Perennial Yield Plus Conservative Trust

Monthly Report November 2021

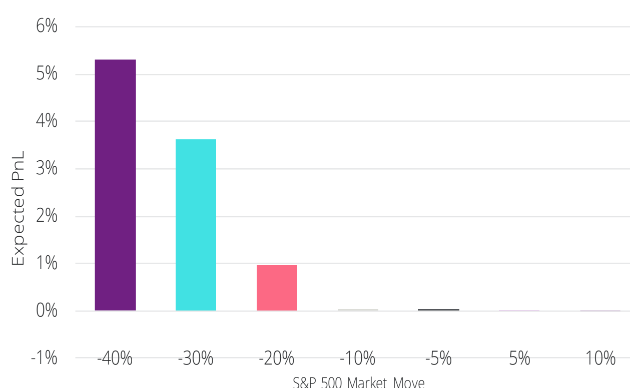
	Month (%)	Quarter (%)	FYTD (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	-0.2	-0.7	-0.5	-0.5
RBA Cash Rate Total Return Index	0.0	0.0	0.0	0.0
Value Added	**-0.2**	**-0.7**	**-0.5**	**-0.5**

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

Overview

- The fund returned -0.2% for November, driven by the Core Income strategy. The fund's performance was impacted by wider credit spreads, though this was partially offset by the fund's modest duration stance. Sector performance was mixed: corporate spreads were relatively stable while senior and subordinated financial spreads were wider
- Equity markets were largely calm for the month, until this sense of tranquility was burst by the arrival of the Omicron variant and a Fed that seems to be backing out of the transitory camp. These events saw equity volatility finally start catching up to the volatility we have seen in rates markets
- The Option Strategy produced a small profit for the month, with the overall long volatility profile more than offsetting a small drawdown on the Put Write strategy. We expect market volatility to continue, at least for the immediate future

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 30 November 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 $12.1 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

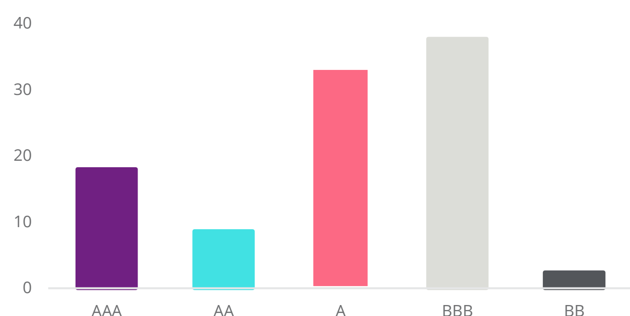
Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

Expense Recovery
Capped at 0.1% p.a.

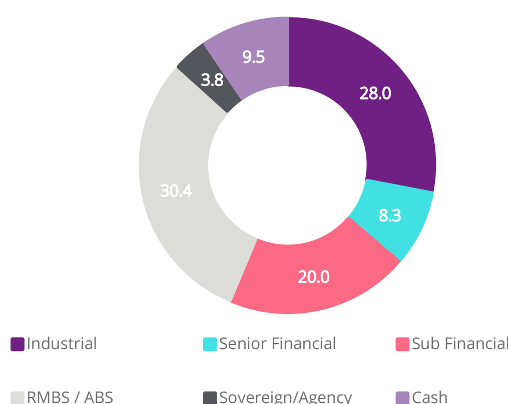
Rating Exposure



Portfolio Characteristics	
Modified Duration (Yrs)	0.26
Spread Duration (Yrs)	3.44
Portfolio Yield (%)	1.49
Average Credit Quality	A

Source: Perennial Value Management. As at 30 November 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.

Sector Active Exposure vs Index



Trust Review

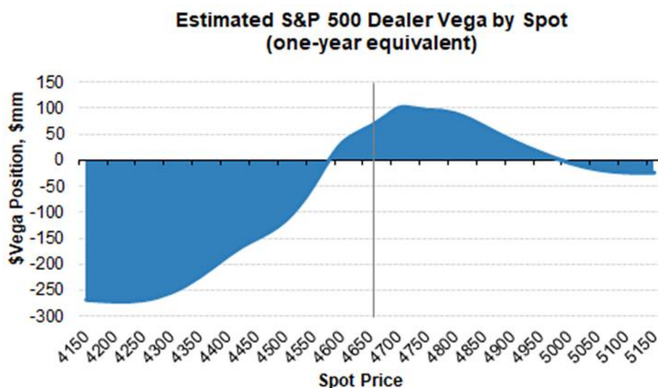
The Core Income Fund returned -0.19% for the month, leaving the rolling three-year return at 188 basis points above cash, net of fees. The fund's performance was impacted by wider credit spreads, though this was partially offset by the fund's modest (0.31 year) duration stance, which added value. Sector performance was mixed: corporate spreads were relatively stable while senior and subordinated financial spreads were wider. Longer tenor spreads underperformed shorter tenor while offshore names also underperformed, particularly higher beta names as the US high yield market saw its weakest monthly performance for the year to date.

Implied volatility was at the low end of the recent range, for much of November. This led to longer tenors being implemented in the Put Write strategy as positions were rolled, and premiums at shorter tenors became unappealing. In addition, the Put Write strategy weight was held at 25%, the lower bound of the 25%-50% range.

However, this dynamic quickly reversed at the end of the month, as Omicron-fears and Fed-anxiety combined for a 2.3% drop in the S&P 500 and associated 54% jump in the VIX. This VIX beta is at the extreme end of the range, and reflects a jolt to the market that was otherwise becalmed. The move is further explained by market positioning, as seen in the chart below from Morgan Stanley, from Nov 15th. This graph shows dealer positioning in S&P 500 options becoming dramatically shorter as the index drops.

Trust Activity

We participated in five securitized transactions: Blackwattle RMBS, Pepper RMBS, Latitude ABS, Madison Park CLO and Think Tank RMBS. Financial issuance was relatively modest, and we chose not to participate in any new issues. Within non-financial corporates we participated in new issues from Computershare, Optus (a sustainability-linked bond), Goodman Australia Industrial Fund and Mercury New Zealand.



Source: Morgan Stanley QDS

Outlook

November saw a continuation of volatility in interest rate markets. Although the relentless rise in bond yields seen in October did not continue, it took the risk-off sentiment surrounding Omicron to push bond yields decisively lower. This same sentiment saw credit spreads pushing wider.

Lower bond yields were not universal; for example, the US 2-year yield continued to see significant upward pressure. Investors remain uncertain as to the severity of US inflation, the likely policy response, the extent of the subsequent slowdown in US demand and the severity of global spillovers. Such uncertainty will linger for some time, and this is driving a significant uptick in the volatility of government bond markets globally. Interestingly, with expectations now heightened that the Fed will taper asset purchases more quickly than expected, US yield curve flattening pressure has also increased. This means investors are increasingly starting to focus not just on the nearer-term trajectory for monetary policy, but also on the level and timing of the end of the current monetary cycle. This part of the cycle is usually where financial asset returns become more volatile, and the faster-than-expected removal of price-insensitive quantitative easing will exacerbate this pressure. We keep a close eye on US real yields as these remain at deeply negative levels but, we feel, susceptible to upward pressure in 2022. If we are correct in this view, higher real yields will reduce the value of the future cash flows across the spectrum of financial assets.

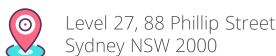
We believe that we may be entering a period of heightened volatility, due to the combination of a new Covid variant, a Fed that seems to be shifting out of the transitory inflation camp, and a market that has been setting record prices on a number of fronts. This may be exacerbated by structural issues such as dealer positioning, where volatility is likely to produce further demand to cover short option positions, and a potential for retail buy-the-dip to come off the boil.

We will therefore be applying some discretion as to implementation of the option strategy, in the coming months, to ensure that a meaningful protection profile is maintained whilst trying to capture opportunities to increase the Put Write exposure where sensible. Whilst higher implied volatility makes for more attractive Put Write premiums, this will also make it more expensive to roll protection.

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

Contact us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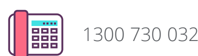
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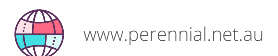
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