Perennial Yield Plus Conservative Trust

Monthly Report August 2022

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.0	-1.0	-0.4	-3.5	-2.8
RBA Cash Rate Total Return Index	0.2	0.3	0.3	0.4	0.4
Value Added	**-0.2**	**-1.3**	**-0.7**	**-3.9**	**-3.2**

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

Overview

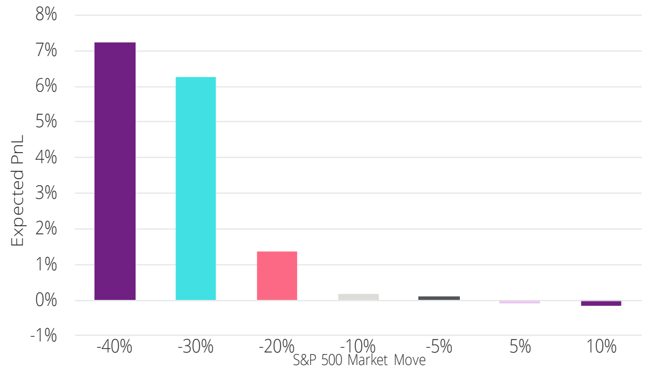
US CPI and PPI prints below expectations helped the S&P 500 briefly surpass 4300 as the market hoped for a shift in Fed rhetoric. However, Powell delivered a hawkish blow to such dreams, combining with ongoing energy dramas to push markets lower.

The Trust delivered a gain of 0.04% for the month, net of fees, with a modest positive return for the Core Income strategy, and flat Option Strategy performance.

Core Income performance was supported by narrower credit spreads and coupon income, with a partial offset coming from duration positioning. The strategy remains defensively positioned amid volatile market conditions, although we have started to lengthen duration exposure and increase exposure to short-dated assets.

The Option Strategy saw a small loss on the Put Write component, which was offset by gains on the Protection sleeve, for a flat performance.

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 August 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.

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 $17.5 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

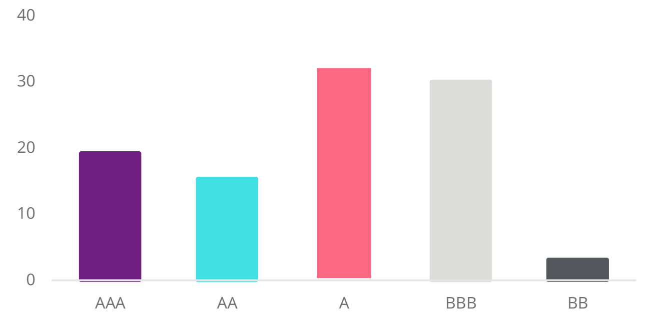
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.23
Spread Duration (Yrs)	2.07
Portfolio Yield (%)	4.11
Average Credit Quality	A

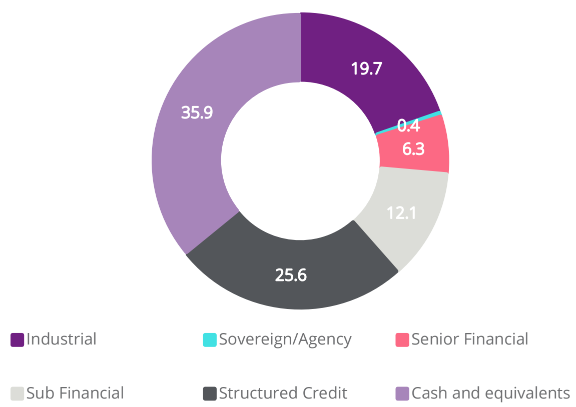
Source: Perennial Value Management. As at 31 August 2022

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.

Rating Exposure



Sector Active Exposure



Trust Review

The Core Income strategy contributed 0.1% for the month, gross of fees. The fund's performance was positively impacted by coupon income and a modest rally in credit spreads. However, these were offset by a negative contribution from our duration position which was impacted by a meaningful rise in interest rates during the month. A few sectors were positive contributors during the month including Industrials, bank Tier 2 and RMBS. On average, Australian and US credit spreads were approximately four basis points tighter on the month, both significantly outperforming EUR spreads which were fifteen basis points wider. Our interest rate position at month end continued to be modest at 0.25 years.

We have maintained a low exposure to the Put Write strategy, at around 10% of notional. This defensive positioning is predicated on the view that the market lows are still not in as yet. We have maintained a defensive position for a number of months now, which has resulted in a modest since inception profit on the Put Write sleeve.

Trust Activity

Given our defensive positioning and continuing modestly bearish outlook for spreads over the medium term, we largely avoided new issues during the month. We did however participate in some of the new RMBS deals including Triton and Think Tank, but otherwise we continue to carry larger than normal cash and short-term securities weightings in the fund.

Two Put Write positions were rolled during the month, at a profit, with further expiries coming up in September. In addition to this a new tranche of protection will be bought next month.

Outlook

A rally across the risk asset complex in early August was scuppered by Federal Reserve chairman Jerome Powell at the annual Jackson Hole Symposium. A nine-minute speech was all that was required to leave the markets in absolutely no doubt as to the Fed's intentions. Following the speech, yield curves have remained inverted as the US 2-year yield reached cycle highs above 3.5%. Estimates of terminal rates also rose by 30-50 basis points and are closing in on four percent. Concurrently, market expectations for a subsequent "pivot" were wound back, as Powell and other Fed governors made clear that they would move policy into appropriately restrictive territory and then wait for clear signs of moderation.

Outlook

Financial conditions began to tighten again toward the end of the month but remain far from onerous in the context of the inflation problem the world faces. Evidence continues to mount that supply chain issues are easing, but the extent of the disruption means the benefits will flow through gradually over time. More pressingly, severe shortages of energy and illiquid markets will keep headline inflation volatile in coming months. Indeed, some analysts in the UK believe headline inflation could reach 20% this year as retail energy and gas prices surge. In our view, illiquid markets are a symptom of underlying caution, which has contributed to oil prices, equity markets and credit spreads all exhibiting volatility at times without any obvious catalyst.

Europe is particularly exposed to energy shortages this winter, contributing to very poor consumer confidence across the continent. With the price of gas at completely unsustainable levels, intervention in some form is not just inevitable but necessary to avoid a disastrous scenario that could include a recession. Meanwhile, the ECB is poised to increase its policy rate by up to 75bp in September. Expectations are that the policy rate could reach 2% by the end of the year. While modest compared to most other economies, a rate even this high for Europe could become increasingly challenging to justify to a populace struggling with extensive cost-of-living concerns.

Thankfully, these same pressures are not as acute locally, but Australia is not immune to the pervasive nature of inflation. Despite record resource and agricultural exports, a weaker Australian dollar will put upward pressure on imported goods prices, while severe labour shortages and immigration delays are impacting the cost of services. In addition, the residential property market is showing clear signs of moderation across most capital cities and is contributing to weak consumer confidence. In our view, after recent missteps the RBA will not accept being seen to be falling behind the curve in dealing with inflation, and thus the cash rate could rise past the estimated neutral rate of 2.5% and enter restrictive territory by the end of this year.

We remain circumspect in our outlook for credit spreads. We expect the widening trend to continue both locally and offshore. While credit spreads participated in the risk rally early in August, there was a lack of conviction on low trading volumes that quickly reversed following Jackson Hole. Credit denominated in EUR was the weakest performer as the multitude of issues plaguing the continent took their toll. The risk of significant slowdown or recession is less evident in other developed markets, making some of the movements in parts of the credit complex seem disproportionate to the risks. However, it has been a long time since borrowing costs have been this high, and with no relief in sight we retain a strong bias toward high quality and shorter tenor within our portfolios.

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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