Perennial Yield Plus Conservative Trust

Monthly Report March 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.1	0.8	1.0	-0.2	-1.1
RBA Cash Rate Total Return Index	0.3	0.8	2.0	2.1	1.3
Value Added	**-0.2**	**0.0**	**-1.0**	**-2.3**	**-2.4**

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

Overview

Markets seemed to compress a financial crisis cycle into a single month in March, with large banks going under and central banks and governments stepping in to staunch any further ructions.

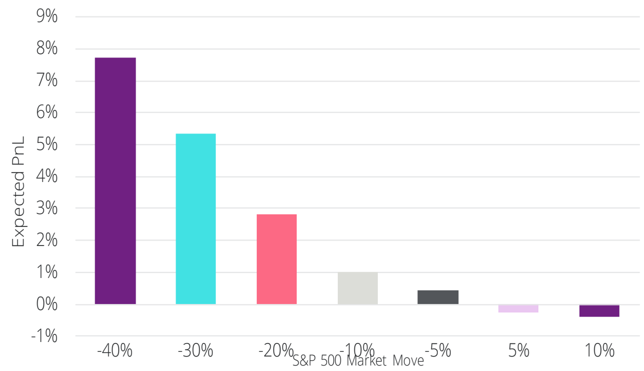
The Trust delivered a gain of 0.09% for the month, net of fees, driven by modest gains on the Core Income strategy, and a flat performance from the Option Strategy.

Coupon income and duration positioning supported performance during the month, even as stresses in the US and European banking systems saw credit spreads widen.

The Option Strategy produced a flat outcome for the month as small gains on the Put Write offset small losses on the Protection strategy. However, the Option Strategy did show meaningful reactivity earlier in the month, gaining 30 bps with profits accelerating as markets tipped over.

We remain conservatively positioned as we believe a recession is still not yet priced by equity markets and is our base case outcome.

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 March 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 $15.6 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

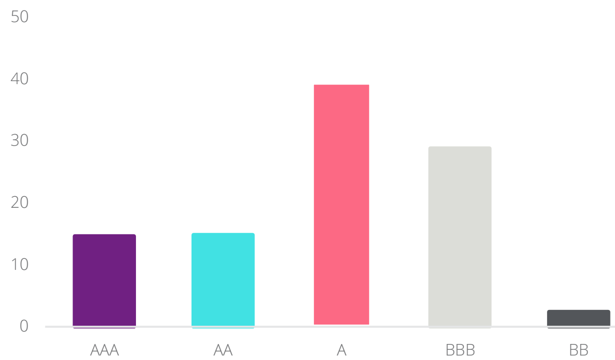
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.45
Spread Duration (Yrs)	2.24
Portfolio Yield (%)	5.36
Average Credit Quality	A

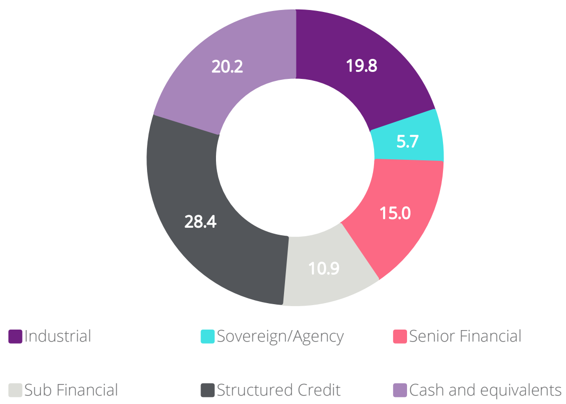
Source: Perennial Value Management. As at 31 March 2023

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 0.14% for the month, net of fees. The fund's performance was supported by coupon income and duration. Credit spreads were the main detractor, forced wider by uncertainty among banks.

Interest rate expectations shifted abruptly as these banking issues emerged in the United States and Europe. The sector was rocked by several failures among tech and crypto focused institutions in the US, while an unfortunate series of events snowballed quickly into the forced sale of Credit Suisse to cross-town rival UBS.

As a result, investors grew more confident in their view that rates were at or near their peak and that continued weakness in the financial sector will force central banks to pause and begin cutting much sooner than had been the case at the start of March.

As we had modestly increased duration during February and March, the shift in market expectations was a positive for fund performance. However, following a strong start to the year, credit spreads reacted negatively to the challenges emanating from the banks and tempered the overall performance for the month.

The Option Strategy was flat for the month as moderately higher equity markets delivered a small positive PnL for the Put Write, which was offset by a small loss on the Protection sleeves. In the Protection portfolio the loss was smaller than it might have been, given the upward trend in equity markets, as implied volatility was marked higher across the board.

Importantly, Option Strategy reactivity was strong as markets drew down through March, delivering a gain of ~30bp which would have accelerated higher in a non-linear fashion had the dislocation continued. However, this PnL came back as markets regained their footing through the month.

Trust Activity

We continue to prudently shift portfolios away from cash and short-dated assets, selectively participating in primary issuance where market technicals were supportive, and in securitised assets where relative value remains attractive.

In the Option Strategy both tranches of the Put Write (still being run at reduced notional) came up for rolling, though we held a tranche back in case the markets start looking wobbly again coming into April. The expiring positions were unwound profitably.

On the Protection side we bought Mar 2024 protection at attractive levels in early March, when protection costs had approached pre-COVID averages, and with the view that markets remained at-risk. These were instantly re-valued meaningfully higher when the financial sector started coming under pressure, though this revaluation had largely reverted by the end of the month.

Outlook

Financial instability, with bank failures in the United States and the forced sale of Credit Suisse in Europe, is driving bearish revisions to the growth outlook globally. Receding availability of credit and the prospect of loan losses particularly in segments of property lending will keep investors on edge. The gap between near-term growth expectations and persistent inflation has led to weakness in the US dollar and been supportive for safe-haven assets like gold.

Volatility in interest rates remains notably elevated. Daily moves in the US 2-year Treasury yield topped 50bp on multiple occasions during March, indicative of a market that had simply not anticipated the possibility of bank failures. Long end rates also fell, but the extreme moves in the short end drove a bearish flattening of what are still inverted yield curves in the US. While we do not believe that the issues in the banking sector alone will precipitate a recession, the risk of further flare-ups will remain in the months ahead.

Markets remain convinced that the inflation threat has receded, and at time of writing were expecting cash rates in the US and Australia to be lower than they are now by the end of 2023. With the RBA deciding to pause in April at a cash rate of 3.6% these views have hardened. While headline inflation is likely to fall in coming months owing to base effects and more stable energy and food prices, persistent services inflation is preventing the core measures from moderating at anywhere near the same pace. In our view, this thematic will remain for as long as employment remains high and business confidence remains buoyant.

China's economy continues on a path of tepid recovery. China seems more focused on international relations now that Xi Jinping has been re-appointed for another term as President and leader of the Communist Party. While relations seem to be thawing between Australia and the Middle Kingdom, the same cannot be said for Sino-US relations. While the Chinese have made no secret of their dislike for the AUKUS agreement, criticism has mostly been leveled at the US. In spite of other issues under discussion, trade sanctions continue to be removed, allowing local exporters to re-establish important commercial links across a range of industries.

High commodity prices and a subdued Australian dollar have seen exports emerge as a key contributor to the local growth outlook. Recent retail sales data have slowed but are yet to show signs of stress among consumers. As cost-of-living pressures persist and a greater proportion of mortgages reset to higher variable rates over the course of 2023, we expect consumption patterns to change. Growing stresses in the building and construction sectors are symptoms of cost pressures and labour unavailability. This may prove to be an ongoing issue as it coincides with expected record migration over the next few years, raising the prominence of housing availability and housing affordability concerns in the national debate.

Credit spreads widened across the board during March in response to the pressures on financial institutions. The unexpected and swift nature of events caught most investors off-guard, leading to a reversal of part of the gains made so far this year. Yet strong corporate fundamentals have been a feature of this cycle, with one of the outcomes from the COVID pandemic being a general wariness of excessive leverage. We cannot rule out further spread widening as the current economic cycle matures, but a strong corporate sector and high absolute yields should limit the impact, particularly in the investment grade segment where our portfolios are heavily biased.

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.

Contact us

Level 27, 88 Phillip Street
Sydney NSW 2000

1300 730 032

invest@perennial.net.au

www.perennial.net.au

Source: OptionMetrics/PSG