

|   | Month (%)   | Quarter (%) | FYTD (%)    | Since Inception <sup>^</sup> (%) |
|---|-------------|-------------|-------------|----------------------------------|
| Perennial Yield Plus Conservative Trust (Net) | -0.1        | -0.1        | -0.4        | -0.4                             |
| RBA Cash Rate Total Return Index              | 0.0         | 0.0         | 0.1         | 0.1                              |
| <b>Value Added</b>                            | <b>-0.1</b> | <b>-0.1</b> | <b>-0.5</b> | <b>-0.5</b>                      |

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

## Overview

- The new year started with a bang, with many major markets entering correction territory during the month. The Fed, and markets in general, finally conceded defeat and recognized that inflation will not be fleeting. The fund lost 0.1% for the period, net of fees, as the Option Strategy produced a small loss. However, if the market had continued to fall, this loss was expected to swing to a meaningful profit.
- Performance in the Core Income strategy was negatively impacted by wider credit spreads and higher bond yields, however that was more than offset by coupon income and overlay trades. Credit spreads were wider across most sectors, however RMBS/ABS held in relatively well.
- The Option Strategy produced a small loss as the somewhat challenging market structure, that we have highlighted previously, combined with an equity drawdown not large enough for the protection strategy to really deliver.

## 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 \$12.8 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.

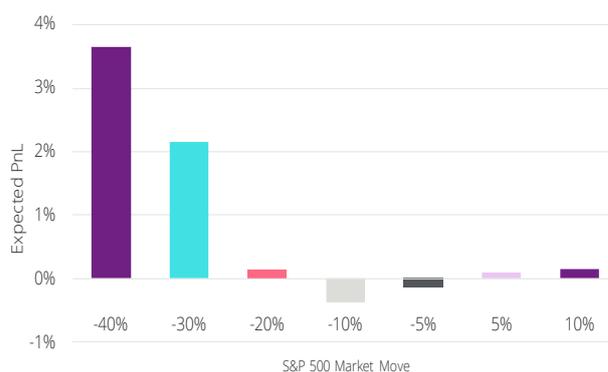
## Portfolio Characteristics

|                         |      |
|-------------------------|------|
| Modified Duration (Yrs) | 0.53 |
| Spread Duration (Yrs)   | 3.42 |
| Portfolio Yield (%)     | 1.7  |
| Average Credit Quality  | A    |

Source: Perennial Value Management. As at 31 January 2022

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.

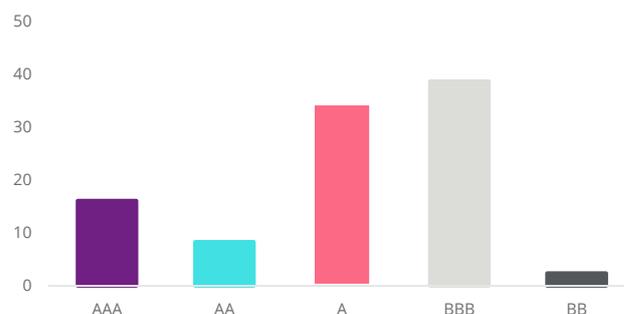
## Estimated PnL Outcomes by Market Move



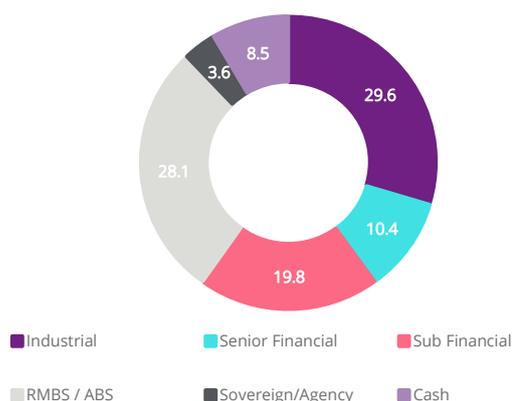
The chart provides the total expected portfolio PnL given a high velocity move in the S&P500. Source: Perennial Value Management. As at 31 January 2022.

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 0.04% for the month bringing the rolling three-year performance to 2.37% net of fees. The fund's performance was negatively impacted by wider credit spreads and higher bond yields, however that was offset by coupon income and overlay trades to produce a slightly positive return for the month. Credit spreads were wider across most sectors, however RMBS/ABS held in relatively well. The fund continues to have a very modest neutral interest rate duration positioning of 0.30 years.

Implied volatility, as might be expected, found a strong bid during the pullback. This was exacerbated by dealer exposure swinging from long to short volatility, a rare occurrence in recent times (see graph below, where gamma is a volatility exposure metric). This profile contributed to the wild swings in the market, as dealers no longer acted as volatility dampeners. However, should markets stabilise at these levels it is likely that volatility sellers will come in, and dealer exposure may swing back to long.

The dealer positioning and demand for hedging created a strong bid for short-tenor options, which is the tenor we tend to sell in the Put Write strategy. This dynamic, coupled with the challenging option market conditions leading up to January, meant that the Option Strategy produced a small loss for the month. However, if the market had continued falling the much higher notional held in the Protection Strategy would have swung into action, and a meaningful profit would have been expected on the overall Option Strategy.

## Trust Activity

New issuance in Australia remained very modest, however the pipeline is ramping up with multiple deals announced including Liberty Auto, AFG, Metro ABS, Mortgage House and Bank of Nova Scotia.

## Outlook

January 2022 was of course the month that Jerome Powell finally confirmed, as expected, that the FOMC would tighten US monetary policy. History may show that although a change in stance was expected, January was the month that markets started to take the Fed seriously. Bond yields rocketed higher, led by the short end of the US yield curve as the market once again reassessed the number of rate hikes that the US Federal Reserve will need to administer before this tightening cycle concludes. This bought more pain for those who continue to hold standard 60/40 asset allocations in the belief that a 40% allocation to long duration sovereign bonds will act as a stabiliser to a 60% growth asset allocation. Equities and bond duration both suffered in tandem, and we believe such behaviour will remain a feature in markets for the foreseeable future.

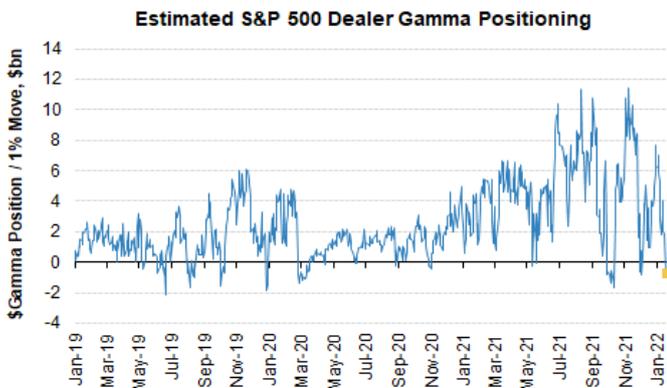
Commodities are most clearly reacting to the uncertain geopolitical backdrop, particularly in oil where the increase in price over the last 12 months is in fact the biggest 12-month percentage increase in the last 20 years. This is a tax on consumption that should, all else being equal, reduce the need for interest rate hikes. The US data may be rolling over as well: retail sales, industrial production, empire manufacturing and Richmond Fed manufacturing were all weaker in January. The market sees the Fed hiking into a falling fiscal impulse and believes inflation will be bought under control as a result. Still, we remain wary that real yields can rise further because with inflation having taken root in the US economy, the balance of risks is skewed to financial conditions needing to be tightened more than expected to eradicate the problem.

What is interesting is that although risk assets are clearly at risk if the geopolitical backdrop worsens, they are also at risk if it does not. Upside risks to growth increase the urgency that financial conditions tighten to rein in inflation. Slower data points to a potential stagflationary scenario. 2022 is certainly shaping up as a challenging year for markets that we believe will remain susceptible to bouts of volatility.

We continue to believe that inflation will remain a key driver of asset prices, and concern over current valuations. However, now that the Fed has confirmed what the market was already pricing, more or less, it will be essential to watch how inflation and rising rates feeds down to company profits, growth expectations, and economic activity. The market may not truly surrender to a further large pullback until we see some impact on these fronts, or if we see a large spike in rates.

It is likely, given the scale of the January drawdown, that it may take a bit longer for short-tenor implied volatility to come in. This will work in the Trust's favour, as we have a number of Put Write positions that will need to be rolled this month and next.

**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: Morgan Stanley QDS

## Contact us

Level 27, 88 Phillip Street  
Sydney NSW 2000

1300 730 032

invest@perennial.net.au

www.perennial.net.au

Signatory of:

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