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March 2026

Schroder Wholesale Australian Equity Fund – Wholesale Class

Performance overview

The S&P/ASX 200 Accumulation Index fell 1.61% during the March quarter while the Schroder Wholesale Australian Equity Fund – Wholesale Class returned 2.04% (after fees), outperforming the index by 3.64% during the quarter.

At the sector level, an overweight allocation to Industrials, Communication Services and Consumer Staples detracted the most from relative performance during the quarter. An overweight allocation to Materials and underweight allocations to Consumer Discretionary and Real Estate added positively to relative returns.

At the stock level, overweight positions in Santos, Ramsay Health Care and South32 contributed positively to performance during the quarter. Conversely, overweight positions in Seek, CSL and Fletcher Building were the primary detractors.

Market Review

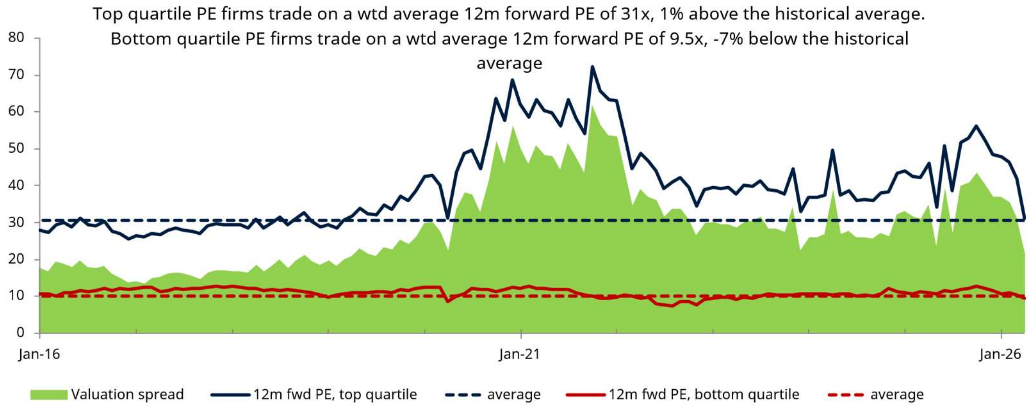
A 7% decline in the Australian equity market in March can easily be explained by Operation Fury and the resulting closure of the Strait of Hormuz, seeing globally a rise in energy prices and inflationary pressures. Locally, inflationary pressures were already evident such that interest rates were increased to approach bond yields of 4% in the US and 5% in Australia. The underlying settings for a correction were and are in abundance; Operation Fury was simply lighting a match and putting it next to the fuel. Having said that, for context, this was still a simmer rather than a bonfire; for the year ending March the ASX200 index is still 11.7% higher than it was a year ago, even after the market shiver in March. And that followed four of the past five years seeing the market increase double digits, with the only down year (2022) being a de minimis decline (1.1%).

In this context, local dividend yields of 3.5% being well below the risk free rate, coupled with high multiples notwithstanding tepid cashflow growth for the fourth year in a row (excuse us whilst we expense otherwise capitalised amounts such as, well, salaries paid as shares), reflecting increasing inflationary pressures into a local environment where productivity continues to struggle – it is little surprise that a fall in equity markets occurred. What is more surprising is that the prospect of such a decline was, and remains, so discounted. As the protagonist Ryland Grace in Andy Weir's excellent novel (now movie) Project Hail Mary reflects to his alien engineer collaborator Rocky, "Human beings have a remarkable ability to accept the abnormal and make it normal".

One abnormality which had been normalised increasingly through the past decade, until recent months, was that equity valuations could be sustained into perpetuity, whilst pricing a minimal equity risk premium. This mostly manifested itself through the aggressive rerating of the high multiple cohort of the market through the past five years. This has somewhat retraced through recent months, and should it continue to retrace it can be seen that it can readily present to us an opportunity to diversify our portfolio holdings. We would add that whilst the unwind of recent months has undone much of the rerating enjoyed through the prior five years, we are now at a level which is more normal rather than cheap. From this point, earnings need to deliver for the higher multiple cohort to outperform.

Multiple disparity has converged but remains wide

Higher bond yields and debasement fears should logically suppress long duration stocks



Source: Datastream, Schroders, 31 March 2026

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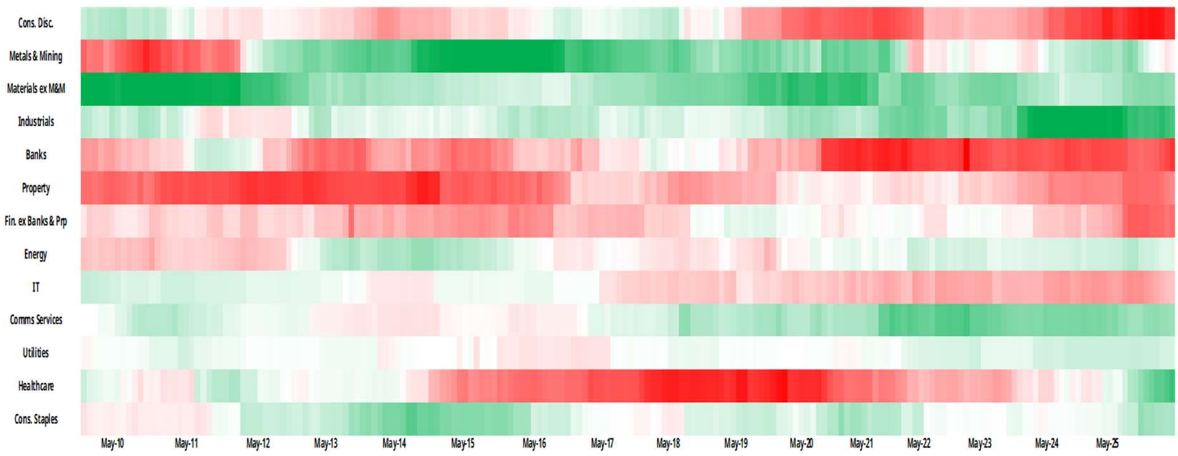
As can be seen, in recent months we have assumed an overweight position in the Healthcare sector (with exposures to CSL joining our longer standing positions in ResMed and Sonic Healthcare), and we were keen to again be overweight the IT sector if multiples retraced sufficiently such that the stocks became relatively attractive on our valuations. In a couple of instances, they are now not far off. The Australian market already suffers from an absence of diversity; it behoves us to continue to demonstrate a willingness to position the portfolio across all of its sectors, when valuations present an opportunity for us to do so. As can be seen, for almost all sectors of the market, through time, we have spent almost as much time underweight them as we have overweight; within the portfolio risk constraints, we are sector agnostic, simply trying to reflect the best relative opportunities presented as market moods change and take equity prices with them.

Australian Equities Core

Active exposure by sector through time



Source: Schroders. S&P/ASX 200 as at 31 March 2026.

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This view could be tempered to the extent that earnings growth for higher multiple stocks continue to miss expectations, especially if there was a persistence in doing so. The term “value trap” is a well worn axiom;

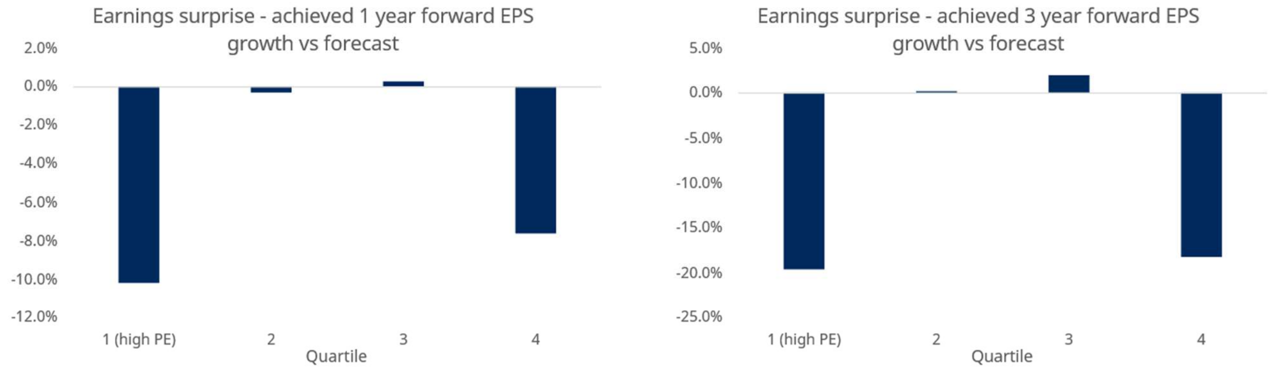
that is, an apparently cheap multiple proves illusory as earnings corrode. We have fallen prey to more than our share of these; and indeed, having been derated aggressively, that ad hominem is now attaching to some of the poorer performing Healthcare stocks through the past quarter, notably CSL and Cochlear. Having been derated through prior years, Ramsay Health Care has actually been our best contributor through the past quarter as the refocus upon capital allocation was writ large with the announcement of an intention to undertake an in specie distribution off its 53% holding in Ramsay Sante. Whilst we value this holding at zero, and hence are indifferent as to whether Ramsay sell or distribute the asset, what is important is that no further capital be allocated to it. This announcement confirmed this would occur, which has led to increased confidence in the potential for an ongoing improvement in returns for the business after several years of progressive degeneration. Indeed, Ramsay was the very definition of a value trap.

What is less discussed in the market is the prospect of a “growth trap”. What is the evidence in the Australian market, especially assuming like for like accounting, that the earnings growth promised by the higher multiple cohort is actually delivered? Is there a good reason for a higher bifurcation between multiples for stocks on the ASX, simply reflecting the observed and expected persistence in earnings (as in, cashflows) growth rewarding investors in higher valued cohorts?

The short answer is no. The evidence suggests to the contrary. Within the market as a whole, earnings expectations are persistently too high, and that has been observable almost without exception every year through the past decade. Subject to what is yet to emerge as the economic damage wrought from Operation Fury, this year, though, may yet prove a rare exception, with earnings exceeding expectations; albeit only because of strength in commodity prices, seeing the Materials sector being the best contributor to portfolio performance through the past year as well as quarter. For the general rule, though, where earnings forecasts are persistently too high, the evidence supports the value trap thesis – lowest multiple stocks are very susceptible to downgrades – but interestingly on a rolling one and three year basis earnings disappointments are at least just as severe for the highest multiple cohort. Growth traps on an earnings basis are just as much a source of mischief for investors as value traps. And when coupled with high starting multiples, the root cause of performance grief for ASX equity portfolios tilted towards higher multiple stocks through recent months becomes clear.

Growth Traps outnumber Value Traps on the ASX

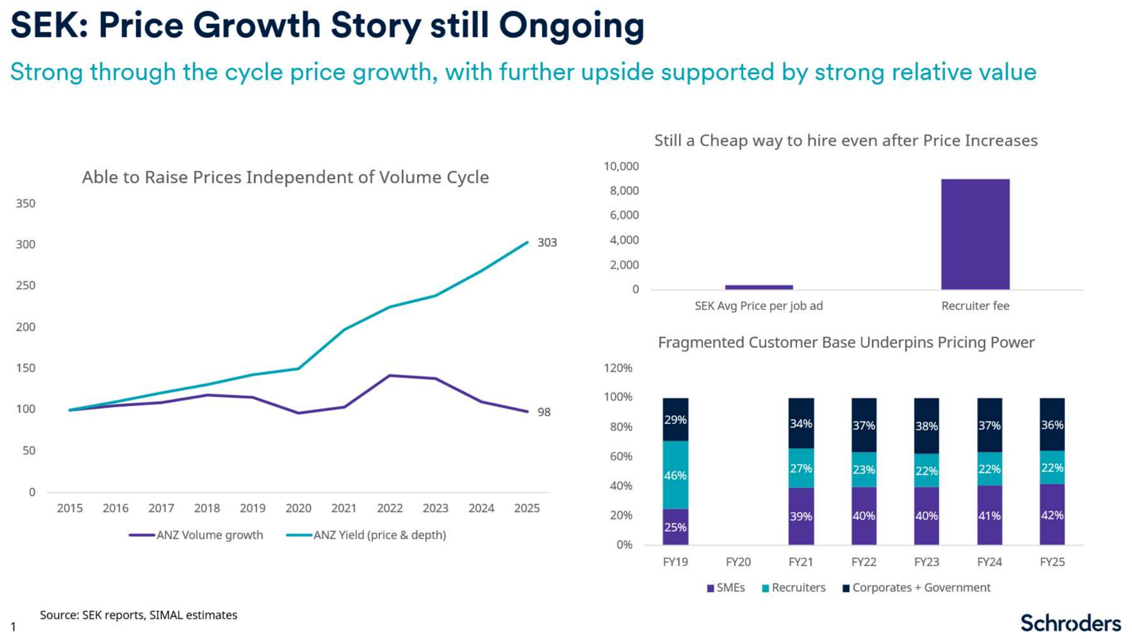
ASX200 by PE quartile; earnings surprise through the past decade



Source: Datastream, Schroders.

The importance of this for our portfolio now is clear. We have enjoyed relative outperformance in recent months as the derating of the highest rated cohort has occurred; just as we had endured a torrid period of relative underperformance as they were rerated through the prior several years. Having now come back towards more palatable multiples, the temptation is for us to rotate the portfolio into growth stocks. For context, through the past year the IT sector has underperformed by 35%, but with 28% earnings growth forecast next year (last year it did 6%) it now trades on a P/E of 50 times. Mind the growth trap; or as Ryland Grace may say, be careful in taking the abnormal and making it normal.

Within the portfolio, whilst the performance of some of the Healthcare names, Reliance Worldwide, Fletcher Building and Orica all may have met the definition of being value traps during the quarter, the biggest detractor to performance was Seek. Amidst a sell off of IT and marketplace stocks through the quarter, Seek was as poorly performing as any. We believe the management have done a good job in replatforming the business through recent years (not many major IT system projects have been within time and budget) and in turn have been able to use the platform to better manage yield (price) whilst not harming the franchise. To an even greater extent than with its marketplace peers, REA Group and CAR Group, we believe the cost base for Seek could be (materially) reduced without harming its franchise, and yet it is cynical to model this given management have no intention of running the business this way. Even with the demonstration of AI led efficiency each of them are now keen to demonstrate, in no case are those “productivity gains” flagged to emerge in reduced dollar costs. In the face of potential AI disruption, and uniquely among its marketplace peers, Seek has a relatively unobservable inventory and immense trust placed in it by candidates with the treatment of their data, which is a large part of why we remain alert, yet not alarmed, to the prospect of its business being subject to disintermediation in an AI world.



Market Outlook

Rocky contrasted the intelligence and approaches to problem solving of the alien Eridians, which can calculate and retain information perfectly, with humans by saying to Ryland “… Math is not thinking. Math is procedure. Memory is not thinking. Memory is storage. Thinking is thinking…”. Recent months prove thinking still has a critical role in investment. In an environment where assets remain expensive relative to their underlying earnings and cashflows, even after the modest declines seen in March, any assumption that equity returns in future years can continue to be driven by rerating, in the face of increasing inflationary pressures and high starting multiples, seems courageous. For higher multiple stocks in the market, it is true that the easier unwind of multiple excess has now been banked; but the harder element of earnings and cashflows now being produced to meet expectations which have hitherto regularly been unmet, is still in front of us. Aggressive portfolio rotation is not a gimme. Growth traps may still be as prevalent as value traps. We need a Rocky to remind us to think; and help us avoid both.

Andrew Fleming

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