Perennial Value Shares for Income Trust

MONTHLY REPORT OCTOBER 2020

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception (%p.a.)
Income Distribution	0.4	1.3	1.7	4.9	7.3	7.5	6.2
Capital Growth	0.9	-2.3	-3.5	-20.1	-9.2	-5.6	-1.5
Total Return	1.3	-1.0	-1.9	-15.3	-1.9	1.9	4.7
Franking Credits#	0.3	0.5	0.8	2.1	3.2	2.9	2.3
Income Distribution including Franking Credits	**0.7**	**1.8**	**2.4**	**7.0**	**10.5**	**10.3**	**8.5**
Benchmark Yield including Franking Credits*	0.0	1.3	1.3	3.8	5.4	5.8	5.9
Excess Income to Benchmark#	**0.7**	**0.5**	**1.1**	**3.2**	**5.1**	**4.5**	**2.6**

#Franking credits are an estimate as tax components will only be known with certainty at the end of the financial year. Since inception: December 2005. *Benchmark yield including franking credits is calculated as the difference between the return on S&P/ASX300 Franking Credit Adjusted Daily Total Return Index (Tax Exempt) and the return of the S&P/ASX300 Index. Past performance is not a reliable indicator of future performance.

Overview

- Global markets were softer in October, with most major indices declining, due to the combination of a growing second wave of COVID-19 infections in Europe, the suspension of several critical vaccine trials and pre-election jitters in the US.
- The Australian market performed better, buoyed by the easing of lockdowns in Victoria, updates from many companies suggesting a generally improving economic outlook and consumer confidence rising strongly.
- The Trust is targeting an FY21 pre-tax distribution yield of around 7%. While market dividends will be lower, the Trust will seek out the best dividend opportunities and may seek to supplement income generation by undertaking limited call-writing.

Perennial Value Shares for Income Trust

The objective of the Trust is to provide investors with an attractive level of tax effective income, paid via monthly distributions. The Trust aims to provide a gross distribution yield, adjusted for applicable franking credits, above that provided by the S&P/ASX300 Franking Credit Adjusted Daily Total Return Index (Tax-Exempt).

Portfolio Manager
Stephen Bruce

Trust FUM
AUD $19 million

Distribution Frequency
Monthly

Minimum Initial Investment
$25,000

Trust Inception Date
December 2005

Fees
0.92%

APIR Code
IOF0078AU

Portfolio Characteristics – FY22	Trust	Market
Price to Earnings (x)	14.3	16.6
Price to Free Cash Flow (x)	13.4	15.3
Gross Yield (%)	6.6	4.7
Price to NTA (x)	1.8	2.2

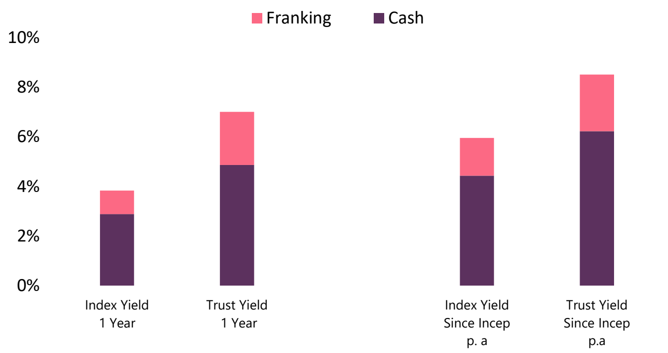
Source: Perennial Value Management. As at 31 October 2020

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.

Franking Levels (%)

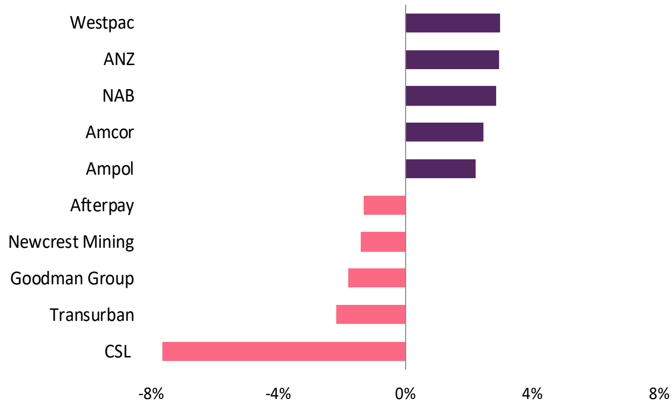
FY20	94.4	FY17	65.6
FY19	95.1	FY16	55.9
FY18	99.2	FY15	88.4

Distribution Yield

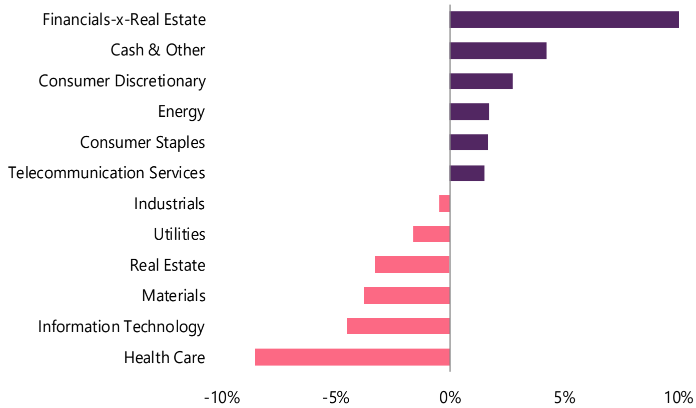


Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

Global markets were softer in October, with most major indices declining, due to a number of factors including a growing second wave of COVID-19 infections in Europe as well as news that trials of several of the key vaccine candidates had been suspended. In addition to a third wave of infections, the US market was dealing with uncertainty leading into the US election.

The Australian market performed better, rising +1.9%, buoyed by the easing of lockdowns in Victoria and updates from many companies suggesting a generally improving economic outlook. In addition, consumer confidence readings rose strongly. Of particular note was the information released relating the loan deferrals by the major banks. Pleasingly, a significant proportion of borrowers who had taken up the option of deferring repayments on either mortgages or business loans have now resumed payments. This is especially positive given that Victoria was still in lockdown over this period. Further, to date, the combined impact of repayment deferrals, low interest rates and first home buyer incentives has seen the property market remain sound, removing a significant risk to the economy.

Financials was the best performing sector over the month, with the major banks up an average of +7.2%. The Trust has an overweight position in the sector, as the banks are trading on very attractive medium-term valuations and are likely to deliver significant share price upside as economic conditions normalise. As mentioned above, credit quality appears to be holding up well and, should this continue, the banks earnings will increase as bad debt charges revert to more normal levels. Further, the accelerated shift to online banking will present a cost reduction opportunity for the banks as they increasingly digitalise their operations. In addition, the banks are close to having put their various regulatory issues stemming from the Royal Commission behind them, have sound capital positions and are set to resume paying attractive levels of dividends.

Other stocks which outperformed over the month included Coca-Cola Amatil (+30.8%), which received a takeover offer from its European bottling equivalent. Mining services company Seven Group (+8.4%) rallied, standing to benefit from increased infrastructure spending as well as ongoing strength in the iron ore sector. Further, the company will likely realise significant value over time from its recent investment in Boral, where it now holds close to 20%. Packaging company Orora (+7.5%), rallied after delivering a positive trading update which highlighted the stability of its Australian operations and indicated that their problematic US operations were showing early signs of improvement. Macquarie Group (+6.0%), Sonic Healthcare (+5.0%) and Woolworths (+4.7%) also outperformed.

The resources sector was generally weaker during the month. While the Trust is underweight the resources sector overall, it holds a significant exposure to the iron ore stocks such as Fortescue Metals (+6.6%), Rio Tinto (-2.0%) an BHP (-5.1%). These companies are generating very strong cash flows and have low levels of debt. This is expected to allow them to continue to pay large dividends over the coming year.

Holdings which detracted from performance over the month included Event Hospitality (-14.4%), which gave back last month's gains despite a generally positive AGM update. Rail operator, Aurizon (-11.3%), declined on the expectation of declining coal haulage volumes, while Monadelphous (-9.9%), Graincorp (-6.3%), Crown Resorts (-5.8%) and Aristocrat Leisure (-4.5%) also underperformed.

Trust Activity

During the month, we exited our holding in Coca-Cola Amatil after the stock rallied strongly to trade close to the takeover price. We also took some profits and trimmed our holdings in BHP and Fortescue Metals following their strong performances in recent times. As mentioned previously, we retain a significant position in these stocks. Proceeds were used to add a number of new stocks to the portfolio including diversified property company GPT, and healthcare company, Healius, which stands to benefit from the recovery in medical procedures. At month end, stock numbers were 35 and cash was 1.2%.

Distribution

In order to provide a regular income stream, the Trust pays monthly distributions. We aim to pay equal cash distributions each month, based on our estimate of the dividend income to be generated over the year. Franking credits, surplus income and any realised capital gains will then be distributed, as per usual, with the June distribution.

The Trust declared a distribution for October of 0.35cpu, bringing the total income return for the last 12 months to 4.86% or 7.00% including franking credits.

Looking forward, the outlook for dividends for FY21 will become clearer over the next few months. While it is certain that many companies will be reducing their dividends, the market overall should still be expected to generate an attractive level of dividend income in the year ahead, particularly compared to other alternative sources of yield. In addition, we may seek to enhance the income generation of the Trust by undertaking limited call-writing. At this stage, we are targeting a pre-tax distribution yield of approximately 7.0% for FY21.

Outlook

The domestic outlook seems increasingly positive, with COVID largely under control, restrictions being eased and borders set to reopen. Further, the economy is underpinned by historically low interest rates and meaningful fiscal stimulus. If this improvement continues, then corporate earnings and dividends are likely to rebound strongly over the coming year.

Looking internationally, while the recovery that was being seen in Europe is being curtailed by the second wave of COVID infections, the US continues to improve. At the time of writing, the likely election US election outcome – a Biden presidency with a Republican Senate – should usher in a period of stability in terms of domestic and international policy and, hopefully, a generally more harmonious backdrop. From an economic point of view, there is likely to be increased fiscal stimulus, although not of the scale originally proposed. Similarly, tax increased are less likely and interest rates are likely to remain low. On balance, this should be positive for economic growth, corporate earnings and markets overall.

The Trust is positioned to benefit from an ongoing economic improvement. In the meantime, the Trust continues to offer a higher forecast gross yield than the overall market and, as always, our focus will continue to be on investing in quality companies with strong balance sheets, which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors. Further, we believe the current very low interest rates highlight the relative attractiveness of financially-sound, high dividend yielding equities.

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