Perennial Yield Plus Conservative Trust

Monthly Report December 2021

	Month (%)	Quarter (%)	FYTD (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.2	-0.3	-0.3	-0.3
RBA Cash Rate Total Return Index	0.0	0.0	0.0	0.0
Value Added	**0.2**	**-0.3**	**-0.3**	**-0.3**

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

Overview

- The fund returned 0.2% for December, net of fees, aided by narrower credit spreads and coupon income, with interest rate positioning a small detractor. Credit spread movements were relatively minor with some modest widening in corporates and RMBS, while subordinated financials were tighter.
- December saw a strong finish for equity markets, to finish a year that will go down in the history books. This ebullience also precipitated a steep fall in the VIX of nearly 10 points, a 37% decline from the start of the month. The bid for downside options remains, as well as for longer tenor options, as hedging demand continues
- The Option Strategy once again produced a small profit for the month, as the losses on the long volatility position of the portfolio were more than compensated for by the small positive beta (or delta) to equity 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 $10.2 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

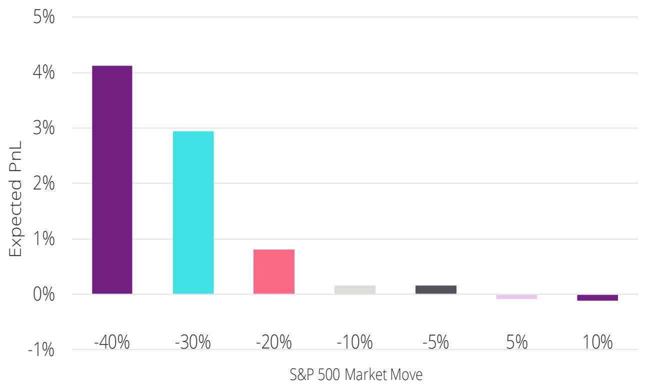
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.27
Spread Duration (Yrs)	3.44
Portfolio Yield (%)	1.59
Average Credit Quality	A

Source: Perennial Value Management. As at 31 December 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.

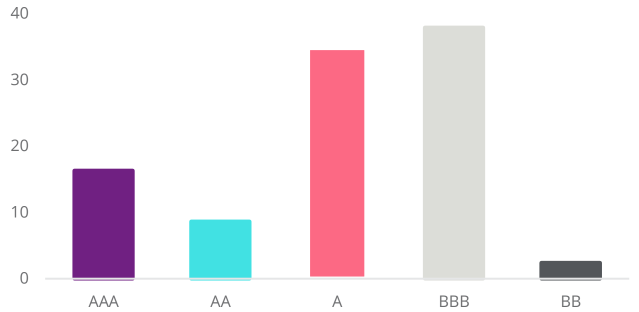
Estimated PnL Outcomes by Market Move



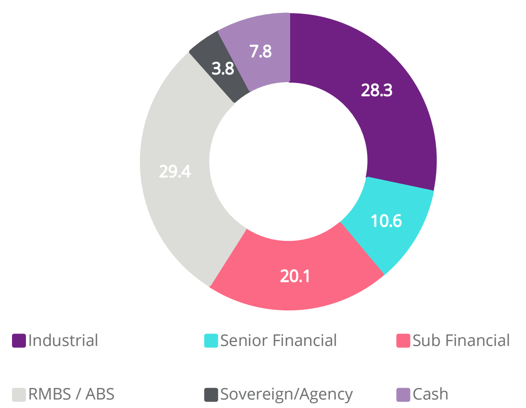
The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.
Source: Perennial Value Management. As at 31 December 2021

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



Trust Review

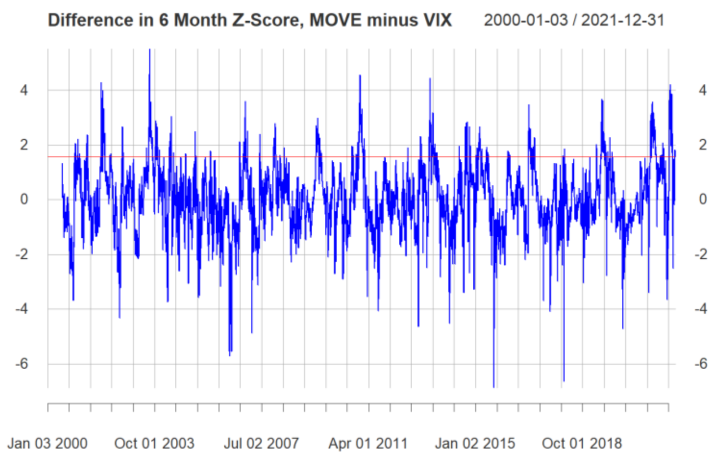
The Core Income Fund returned 0.17% for the month bringing the rolling three-year performance to 2.46% (1.92% above cash). The fund's performance was aided by narrower credit spreads and coupon income, with interest rate positioning a small detractor. Credit spread movements were relatively minor with some modest widening in corporates and RMBS, while subordinated financials were tighter. The fund continues to have a very modest interest rate duration positioning of 0.27 years.

Implied volatility saw a rapid reversal from the levels reached during the November spit in the markets. As mentioned last month we took a cautious approach to increasing the Put Write exposure, as the triggers for the fall last month (Omicron, the Fed turning more hawkish) seemed like viable candidates for causing a more prolonged pullback. However, buy-the-dip apparently remains in fine fettle.

The Put Write strategy did see some benefit from the small dip in markets in the back half of December, as we were able to roll some expiring positions into new two and three-month positions at reasonable levels. Ideally, we might see a similar dip in January, as we have further Put Write positions expiring (well out-of-the-money) next month. A more volatile markets makes for more attractive Put Write entry levels.

Trust Activity

No surprise that new issuance slowed down during the month. There were no new RMBS transactions for the fund, however we did participate in the Computershare 2027 transaction. Given the illiquidity going into year-end, we have left cash levels modestly elevated.



Outlook

Covid continued to cast a long shadow over most activity in 2021, as it did in 2020, with long-lived lockdowns in many parts of Australia and New Zealand. Moving into 2022, however, there has been a change in sentiment. The reality of living with the virus has been accepted by most in antipodean politics and the shadow of Covid is therefore receding. Against this backdrop, high household savings rates in Australia have driven expectations among some market participants that household spending will drive above-trend local growth in 2022. We do not subscribe to this view. The consumer caution that has been a feature of the post-GFC landscape will not suddenly disappear, regardless of household balance sheet strength. The crucial element that drives our view is low wages growth. For several years, labour force underutilisation has been too elevated to sustain higher wages. We believe the opening of the international border will in fact cause a supply shock that drives this underutilisation higher. Whilst this shock will dissipate over time, it will nonetheless elongate an already long path to sustained higher wages in Australia.

It should also be remembered that low fixed home loan rates will start reverting to standard variable rate pricing or higher fixed rates in 2023, while the delivery of stage 3 tax cuts that might be expected to act as an offset to this will mostly benefit higher income households with a higher propensity to save. We therefore retain our view that rate hikes in Australia are more likely in 2023 or 2024 than in 2022.

We continue to believe that the market will be susceptible to bouts of volatility, whether it is driven by the pandemic's (hopefully) final act, the Fed, geopolitical strains, or some other factor. It certainly remains clear to us that the market remains overly sanguine over the impact of potentially rapidly rising interest rates, to asset valuations, and to the real economy.

Indeed, whilst the spread has compressed somewhat, the shift in interest rate volatility as compared to equity volatility remains stark, as can be seen in the chart to the left. This chart shows the 6-month difference in Z-Score for the MOVE index (akin to a VIX for interest rate volatility), and the VIX itself. The red line is the end-of-December level, and highlights that currently the interest rate market is forecasting a bumpier future than equities.

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, PSG

Contact us

Level 27, 88 Phillip Street
Sydney NSW 2000

1300 730 032

invest@perennial.net.au

www.perennial.net.au