Perennial Yield Plus Conservative Trust

Monthly Report September 2021

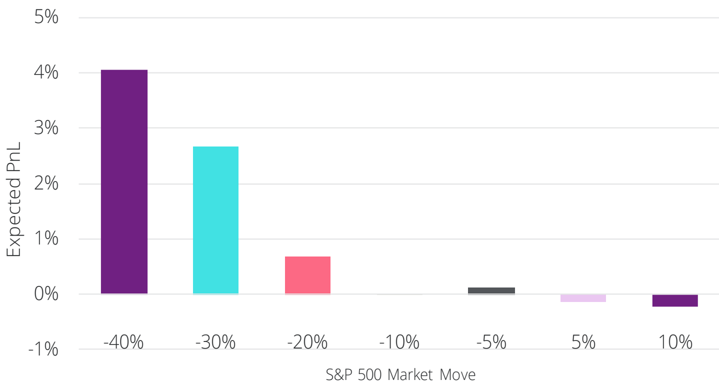
	Month (%)	Quarter (%)	FYTD (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	-0.2	0.1	0.1	0.1
RBA Cash Rate Total Return Index	0.0	0.0	0.0	0.0
Value Added	**-0.2**	**0.1**	**0.1**	**0.1**

^Since inception: June 2021. Past performance is not a reliable indicator of future performance.

Overview

- September finally saw a breakdown of buy-the-dip in equity markets (for now) as inflation and energy concerns, supply chain disruptions, and default risk in China, amongst other themes, weighed heavily on the Panglossian sentiment of recent times. Overall, the Trust delivered a loss (net of fees) of 15 bps, largely driven by the Core Income portfolio.
- A general re-pricing of risk premia was noticeable in wider credit spreads, which coincided with rising rates. However, the widening of spreads and rates means future return expectations for the portfolio are higher than last month.
- The option strategy was reasonably flat for the month, given the modest pullback in equities, but the market structure looks better for future gains in this component.

Estimated PnL Outcomes by Market Move



The chart provides the total expected portfolio PnL given a high velocity move in the S&P 500 .

Source: Perennial Value Management. As at 30 September 2021

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.

Fund Characteristics

The Trust aims to generate income by harvesting equity, credit and volatility risk premia; with a conservative risk profile. A portion of this income is invested in an explicit rules-based equity option defensive strategy to offset, or benefit from, market drawdowns.

Portfolio Manager
Michael Pollard

Trust FUM
AUD $10 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

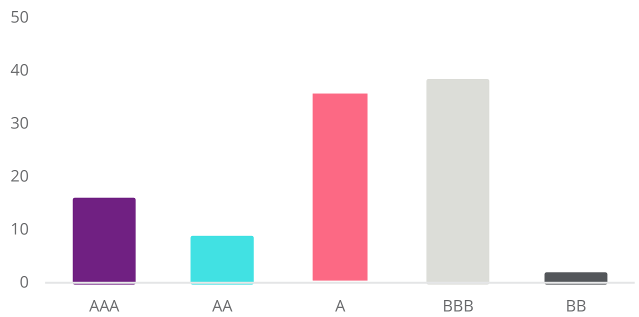
Trust Inception Date
June 2021

Fees
0.6% p.a.

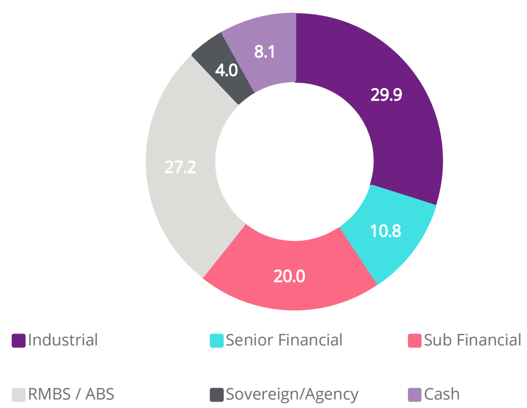
APIR Code
WPC3204AU

Expense Recovery
Capped at 0.1% p.a.

Rating Exposure



Sector Active Exposure vs Index



Portfolio Characteristics	
Modified Duration (Yrs)	0.44
Spread Duration (Yrs)	3.76
Portfolio Yield (%)	1.49
Average Credit Quality	A

Source: Perennial Value Management. As at 30 September 2021

Portfolio yield is the expected return over the next year, assuming no changes to either portfolio composition or market yields. Average credit quality excludes overlay positions. Portfolio yield and spread duration reflect the net credit default swap exposures in the portfolio.

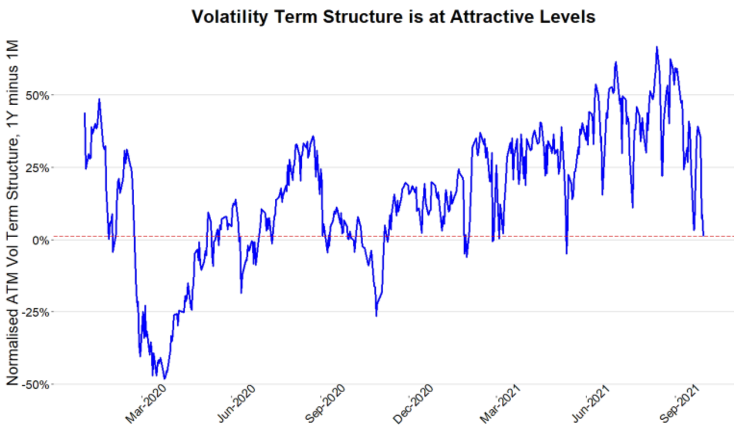
Trust Review

The Core Income strategy contributed a loss of 16 bps for the month. During this time both duration and credit spreads were negative contributors, which more than offset coupon income. Most sectors in the portfolio were negative but RMBS/ABS and subordinated financials were the largest negative contributors. Broader Australian credit spreads were very mixed across sectors and tenors. Energy names performed better than most on the back of higher energy prices. The fund continues to have a modest interest rate duration positioning at 0.45 years.

During the month a modest drawdown on the put write strategy, with the S&P 500 showing a total return of -4.7%, was largely offset by gains in the protection strategy. The weighting to the put write strategy was around 24% at the end of the month, with weighting to the protection strategy around 70%, a ratio of approximately 3X. The option market structure is looking reasonably attractive (see discussion below), so we would expect to increase the put write weighting from 24% in the coming month, with a commensurate increase in protection notional.

Trust Activity

RMBS/ABS issuance was healthy with seven new deals pricing during the month totaling $4.3 billion including the first RMBS deal from a major bank since 2020 as Westpac priced a new deal. Total issuance by corporates and financials was $3.7 billion during the month. Issuance continues to remain below maturity levels with net issuance at -$22.8b year to date. This strong technical has helped overall spreads remain relatively stable despite weakness seen in some offshore markets. We participated in several new deals during the month including Woolworth SLB 2027, Zip 2021-2, Allied 2021-1, Shopping Centre Australia 2029, Dexus Property 2028 and Electranet 2028.



Normalised term structure = 1Y 50 delta implied vol minus 1M 50 delta implied vol.

Source: Perennial Value Management, OptionMetrics

Outlook

The Australian benchmark 10-year government bond maturing in November 2031 saw its yield move more than 40 basis points higher from its low of 1.0785 on August 20, ending September at 1.49. Weakness was not confined to government bonds, as credit spreads also moved wider. Volatility in credit markets, however, remains much lower than volatility in either government bonds or equities.

The balance of risks with respect to inflation seems clear and the required policy response is clear as well. What is unclear is the willingness of central banks to cause the sort of market disruption that an accelerated pace of tightening will cause. We are positioning our portfolios defensively given the particularly uncertain backdrop. Central bank tapering is well-priced by markets, but we watch real yields in the longer-end of the US curve which have risen sharply from record lows over the last two months. Further increases could hamper risk asset valuations.

We see US wage growth as perhaps the single most important variable to focus on in the near term, because the transient inflation narrative will come under further pressure if wages growth does not slow in the coming months in line with increased US labour supply (given the end to unemployment benefits earlier this month) and a decelerating US fiscal pulse. If wage growth cannot decelerate against this backdrop, we feel that treasury yields will see more upward pressure. The likelihood that both treasuries and equities fall in value together will increase.

Last month we described the option market structure as a somewhat challenging backdrop for the strategy, particularly with respect to term structure, where we looked at a normalised measure of longer-dated volatility minus shorter-dated volatility. As we will tend to write puts at shorter tenors, and own puts in longer tenors, when the term structure is steep it will be more difficult to achieve excess returns.

As you can see in the chart to the left, term structure is now at an attractive entry point for the Yield Plus option strategy. Such flattening of the term structure will naturally occur during equity drawdowns. Whilst a modest equity drawdown may diminish returns on the option strategy in the short-term, it does set up the strategy to potentially do well in coming months. We will also look to add to the overall protection profile, especially if markets stabilise or move higher.

As always, our aim will be to generate a running yield from credit and fixed income markets, with a conservative risk profile, whilst deploying an options strategy that carries flat to small positive with potential upside in a large equity drawdown. If market conditions make striking a balance between return and protection difficult, we would tend toward prioritising protection.

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