Perennial Yield Plus Conservative Trust

Monthly Report January 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.5	1.6	0.6	-1.9	-1.4
RBA Cash Rate Total Return Index	0.3	0.8	1.5	1.6	1.0
Value Added	**0.2**	**0.8**	**-0.9**	**-3.5**	**-2.4**

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

Overview

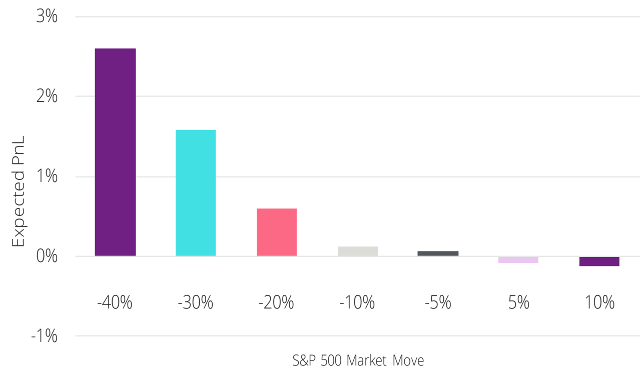
Markets missed out on a traditional Santa rally to start the year but finished the month with decidedly positive momentum. Steady moderation of core inflation in the United States is feeding expectations that the peak of the hiking cycle is within view, albeit the payrolls data at end of month dented these expectations.

The Trust delivered a gain of 0.45% for the month, net of fees, driven by strong gains on the Core Income strategy, and a drag from the Option Strategy.

Narrower credit spreads supported Core Income performance during the month, though hedging strategies detracted somewhat. As our views are becoming more constructive on markets we have increased the exposure of the portfolio to both duration and credit – we expect this to be the first of several step changes.

The Option Strategy dragged for the month as we maintained a defensive profile throughout with a view that markets may suffer a pullback, though we shifted to a less defensive profile at month end.

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 2023.

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 $19.9 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

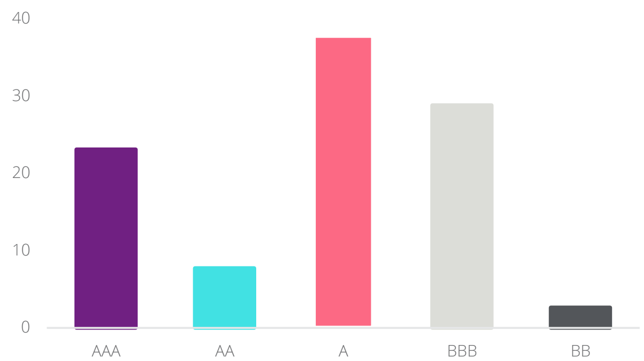
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.23
Spread Duration (Yrs)	1.89
Portfolio Yield (%)	4.67
Average Credit Quality	A

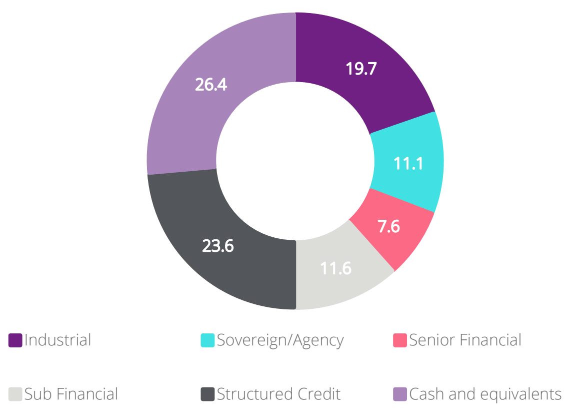
Source: Perennial Value Management. As at 31 January 2023

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 0.59% for the month net of fees. The fund's performance was driven by coupon income and narrower credit spreads. Hedges in the portfolio detracted somewhat from performance.

Bond markets performed well in January, with bond yields falling and credit spreads narrowing. The Australian 10-year bond yields finished the month at 3.55, having traded in a 3.32 – 4.05 range, a range of more than 70 basis points. The post-Bank of Japan selloff in bonds through the second half of December was reversed in January, with markets starting to consider whether central bank terminal rates were in view. We used this selloff to increase the duration of our portfolio for the first time in more than 8 months.

Credit spreads narrowed across geographies and sectors during January, with performance across the credit space boosted by hopes of a soft landing in the US. Non-financial paper outperformed financial paper, and within financials offshore names outperformed onshore names. Whilst we remain cautious as to the trajectory of credit markets into 2024, we believe that the balance of risks has tilted constructively for credit. This has led us to add incremental risk to our portfolios – a change in stance from the defensive tilt we have retained across our portfolios for more than 12 months.

The Option Strategy dragged for the month as we maintained a defensive profile, until reversing this stance somewhat right at month end. A single tranche was added to the Put Write sleeve at month end, as it became apparent that our belief in a further pullback may not be realized in the short term.

Outlook

An extremely strong payrolls print in early February has now injected further uncertainty into the monetary policy path, but despite the volatility in government bond markets it is interesting to note that the future volatility as implied by the swaptions market has been falling for the last four months. In short, bond markets are in a state of flux and are likely to remain so as the market debates the likely trajectory of the growth/inflation trade-off in the US and elsewhere. Still, we believe that markets will struggle to push the US terminal rate for the cycle meaningfully above 5%. Thus, we see the potential for asymmetry in short end yields – there is upside of course; but yield curves should be able to bull-steepen from current extreme levels of inversion at some point in the coming months. At this point duration positioning will be particularly valuable for the portfolio, and we will therefore look for opportunities to further increase our duration positioning.

There has been an improvement in the growth backdrop, stemming from various drivers such as the re-opening of China, strength in US consumption that is likely to continue for longer than expected, a potential stablisation in the US housing market, and the absence of the fiscal drag in the US that featured in 2022. In Australia too, the re-opening of China should support growth. We acknowledge that the RBA may remain hawkish for longer as a result. Even so, we feel the 'mortgage cliff' will temper rate hikes and see the RBA pause in the first half of the year, even as the external sector strengthens. The improvements in the growth backdrop should support markets, given valuations prior to the recent rally were implying a more serious growth slowdown.

Importantly, the press conference following the FOMC meeting in February gave the Fed Chair, Jerome Powell, ample chance to push back on the easing in financial conditions seen during January. That he failed to do so was a change in the behaviour that markets had come to expect from Powell during 2022, and this in our eyes has validated a risk-on tone for markets over at least the next several months.

To be clear, we retain our view that credit markets may well slow again later in the year. A 'higher for longer' stance from central banks should ultimately constrain risk asset valuations. A slowdown in US growth is also still in prospect, even if it proves to be less severe than feared. In the face of these headwinds, we remain nimble. We are ready to reduce risk when we have cause to do so. For now, however, the headwinds that have seen us constrain our positioning have receded somewhat and we feel the time is right to start to re-engage in both duration and credit exposure across our portfolios.

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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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