

	Quarter	FYTD	1 year	3 years	5 years	Since Inception [^]
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Wealth Defender Australian Shares Trust*	4.7	9.3	6.2	-	-	3.9
S&P/ASX 300 Accumulation Index	4.9	10.4	11.8	-	-	5.9
Value Added (Detracted)	-0.2	-1.1	-5.6	-	-	-2.0
Net Performance	4.5	8.8	5.4	-	-	3.2

*Gross Performance. ^Since inception: 30 May 2014. Past performance is not a reliable indicator of future performance.

Perennial Value Wealth Defender Australian Shares Trust

The Trust aims to outperform the S&P/ASX 300 Accumulation Index by investing in a diversified portfolio of Australian shares and using protection strategies to dynamically protect the portfolio through market cycles, thereby reducing the magnitude of significant negative returns in falling equity markets.

Trust manager:

Dan Bosscher

Risk profile:

High

Trust FUM* (as at 31/12/16):

AUD \$49 million

Income distribution frequency:

Half yearly

Strategy FUM (as at 31/12/16):

AUD \$434 million

Team FUM (as at 31/12/16):

AUD \$7.2 billion

Trust redemption price (as at 31/12/16):

\$ 1.0034

Any material changes to risk profile, strategy, key service providers or portfolio managers during the period:

Nil

Minimum initial investment:

\$25,000

Trust inception date:

May 2014

APIR code:

IOF0228AU

*Trust FUM is equivalent to the net asset value of the Trust. It is the value of the assets less the liabilities of the Trust, as calculated in accordance with the terms of the Trust's constitution.

- ▶ **Markets rallied over the December quarter, with the S&P/ASX300 Accumulation Index (the Index) up 4.9%.**
- ▶ **Financials and resources outperformed, while defensive sectors lagged.**
- ▶ **The Trust delivered a strong return of 4.7% for the quarter.**

Trust Characteristics

The objective of the Perennial Value Wealth Defender Australian Shares Trust (the Trust) is to be invested in a diversified portfolio of financially sound companies and carry a level of protection sufficient to reduce the magnitude of significant negative returns during sharp equity market falls.

Trust performance

The Trust delivered a solid return of 4.7% for the December quarter, marginally behind the Index.

Global markets were positive, with the S&P500 up 3.3%, Nikkei 225 up 16.2%, FTSE100 up 3.5% and the Shanghai Composite up 3.3% all advancing over the quarter. Commodity prices were up strongly with oil up 13.0%, iron ore up 41.0%, thermal coal up 31.0%, coking coal up 8.0% and copper up 14.0%, while gold declined 13.0%. The highlights of the quarter were the result of the US election and the Federal Reserve's decision to lift the Federal Funds rate by 25 basis points – the first US rate hike since the Global Financial Crisis (GFC). The Reserve Bank of Australia (RBA), however, left the cash rate steady at 1.5% and the Australian Dollar (AUD) fell five cents to 72 US cents.

During the December quarter, the more cyclical parts of the market continued to outperform, led by financials (up 12.7%), metals and mining (up 8.4%), energy (up 7.4%) and materials (up 7.4%). By contrast, the “expensive defensives” such as healthcare (down 8.8%) and REITs (down 0.7%) underperformed. This continued the trend, beginning in the September quarter, which has seen a rotation into more cyclical stocks at the expense of the defensive “bond proxy” sectors, which had rallied strongly over FY16.

With this backdrop, stocks which contributed positively over the quarter included resources holdings, Rio Tinto (up 16.1%), BHP (up 12.0%) and Woodside Petroleum (up 8.9%) as well as mining services companies Orica (up 18.2%) and Downer (up 13.0%). Financials also performed well, with QBE Insurance (up 33.7%) with its leverage to rising US interest rates, Clydesdale Bank (up 9.8%) and Macquarie Group (up 8.6%). Other strong performers included Graincorp (up 22.2%) as the east coast grain harvest shapes up to be a record and AGL Energy (up 16.0%) as electricity prices strengthen.

The Trust also benefitted in a relative sense from the declines in many of the “expensive defensives” which we do not hold on valuation grounds. Examples include Ramsay Healthcare (down 13.9%), Sydney Airport (down 11.8%), Transurban (down 7.0%) and CSL (down 6.2%). While these stocks are all down significantly from their highs, they are still trading on expensive valuations, with an average FY17 P/E (Price to earnings ratio) of over 30 times, meaning there is further potential downside should interest rates continue to rise. We also avoided many of the recent disasters, such as Estia Health, TPG Telecom, Bellamy's and Blackmores – all popular stocks which have failed to live up to expectations.

Holdings which detracted from performance included Vocus Communications (down 37.9%) which fell after issuing disappointing FY17 earnings guidance, Flight Centre (down 14.0%) with ongoing airfare discounting, Crown Resorts (down 11.7%) on a decline in VIP business following arrests in China and Caltex (down 11.1%) on the loss of the Woolworths petrol supply contract and. These companies are all underpinned by strong balance sheets and we remain comfortable with the medium-term outlook for each.

Overall, the protection portfolio detracted for the quarter, with November being a difficult month given the large fall in volatility and strong rally after the US election. Nonetheless, it was certainly prudent to carry protection given the increase in volatility leading into that event – and the unexpected outcome. It was pleasing, however, to see a much better result from the protection portfolio in the very strong month of December.

Trust Activity

During the quarter, we took profits and sold out of our holdings in a number of stocks which had performed very strongly over the last 12 months including Downer, Aristocrat Leisure, and Harvey Norman. We also reduced our holdings in Macquarie Group, Wesfarmers and Telstra.

Proceeds were used to establish a position in Boral in December. We had previously sold out of this stock in October at an average price of \$6.87. The stock subsequently sold off sharply after announcing the acquisition of US building materials company, Headwaters, funded by a \$2.1 billion capital raising. Following the acquisition, Boral will generate nearly 40.0% of its revenue from the US and is one of the few stocks which give exposure to the improving US housing and construction cycle, which is expected to have a significant time to run. At our entry price of \$5.23, the stock represents good long-term value, trading on a FY18 P/E of 13.9 times and gross yield of 5.6%. The improving US economy is a key driver of markets at present and, in addition to our Boral position, the Trust is well exposed to this theme via its holdings in Ansell, Henderson Group, Lend Lease, Macquarie Group, NewsCorp and Westfield Corporation.

Environmental, Social and Corporate Governance (ESG)

Perennial Value remains alert and active in ESG matters. During the quarter we engaged with Clydesdale Bank in relation to their remuneration policies. We were pleased by both the approach being taken to executive remuneration which centred on a balanced scorecard of “risky” measures as opposed to simple earnings per share or total shareholder return metrics as well as the way they were proactively seeking out shareholder feedback prior to finalising the remuneration structure and believe this should set an example for other companies.

Outlook

Markets have responded positively to the US election results and the prospect of this leading to more pro-growth fiscal policies as opposed to ongoing monetary easing. Should this eventuate, the Trust will likely benefit from being overweight in the large-cap, low-cost, financially-sound resources companies as well as in a range of quality industrial and financial companies where we see attractive valuations. This would also see continued upwards pressure on interest rates which would benefit the Trust through its underweight position in the expensive defensive sectors such as healthcare and REITs and infrastructure.

The Trust continues to exhibit Perennial Value’s true to label value characteristics, with the portfolio offering better value than the overall market on each of our four valuation characteristics: price to earnings, price to free cash flow, gross dividend yield and price to net tangible assets.

Since the US election, the cost of protection has fallen which has allowed us to replace positions at much better levels than previously. This gives us confidence that the cost of protection will return to more normal levels going forward.

As always, our focus will continue to be on investing in quality companies which are offering attractive valuations, while carrying a level of protection sufficient to reduce the magnitude of significant negative returns during sharp equity markets falls.

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Top 10 Holdings		
Stock name	Trust weight %	Index weight %
Commonwealth Bank	6.7	9.3
Westpac Banking Corporation	5.5	7.1
National Australia Bank	5.4	5.3
BHP Billiton Limited	5.1	5.3
ANZ Banking Group Limited	4.9	5.8
Wesfarmers Limited	3.2	3.1
Woolworths Limited	3.1	2.0
Woodside Petroleum	3.0	1.5
Telstra Corporation	2.6	4.0
Crown Resorts Limited	2.5	0.3

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	6.9	4.2
Materials	14.7	16.2
Industrials	1.4	6.7
Consumer Discretionary	7.6	5.2
Consumer Staples	8.2	6.8
Health Care	2.0	6.2
Financials-x-Real Estate	36.0	37.7
Real Estate	7.3	8.6
Information Technology	1.0	1.4
Telecommunication Services	5.2	4.4
Utilities	1.5	2.5
Cash & Other	8.2	-

Rounding accounts for small +/- from 100%.

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