Perennial Value Australian Shares Trust

Perennial Partners

Monthly Report October 2022

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	2 Years (% p.a.)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception ^(% p.a.)
Perennial Value Australian Shares Trust (Net)	5.8	0.7	5.3	-0.6	15.6	5.5	5.8	9.0
S&P/ASX 300 Accumulation Index	6.0	0.5	6.4	-2.6	11.9	4.9	7.2	7.9
Value Added	**-0.2**	**0.2**	**-1.1**	**2.0**	**3.7**	**0.6**	**-1.4**	**1.1**

^Since inception: March 2000. Past performance is not a reliable indicator of future performance.

Overview

Despite inflation data continuing to come in above expectations, some signs of weakening economic data led to hopes of a "Central Bank pivot", which would see the pace of interest rate rises slow. This caused markets to stage a rally in October, with the S&P500 finishing the month up +8.0%, the NASDAQ rallying +3.9%, the Nikkei 225 adding +6.4% and the FTSE100 lifting by +2.9%. The exception was the Chinese market, which fell -4.3%.

The Australian market was also strong in October, with the ASX300 Accumulation Index finishing the month up +6.0%. Financials (+12.1%) led the market higher, with the banking sector rallying into their results. The REITs (+9.9%) were also stronger, on the prospect of slowing interest rate rises, while Energy (+9.1%) rallied as the oil price rebounded. Consumer Discretionary (+8.8%) was also strong, with spending continuing to remain robust. Metals and Mining (-1.0%) was the worst performing sector, as most commodity prices fell on continued weak Chinese economic data and a lack of indications that their zero-COVID policy would change in the near term.

Looking forward, while activity remains strong, markets are increasingly pricing recessions in the US and Europe. Investors are searching for signs of slowing activity and easing inflationary pressures, which could foretell the end of the current rate tightening cycle. Economic activity in Australia continues to remain very robust, with low unemployment and resilient consumer spending despite interest rate rises and inflationary pressures. The course of the war in Ukraine and Chinese government policy will also have significant and unpredictable impacts on markets.

Fund Characteristics

The Trust aims to grow the value of your investment over the long term via a combination of capital growth and income, by investing in a diversified portfolio of Australian shares, and to provide a total return (after fees) that exceeds the S&P/ASX 300 Accumulation Index measured on a rolling three-year basis.

Portfolio Managers
Stephen Bruce, Damian Cottier, Andrew King

Trust FUM
AUD $638 million

Distribution Frequency
Half yearly

Minimum Initial Investment
$25,000

Trust Inception Date
March 2000

Fees
0.92% p.a.

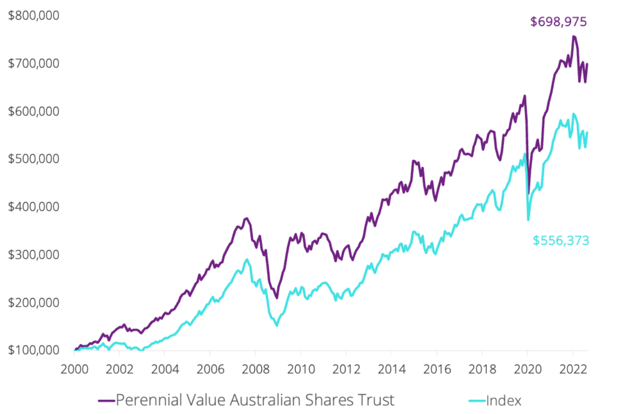
APIR Code
IOF0200AU

Portfolio Characteristics – FY23	Trust	Market
Price to Earnings (x)	13.1	14.8
Price to Free Cash Flow (x)	13.2	13.6
Gross Yield (%)	5.6	5.5
Price to NTA (x)	2.2	2.6

Source: Perennial Value Management. As at 31 October 2022

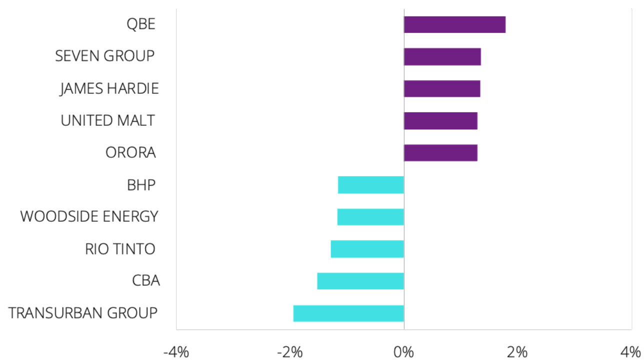
The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Growth of $100,000 Since Inception

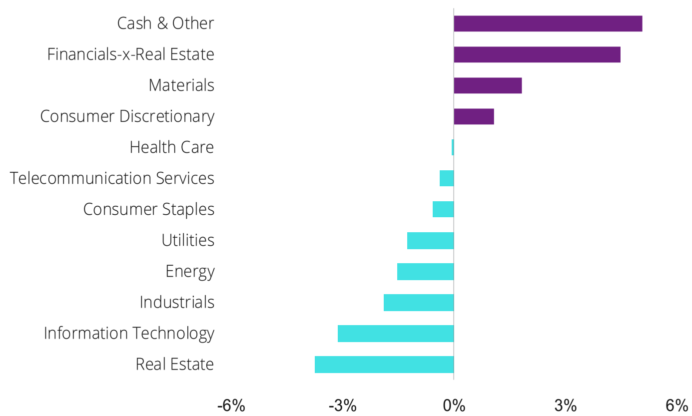


Performance shown net of fees with distributions reinvested. Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The Trust returned +5.8%, after-fees in October, underperforming the index by -0.2%.

Key positive contributors to performance included Qantas (+16.3%), which continued its strong performance, delivering a trading update which guided for first half earnings of more than double what the market was forecasting. This confirmed the current very positive operating conditions, with strong pent-up demand for travel intersecting with industry capacity constraints. The resulting pricing power has seen very strong profitability, despite cost headwinds.

Macquarie Group (+11.0%), outperformed, due to a combination of its high market beta and the delivery of a very strong half-year result. Of note, the high level of volatility has led to very strong results from their Commodities and Global Markets business. In particular, the energy trading business has benefited from dislocations in the global gas markets, which have driven strong trading profits, as well as high levels of customer demand for hedging products. The asset management business continues to grow, with strong demand for green energy investments. Macquarie is uniquely placed to meet this demand, with their expertise in originating and developing renewable energy projects.

Virgin Money UK (+15.8%), continued its volatile performance, buffeted by the political turbulence in the UK. While the economic outlook for the UK is highly uncertain to say the least, this is more than reflected in the valuation of the stock, which is trading at 0.4x book value. Further, the bank has a strong capital position and is carrying large provisions against bad debts. From the current depressed valuation, we believe it is likely this stock may double as the economy recovers.

MA Financial Group (+15.0%), was another small cap holding which rallied strongly over the month. Like many other small caps, this stock has been oversold and presents very significant upside over the medium term, as its asset management business continues to grow strongly.

Nufarm (+11.4%) rallied as, in addition to benefiting from favourable agricultural conditions, the market focussed on the value of its seeds business. This followed the sale by a competitor, UPL, of a stake in their seeds business for an extremely high valuation multiple. Applying a similar multiple to Nufarm's seeds business implies significant upside to the current share price.

Holdings in the major banks outperformed, rallying an average of +14.2% over the month. This strong performance was sparked by the Bank of Queensland result, which showed a larger than expected benefit to margins from rising interest rates. This was also a characteristic of the ANZ result and is expected to be repeated when NAB and Westpac report in early November. The ANZ result also highlighted that credit quality remains very strong, with no signs of stress at present, consistent with the ongoing strength in the Australian economy.

While the revenue environment for the banks is the best it has been in a very long time, margins are likely to come under pressure again as funding costs rise. The ANZ result also highlighted the cost pressures that the banks are facing, particularly in terms of wage increases. Finally, it is likely that there will be an increase in bad debts from the current very low levels, as interest rate rises flow through the economy.

Overall, the Trust holds a neutral position in the sector, with overweights in NAB, which is performing well operationally and is exposed to the strong growth in business lending, and Westpac (+16.8%), which has significant upside should its turnaround be successful. This is offset by underweights in CBA (+15.4%), due to its unjustifiable valuation premium, and ANZ (+12.1%), which has the weakest franchise.

The main detractors over the month were the Trust's Resources holdings. While the Energy sector was stronger, on a rally in the oil price, declines in the prices of key commodities such as iron ore and copper, saw BHP (-3.0%), Fortescue Metals (-12.6%), Iluka Resources (-4.5%) and Oz Minerals (-6.2%) all lower. This resulted from disappointment that the Chinese Party Congress gave no indication of significant new stimulus measures or an easing of the COVID-zero policy. In our view, it is only a matter of time until this occurs, and we remain positive on the outlook for commodities medium-term. Independence Group (+11.6%) was the exception, on continued strength in the lithium market.

Trust Activity

During the month we took profits and trimmed our holdings in Qantas, Santos and QBE Insurance. Proceeds were used to top up holdings in Macquarie Group, James Hardie and a number of resources names. At month end, stock numbers were 59 and cash was 5.1%.

Outlook

Global growth is clearly slowing, as interest rates rise and economies grapple with the impacts of high inflation and energy supply problems. However, we believe that this will be offset to some extent by the benefits to economies as COVID disruptions continue to recede. While economic data is mixed, and varies greatly from region to region, unemployment rates are very low in most major markets. The Australian economy is performing particularly strongly and will continue to be a key beneficiary of the strength in commodity markets. However, there are a number of potentially significant changes in the global economic and political backdrop, from the return of inflation and the change in the interest rate cycle, to rising geopolitical tensions. As a result, the level of uncertainty is elevated, and a degree of caution is warranted.

This view is expressed in the portfolio through holding a combination of stocks with reopening leverage, as well as stocks with solid defensive characteristics. Importantly, the portfolio is positively leveraged to post-COVID reopening, higher inflation, and rising interest rates. Within the cyclical part of the portfolio, this is achieved through overweight positions in the Financials, as well as select parts of the Consumer Discretionary sector and Resources sectors. In the defensive part of the portfolio, this is achieved through holdings in the sectors such as Telcos, Healthcare and Insurance as well as a modest overweight in gold.

While there is a high level of economic uncertainty, our focus remains on investing in quality companies with proven business models and strong balance sheets, which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors.

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