Perennial Yield Plus Conservative Trust

Monthly Report October 2021

	Month (%)	Quarter (%)	FYTD (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	-0.4	-0.4	-0.3	-0.3
RBA Cash Rate Total Return Index	0.0	0.0	0.0	0.0
Value Added	**-0.4**	**-0.4**	**-0.3**	**-0.3**

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

Overview

- The fund returned -0.37% for October, driven by the Core Income strategy. Despite the limited duration exposure, the extreme sell off in shorter-dated bonds more than offset positive performance from other return drivers in the Core Income portfolio, leading to a negative return for the month
- The dislocations seen in Fixed Income markets were not commensurate with the sangfroid displayed by Equities, which rebounded strongly through October. This saw a reversion to the prevailing option market structure of recent times, with a steep term structure in implied volatility
- The Option Strategy was once again reasonably flat for the month, though we have increased the protection profile somewhat. We are currently prioritising protection over carry for the option strategy, given elevated markets

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 $11.2 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

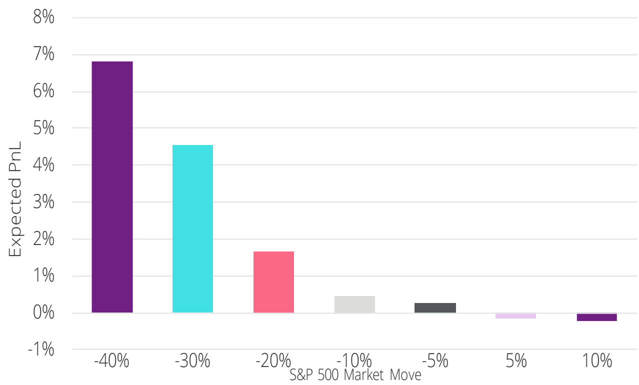
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.52
Spread Duration (Yrs)	3.81
Portfolio Yield (%)	1.75
Average Credit Quality	A

Source: Perennial Value Management. As at 31 October 2021

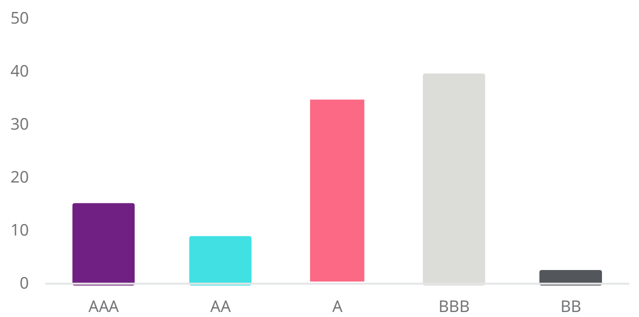
Portfolio yield is the expected return over the next year, assuming no changes to either portfolio composition or market yields. Average credit quality excludes overlay positions. Portfolio yield and spread duration reflect the net credit default swap exposures in the portfolio.

Estimated PnL Outcomes by Market Move

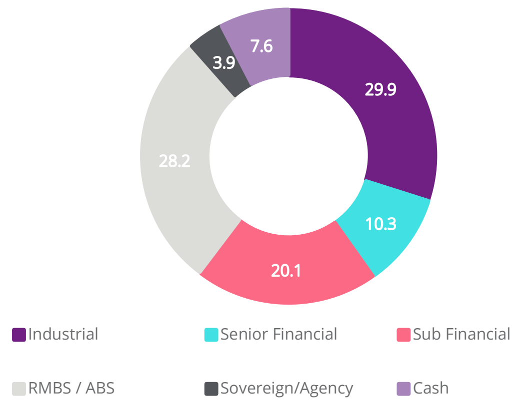


The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.
Source: Perennial Value Management. As at 31 October 2021
The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Rating Exposure



Sector Active Exposure vs Index



Trust Review

The Core Income strategy returned -0.36% for the month. The fund's performance was significantly impacted by the selloff in government bonds which led to a negative 0.62% impact to the fund, more than offseting positive contributions from coupon, credit spreads and overlay strategies. Sector performance was mixed as corporate spreads were generally tighter while subordinated financial spreads were wider. The fund continues to have a modest interest rate duration positioning at 0.52 years.

Australian market credit spreads were a little mixed during the month, with mid tenor financials a touch wider, and similar tenor corporates and RMBS a little tighter. The bulk of the negative spread contribution in the portfolio was driven by longer dated corporates.

Short-tenor implied volatility had reset somewhat higher in September and the start of October, triggering the Put Write strategy to sell one month puts. These decayed through October, contributing to an overall PnL of 0.47% for the Put Write strategy for the month. However, with rising markets this PnL was offset by a loss on the Protection strategy, for an overall flat outcome. Whilst generating a mark-to-market loss, these protection positions remain in the portfolio, whereas a meaningful proportion of the Put Write strategy has now reset into new positions.

In addition, the overall protection profile of the strategy has been increased through the month. Since inception, the Option Strategy has carried reasonably flat, whilst providing substantial protection for the overall portfolio.

Trust Activity

October was another busy month of securitisation issuance with ten transactions pricing. We participated in a number of new deals during the month including AFG 2021-2, Light Trust 2021-1, Athena 2021-1, Brighte Green 2021-1, and Flexicommercial 2021-2 transactions. Corporate and financial issuance was relatively modest, but we did participate in the Investa Commercial Property Fund 2030 transaction.

Extreme Australian Sovereign 3 Year Yield Move in October

Outlook

Many fixed income market participants had expected a 'taper tantrum' of sorts at some point this year. History may well pinpoint October as the month that the tantrum took place, but the catalyst was not the Fed. Instead, we saw bond markets pushing back, in a significant and synchronised way, against forward guidance as a policy tool. After central banks in several emerging markets tightened monetary policy, we then saw the Bank of England turn hawkish. This was followed by a surprise out of New Zealand where CPI was higher than expected, a surprise out of Canada where the Bank of Canada unexpectedly suspended asset purchases, and (most notably) the failure on the part of the RBA to defend the yield target on the 2024 bond in Australia after a slight upside inflation surprise, which sparked a savage sell off.

Yields on longer tenor bonds were relatively well-behaved, but short-tenor bonds rose in unison across the globe in dramatic fashion. Australia, where the 3-year bond pushed higher in yield by 91 basis points, saw the largest move higher in the three-year bond yield in a calendar month since June 1994.

Where does this upheaval leave markets? As we write, the RBA has formally changed its guidance to the market, removing yield curve control. Yield levels and liquidity are now normalizing, but the front end of the Australian yield curve will be more data dependent and the 3-year bond will settle into a new (and higher) range. In our view that is a good outcome, even if the path markets took to get to this outcome was needlessly bumpy.

Equity option markets have reverted to the market structure seen across most of this year, indicating a sanguine view on risk in the short to medium-term, with some concern over longer time horizons. This may lead to a longer-tenor profile on the Put Write, in order to achieve the minimum premiums required by the strategy. It will also mean the Put Write strategy is weighted at the lower end of the range, in terms of notional coverage.

Of course, we have seen that the market structure changes very quickly on a modest equity drop, as occurred in September. If we see this happen again then the Put Write portfolio will likely shift to shorter tenors and higher coverage.

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.

* **Source:** Bloomberg, OptionMetrics, PSG

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