Perennial Yield Plus Conservative Trust

Monthly Report December 2022

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.7	0.7	0.2	-2.4	-1.8
RBA Cash Rate Total Return Index	0.3	0.7	1.2	1.3	0.9
Value Added	**0.4**	**0.0**	**-1.0**	**-3.7**	**-2.7**

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

Overview

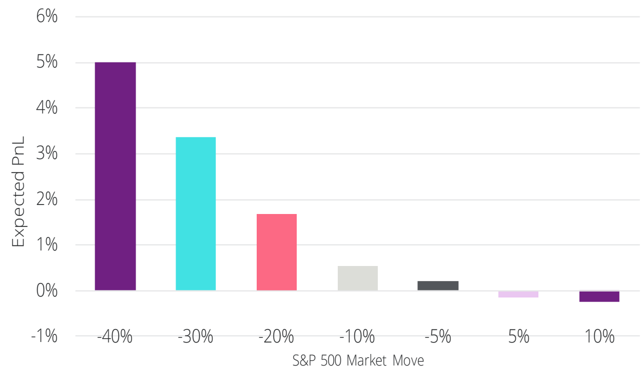
Markets were generally softer in December after strong gains in the prior two months. It remains to be seen whether this pause precedes a more meaningful pullback, but we remain defensive as we believe 2023 will see wage inflation crimp margins.

The Trust delivered a gain of 0.69% for the month, net of fees, driven by strong gains on the Core Income strategy, and a reasonably flat performance from the Option Strategy.

Narrower credit spreads and overlay strategies supported performance during the month. Core Income positioning remains defensive, as we envisage further challenging market conditions in the coming months.

The Option Strategy produced a gain of 0.02% for the month, with a small drag on the Put Write offset by slightly larger gain on the Protection sleeve.

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 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 $19.6 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

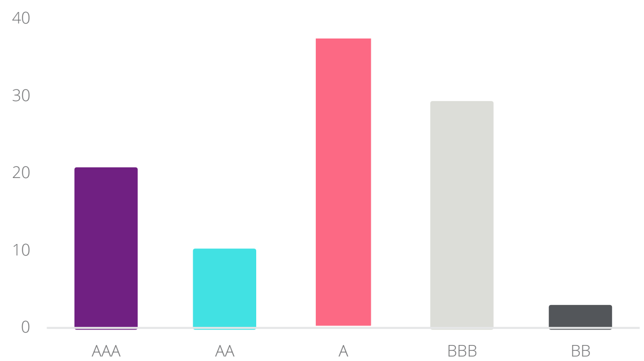
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	-0.09
Spread Duration (Yrs)	1.89
Portfolio Yield (%)	4.78
Average Credit Quality	A

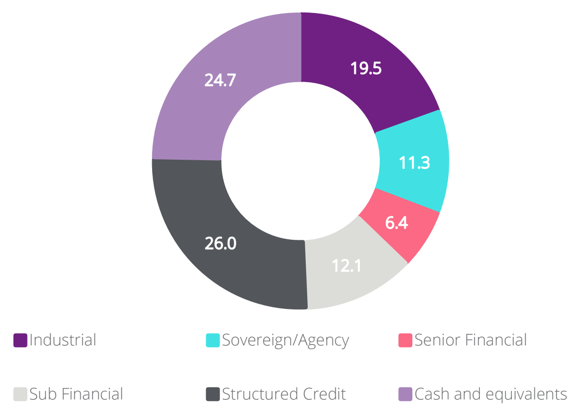
Source: Perennial Value Management. As at 31 December 2022

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 returned 0.75% for the month net of fees. The fund's performance was positively impacted by coupon income, narrower credit spreads and overlay strategies.

The weaker-than-expected US CPI report supported markets, although this was offset by the ECB and Bank of England raising rates and indicating further hikes to come. The Bank of Japan adjustment to its yield curve control program was also a shock to markets amidst illiquid end-of year trading conditions, but the net result was a strong performance for financial issuers, particularly in subordinated paper.

The Australian 10-year bond yield rose by more than 50bp in December, with early January price action moving to reverse this sell off. Our duration position is zero, and our view remains that inflation momentum will be more difficult to lower than what the markets currently assume.

The Option Strategy was fairly flat PnL for the month with a small drag on the Put Write offset by a slightly larger gain on the Protection strategy. We retain a bearish view and have therefore positioned the Option portfolio defensively, with only a small Put Write notional outstanding at end of month.

Trust Activity

Given our defensive positioning and continuing modestly bearish outlook for spreads over the medium term, we avoided new issues during the month. We continue to carry larger than normal cash and short-term securities weightings in the fund.

Two tranches of Put Write were unwound profitably during the month, with a third tranche unwound early (at a smaller profit) given our view that the market may be due a renewed pullback. This left a single tranche of Put Write outstanding at the end of the month, a defensive position.

On the Protection side we rolled out of December 2022 and into December 2023 positions executing tail and shoulder (put spread) strategies on the S&P 500.

Outlook

As we move into 2023 the outlook for financial markets remains cloudy, with many of the issues that investors have grappled with for some time continuing to dominate. The question of how long the US Federal Reserve maintains peak rates is perhaps the most consequential question, in that it encapsulates most of the uncertainties markets are grappling with. Our view is that inflation has peaked in the US. Australian inflation should follow suit in the next couple of quarters. US growth should moderate, and in the absence of the China re-opening we would see the Fed relenting on tighter policy during 2023. We think on balance that bond yields will fall during 2023, but with China emerging from a 3-year lockdown we see the risks to this view as skewed to the upside. The Fed should cease hikes this year, but we think that cuts from the middle of the year that are currently priced by markets are misplaced.

Outlook

The main reasons for this view are that Chinese demand should surge later in the year while the much talked about US recession should be quite shallow. The surge in Chinese demand will collide with supply chains that enter an increasing state of flux, because Covid-related disruptions that are happening now in China are likely to have a long tail. This is inflationary, and while we don't think this portends the sorts of inflation overshoots seen in 2022, we also do not believe the global move back to more normal levels of inflation will be smooth. If anything, the risk is that US inflation does not cement itself back in the 2-3% range this year even as US growth slows, which will leave the Fed in a difficult position in the context of the likely US recession. That said, personal spending growth in the US is still growing at robust rates not seen for more than 30 years. Although this momentum will wane, the strong starting point means that the US will probably experience only a shallow recession. Even so, the Fed may be limited in the amount of support it can provide if stagflation becomes a reality with inflation flattening out at 3-4% rather than 2-3%.

Closer to home, the Chinese re-opening should have a positive impact on Australia, but not to the extent that has been seen in previous Chinese economic expansions. Historically, impacts would have primarily been felt through the commodity export channel as Chinese construction activity ramped up. We do not expect a repeat of this – rather than ramping up activity as strongly as seen in past episodes, Chinese property developers will likely use a better local backdrop to shore up their balance sheets given the traumatic economic period some have weathered. Chinese spending on infrastructure may be more muted as well, as the country continues to strive for a more sustainable growth model. Commodity demand may also be weaker, at least initially, due to stockpiling of Russian commodities. All of this means that any positive impulse to Australian net exports resulting from China's re-opening may be more modest and/or somewhat delayed as compared to past experience.

On the other hand, Australia will benefit directly from a pickup in Chinese demand for services such as tourism and education, a continued pickup in net migration, and increased non-commodity goods exports. New Zealand will benefit similarly through the larger role of services in its export mix. Australia's second and third largest export destinations are Japan and South Korea, both jurisdictions that will also benefit directly from the re-opening of China, which should somewhat offset any reduced Chinese demand for Australia's commodities.

Our view on bond markets remains unchanged – we eventually expect a global slowdown to cause government bonds to perform in the initial instance, with credit catching up with a lag. We remain focused on duration positioning primarily, in the belief that although it is still too early to lengthen duration significantly, the time to change this view is likely to arrive at some point this year. As our views change, we will communicate this with our investors, and in the interim, we wish all readers a prosperous 2023.

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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