristics

Fund manager	John Paulson (Paulson & Co.)
Managed fund since	25 June 2014
Fund launch date	25 June 2014
Fund size (USD)	104.4 million
Ongoing charge*	1.68%
Performance fee	Subject to the "high water mark" principle, 20.00% of the share class outperformance in excess of the BBA Libor USD 3 Month Act 360. See the prospectus for more details. In the fund's last financial year the performance fee was 0.00% of the fund.

Number of corporate issuers	
Long	33
Short	4

Portfolio structure

Gross/net exposure (%)**	
Long Equities	82.8
Short Equities	-58.3
Long Corporate Bonds	9.4
Gross exposure	150.5
Net exposure	**33.9**
Options (delta-adjusted)	-
Gross Exposure (delta-adjusted)	150.5
Net exposure (delta-adjusted)	33.9
Net exposure (delta & cash adjusted)	26.8

Source: Schroders, as at 30 September 2017. Fees are for C accumulation USD shares. *The ongoing charges figure is based on the last year's expenses for the year ending December 2016 and may vary from year to year. The fund's annual report for each financial year will include detail on the exact charges made. **Source: Schroders as at 30 September 2017. Figures are on a delta-adjusted basis. Cash adjustment applies a 7.1% adjustment to the net exposure that may include the cash portion of deals, fixed income and defaulted instruments.

Discrete monthly and yearly returns since inception (%)

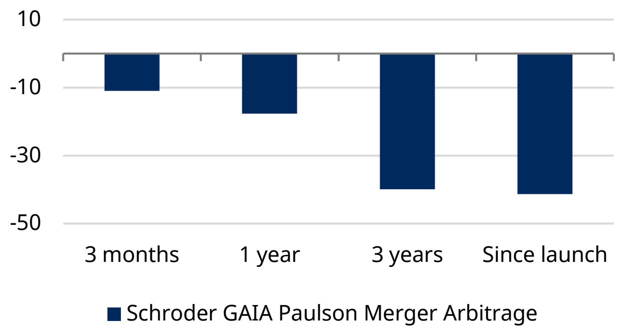
C accumulation shares (USD)

	Annual	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2017	-14.7	0.0	1.7	-4.7	0.9	-2.6	0.6	1.2	-8.9	-3.4	...	...	...
2016	-23.1	-3.2	-4.6	-7.2	-1.0	-1.8	-4.5	3.7	0.2	-3.5	-4.7	2.0	-0.8
2015	-3.4	1.2	3.7	0.5	1.7	2.7	-1.7	2.0	-3.4	-6.5	-4.3	-0.4	1.7
2014	-7.4	-	-	-	-	-	-0.0	-1.5	-0.5	-0.4	-6.0	1.4	-0.6

Source: Schroders as at 30 September 2017. NAV to NAV, net of fees. Fund launched: 25 June 2014.

Cumulative returns to 30 September 2017 (%)

C accumulation shares (USD)



	3 months	1 year	3 years	Since launch
Schroder GAIA Paulson Merger Arbitrage	-11.0	-17.7	-39.9	-41.3

Source: Schroders as at 30 Sept 2017. NAV to NAV, net of fees. Fund launch date: 25 June 2014.

Performance

Schroder GAIA Paulson Merger Arbitrage experienced continued volatility through 3Q 2017 with the strong performance in July offset by drawdowns in August and September. Positive contributors for the quarter included our government-sponsored enterprise (GSE) positions, TIM Participacoes and AIG. However, the extreme volatility in the specialty pharma sector continued, resulting in a Q3 drawdown.

Merger activity

M&A volume remained solid through Q3, with activity in line with 2016 levels at over $2.2bn of deal volume through 30 September. North America represents nearly half of global deal volume followed by Western Europe. Global activity is up year-over-year in industries such as energy, healthcare, consumer and communications. The current administration's pro-growth attitude, effort on reduced regulations and commitment to corporate tax reform could be powerful catalysts leading to increased M&A activity

Merger spreads

Despite the current environment where average spreads are modest, we continue to identify and selectively allocate capital to higher quality deals with wider spreads. Not all deals are created equal; spreads are not always an accurate indicator of deal risk or lack thereof. A spread may remain wide because the amount of dedicated arbitrage capital is insufficient to underwrite the spread or due to mispriced risk in a deal with regulatory, structural or other complexities. For example Time Warner's merger with AT&T and Sky PLC's merger with 21st Century Fox represent attractive annualized spreads in deals where we believe the downside is modest. In other instances, a wide, attractive spread may in fact indicate a greater risk of deal closure and should be avoided. Other deals trading at very tight spreads may be attractive investments if there is the potential for a topping bid.

GSE Preferred

The preferred shares of Fannie Mae and Freddie Mac together represent a top holding and are currently trading at approximately 28% of par value. As discussed in the Q2 letter, if the GSEs were restructured, we believe the shares would be worth up to 70 to 100% or par, offering an option value of 3:1 return. The positions traded up in Q3, as we continue to see Washington moving towards a settlement that should resolve the situation and benefit current shareholders. While Congress is not currently active in legislating on the GSEs, various important and politically significant stakeholders have come out publicly in favour of the Trump Administration and Federal Housing Finance Agency (FHFA) ending the net worth sweep arrangement and raising capital at the enterprises. Most recently, six Democratic senators wrote a letter to the FHFA and Treasury Department calling on them to allow Fannie Mae and Freddie Mac to build capital by retaining profits. The Republican National Committee also passed a resolution stating that investors should be resolved "in a manner that honors and respects the rule of law governing the rights of corporate stockowners."

We believe the GSE reform is likely to be addressed after tax reform, in the first half of 2018. Treasury Secretary Mnuchin, one of the key decision-makers over Fannie Mae and Freddie Mac, has reiterated that his priorities include taxpayer protection and mortgage market liquidity. Both of these goals can best be strengthened by allowing the GSEs to retain earnings, raise new capital, and build up their capital base. Importantly, the capital buffer goes to zero at year-end, so allowing the GSEs to retain capital is the first step to reform and could cause the securities to trade up in the near-term.

TIM Participacoes

Amidst intense competition in the now mature telecom industry, we are witnessing a wave of consolidation both in the US and abroad. Companies are looking to M&A as a tool to increase current market share (horizontal expansion), diversify (vertical expansion) and achieve better economies of scale/maximize synergies. The fund is positioned to benefit as M&A activity in the sector increases.

We established a position in TIM Participacoes as we believe the company will be a participant in consolidation in the wireless telecom market in 2018 / 2019. The business is performing well with year-on-year (YoY) increases in revenues (3%), EBITDA (16%) and EPS (200%).

Ahead of anticipated consolidation, the strong performance of the underlying business led to an increase in share price 63% YTD, with approximately half of the gain occurring in Q3, resulting in gains for the fund. With solid fundamentals and accelerating growth, we expect the company will benefit from accretive acquisition or be acquired at a premium in the near to mid-term.

Specialty pharma

Through July, our specialty pharma portfolio saw stabilization as the market began to give credit to the underlying company fundamentals and some stocks began to rebound. However, in August Teva reported Q2 earnings, which missed estimates and cut 2017 dividend/outlook, putting the company at risk for breaching debt covenants. Business deterioration was caused by conditions in the US generics market where Teva has seen price erosion and decreased volumes. Management turnover has also caused disruption with both CEO and CFO leaving this year. While we had significantly reduced our position in Teva (2.5% end of July), the news had a knock-on effect on other pharma companies, particularly those with higher debt levels or exposure to US generics.

Some of the companies we own had positive news: Valeant announced Q2 earnings which met estimates and maintained full-year guidance; Shire and Allergan also reported Q2 earnings, both beating market expectations and raising full year guidance. However, these positive developments were overshadowed by the continued fear and uncertainty surrounding the sector, causing the broader portfolio to decline.

Specialty pharma still trades at wide discount

We continue to be frustrated over the persistent wide discount at which our specialty pharma positions trade, yet remain confident that the current discount is unsustainable.

Historically, the sector has generally been one of the strongest performing sectors, even during economic recessions. On average over the last 10 years, specialty pharma has traded at a discount of 13% to large pharma, yet currently trades at a 60% discount, with many companies trading for mid-single digit P/E multiples. Furthermore, the lines between "specialty" and "large pharma" are more blurred than ever. Companies such as Allergan and Shire have enterprise values close to that of other "large pharmas," and are spending significantly on innovative R&D focused on new biotech and other breakthrough drugs.

If the discount to large pharma were to close in-line with the historical average, we could see over 150% upside in these stocks and we expect them to be a large contributor to performance going forward.

Summary

While the recent period remains our most challenging since inception, we believe the current portfolio contains considerable imbedded value and feel very confident about the outlook, returning the funds to profitability and meeting our long-term objectives.

Selective merger arbitrage spreads are attractive and we expect returns in this space to improve as interest rates rise in the US.

While the uncertainty surrounding potential tax reform has reportedly kept some deals in the pipeline from being announced, the clarity of the timing and change in corporate tax rates should be a positive catalyst for M&A activity worldwide. After the tech industry, healthcare companies have the most cash sitting overseas, so any reforms to repatriation would be a positive catalyst for the sector.

Pre-announced deals offer the potential for large takeover premiums not only in our specialty pharma portfolio but in other sectors such as telecom, where we are well positioned to capture meaningful returns during industry consolidation. We believe our positions in companies such as T-Mobile, Dish and others could produce significant upside to the portfolio in the near to mid-term.

We see very large upside in the GSEs and believe a resolution could be reached following tax reform, likely in early 2018.

We expect to see a recovery in the specialty pharma portfolio as the companies continue to perform well. If this sector normalizes and our positions trade towards more reasonable valuations or they are taken out, then there is significant upside. Upon realization, we will diversify the portfolio away from specialty pharma accretive acquirers, and the fund will continue to gradually implement and conform to the new risk guidelines announced in 2016, mandating reduced gross sector exposure limits and reduced maximum position sizes on non-merger spread events.

In past periods of drawdowns we have made the necessary adjustments to allow the fund to regain its high water mark and we expect that to happen again in this cycle. The investment team continues to identify and analyse attractive opportunities and remains focused on delivering long term returns.

Performance attribution as at 30 September 2017*

Top 5 contributors	Type	Country	Sector	Quarter (%)
Undisclosed	Long	United States	Information technology	0.9
Undisclosed	Long	United States	Financials	0.8
Undisclosed	Long	United States	Financials	0.7
Undisclosed	Long	Brazil	Telecommunication services	0.6
Undisclosed	Long	UK	Information technology	0.3

Source: Schroders as at 30 September 2017.

Bottom 5 contributors	Type	Country	Sector	Quarter (%)
Undisclosed	Long	United States	Healthcare	-1.8
Undisclosed	Long	Ireland	Healthcare	-1.4
Undisclosed	Long	Canada	Healthcare	-1.4
Undisclosed	Long	Israel	Healthcare	-1.3
Undisclosed	Short	United States	Healthcare	-1.0

Source: Schroders as at 30 September 2017. *Analysis expressed on a gross of fees basis using total return methodology. The impact of any currency movement at security level is reflected within each of the relevant strategies. All data is rounded to one decimal place; as such, any small discrepancies can be attributed to this.

Region (ex. hedging)	Month (%)	Quarter (%)	Year to date (%)
Europe ex UK	-0.1	-1.4	-0.3
United Kingdom	-0.1	0.2	0.2
North America	-2.2	-6.5	-9.5
Pacific ex Japan	0.0	-0.8	-0.8
Emerging Markets	0.2	-0.7	-1.3
Other (including FX Hedging, Options)	-0.6	-0.4	-0.8
Total	**-2.8**	**-9.7**	**-12.5**

*Analysis expressed on a gross of fees basis using a total return methodology. The impact of any currency movement at security level is reflected within each of the relevant strategies. NB All data is rounded to one decimal place; as such, any small discrepancies can be attributed to this.

Performance attribution as at 30 September 2017

Sector	Month (%)	Quarter (%)	Year to date (%)
Consumer Discretionary	-0.4	-1.5	-0.6
Consumer Staples	0.0	0.0	0.1
Energy	0.1	0.1	-1.1
Financials	0.0	0.0	0.0
Healthcare	-1.5	-6.6	-4.3
Industrials	0.0	0.1	0.0
Information Technology	0.1	0.2	1.0
Materials	-0.1	-0.2	0.7
Telecommunication Services	-0.2	0.6	1.2
Utilities	0.0	0.0	0.0
Other (including FX Hedging, Options)	-0.8	-2.4	-9.4
Total	**-2.8**	**-9.7**	**-12.5**

Source: Schroders as at 30 September 2017.

Key positions as at 30 September 2017 (%)

Top 10 long positions

	Sector	Country	Weight (%)
1	Healthcare	United States	9.6
2	Healthcare	United States	9.6
3	Healthcare	United States	7.9
4	Healthcare	United States	4.8
5	Healthcare	United States	4.8
6	Financials	United States	4.7
7	Information technology	United States	4.7
8	Consumer discretionary	United Kingdom	4.7
9	Consumer discretionary	United States	4.6
10	Consumer discretionary	United States	4.6

Source: Schroders as at 30 September 2017.

Top short positions

	Sector	Country	Weight (%)
1	Market index	United States	-27.5
2	Healthcare	United States	-25.3
3	Information Technology	China	-4.2
4	Telecommunication Services	United States	-1.3

Source: Schroders as at 30 September 2017.

Portfolio positioning as at 30 September 2017 (%)

Size	Long (%)	Short (%)	Net (%)
Mega (> 20 billion)	45.4	-5.5	39.9
Large (between 5 and 20 billion)	14.5	-	14.5
Medium (between 1 and 5 billion)	31.8	-	31.8
Small (between 250 million and 1 billion)	0.5	-	0.5
Market & sector Index	-	-52.8	-52.8
Total	**92.2**	**-58.3**	**33.9**

Source: Schroders as at 30 September 2017.

Region allocation

Region	Net Weight %
Northern America	25.9
Europe & Middle East	8.4
Asia Pacific	-4.2
Other	3.9
Total	**33.9**

Strategy allocation

Sector	Net Weight %
Announced Deals	8.0
Offers	0.0
Event / Merger Arbitrage	26.0
Market Hedges	0.0
Total*	**33.9**

Source: Schroders as at 30 September 2017.

Sector allocation

Sector	Net Weight %
Healthcare	21.8
Market index	-27.5
Consumer discretionary	17.9
Telecommunication services	7.9
Financials	9.4
Information technology	0.5
Materials	2.1
Energy	1.8
Total	**33.9**

Source: Schroders as at 30 September 2017.

bond total return swaps may increase the exposure to equity and credit related risks. The use of financial derivative instruments for investment purposes may increase the share price volatility, which may result in higher losses for the investor.