Perennial Yield Plus Conservative Trust

Monthly Report April 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.3	0.6	1.3	0.2	-0.9
RBA Cash Rate Total Return Index	0.3	0.9	2.3	2.4	1.4
Value Added	**0.0**	**-0.3**	**-1.0**	**-2.2**	**-2.3**

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

Overview

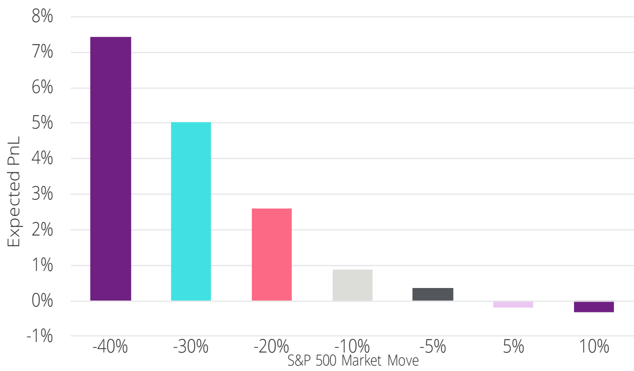
Markets continued in a risk-on mode in April with equities up and the VIX down nearly 3 points. Expectations of a soft landing appear to be moving from the fringe to a more mainstream view, though there are plenty of voices still sounding caution.

The Trust delivered a gain of 0.29% for the month, net of fees, driven by gains on the Core Income strategy, and a drag of around 0.05% from the Option Strategy.

Coupon income and narrower credit spreads supported performance during the month, even as stresses in the US banking system flared once again. Overlay positioning also added to performance while duration detracted.

The Option Strategy produced a small drag for the month as the Protection portfolio was marked down, more than gains seen on the Put Write strategy. We retain a defensive profile in the Option Strategy, whilst risk is being added on the Core Income side.

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 30 April 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 $15.9 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

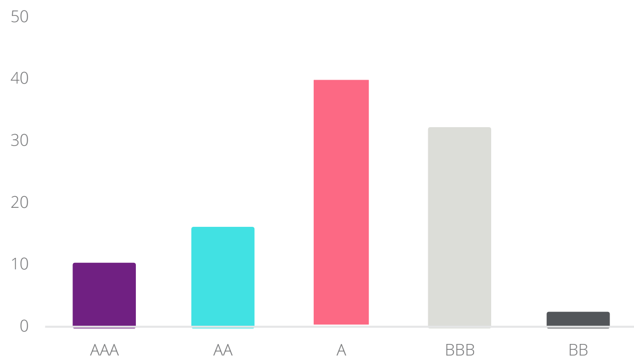
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.25
Spread Duration (Yrs)	2.40
Portfolio Yield (%)	5.7
Average Credit Quality	A

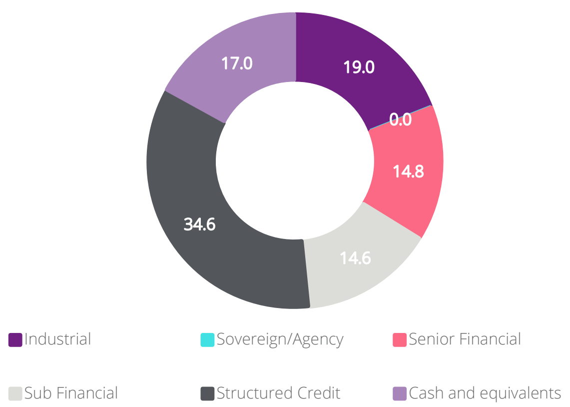
Source: Perennial Value Management. As at 30 April 2023

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 0.38% for the month net of fees. The fund's performance was supported by coupon income and credit spreads. Duration created a modest drag while overlay and hedging contributions were positive.

Volatility in rates markets subsided in April but remained higher than recent years. Incoming economic data remains mixed, but at the margin results are underwhelming market expectations. Yield curves remain inverted but there is growing dispersion between 2yr/10yr and 3m/10yr curves, implying the market is expecting interest rates to be cut as early as this year. We are sceptical that such a scenario will play out during 2023, but we cannot rule out the possibility that short-term interest rate markets are handicapping the possibility of a severe stress event that requires substantial rate cuts.

Difficulties remain among US regional banks, one of the possible sources of a severe stress event. However, even as issues with First Republic Bank play out, recent results have revealed a decidedly mixed picture that nonetheless, is a little better than feared. We expect the situation to remain fluid in the months ahead.

We continue our defensive positioning in the Option Strategy, though our view of impending recession seems to be increasingly discounted by the market. Nonetheless we believe it is more attractive to be adding risk in investment grade credit rather than equities. As Daintree are indeed adding risk in the Core Income sleeve, it makes sense to maintain the defensive profile in the Option Strategy. If we do have a drawdown event we believe that equities have more work to do than credit.

Trust Activity

Following our change in risk appetite in January, we continued in April to prudently shift portfolios away from cash and short-dated assets, selectively participating in primary issuance, predominantly in securitised assets where relative value remains attractive.

In the Option Strategy one tranche of Put Write was unwound towards the end of the month, with a second tranche close to being unwound. Exposure was maintained at a single tranche across month end with the hope that a pullback in markets would deliver more attractive premiums. Short-tenor implied volatility has declined markedly, such that Put Write premiums are lower than we have seen for some time.

Outlook

Markets felt relatively calm during April when compared to the turmoil of March. While economic data displayed resilience, they also continue to convey a fragility below the surface. Core inflation is proving difficult to shift lower as the services component remains elevated, while also being less responsive to central bank actions given strong employment indicators across developed markets.

Meanwhile, a range of other economic indicators undershot expectations in April, signalling that the US economy in particular may be losing momentum. In our view, this is being driven by the rising cost and receding availability of credit, exacerbated by persistent issues among regional banks in the US. Measures to resolve issues at individual institutions have so far been insufficient to allay systemic concerns, but we expect regulators to take all steps necessary to ensure the integrity of the banking system.

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. Despite this, the RBA shocked most by deciding to increase the cash rate in May after the briefest of pauses in April. 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, leading us to expect further upward movement in the RBA cash rate in the months ahead.

Expect debate over the US debt ceiling to ramp up in the months ahead. Speculation around the date at which the US Treasury officially loses its capacity to fulfil its obligations suggests it could be as early as 1 June, but for now the Congress and White House are nowhere near any kind of deal or compromise. Brinkmanship from both sides is common in these negotiations, but the stakes have never been higher with the credit quality and viability of US$31 trillion in government debt on the line. With the cost to insure against US default risk at all-time highs, investors are clearly concerned that protracted or acrimonious negotiations could inadvertently lead to a US default. We see this as a very low probability, but the potential for rates volatility to remain elevated is very high.

Credit spreads performed well overall during April as risk assets benefited from less market noise after the tumult of March. However, while central banks including the RBA and the Federal Reserve felt that systemic issues had receded sufficiently to warrant additional rate increases, recent events among US regional banks suggest this may have been premature. One of the consequences of this ongoing uncertainty will be reduced credit availability, which on balance could push credit spreads wider in the near-term. We cannot rule out further spread widening as the current economic cycle matures, but a strong corporate sector should limit the impact, particularly in the investment grade segment where Daintree portfolios are heavily biased. Much more favourable yields and compensation for risk mean the attractiveness of coupon income will be a more effective buffer to credit spread variability, providing us with opportunities to gradually reposition portfolios in the months ahead.

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

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