Perennial Yield Plus Conservative Trust

Perennial Partners

Monthly Report May 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.3	0.7	1.5	0.9	-0.7
RBA Cash Rate Total Return Index	0.3	0.9	2.7	2.7	1.5
Value Added	**0.0**	**-0.2**	**-1.2**	**-1.8**	**-2.2**

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

Overview

Markets were quiet in May, with little in the way to drive volatility other than concerns over the US debt ceiling.

The Trust delivered a gain of 0.28% for the month, net of fees, driven by gains on the Core Income strategy, and flat performance from the Option Strategy.

Core Income performance was supported by coupon income and credit spreads. Interest rates rose over the month, but having reduced duration toward the beginning of May, the impact on performance was minimal.

The Option Strategy was essentially flat for the month as Put Write performance offset drag on the Protection strategy. We retain a defensive profile in the Option Strategy, whilst risk is being added on the Core Income side.

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 $16.3 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

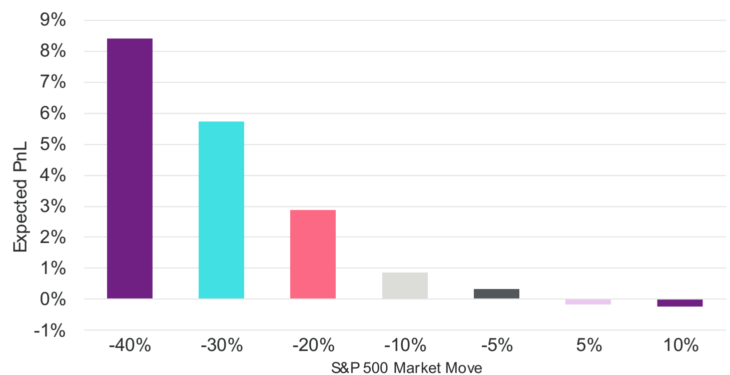
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.11
Spread Duration (Yrs)	2.53
Portfolio Yield (%)	5.99
Average Credit Quality	A

Source: Perennial Value Management. As at 31 May 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.

Estimated PnL Outcomes by Market Move

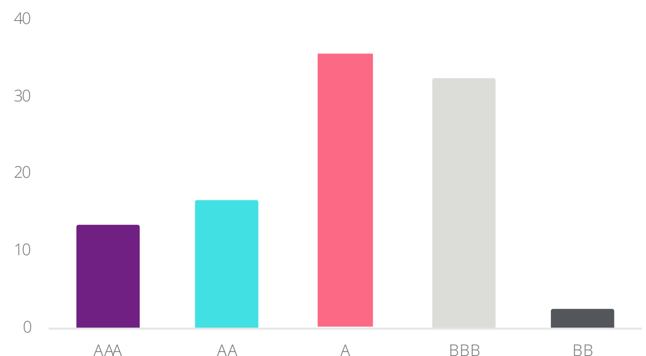


The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.

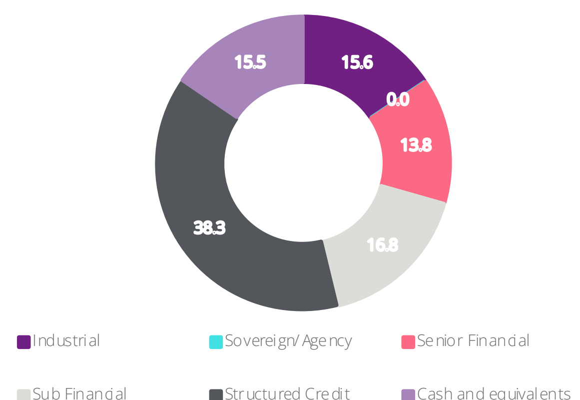
Source: Perennial Value Management. As at 31 May 2023.

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.

Rating Exposure



Sector Active Exposure



Trust Review

The Core Income strategy returned 0.34% for the month, net of fees. The strategy's performance was supported by coupon income and credit spreads. Duration created a modest drag as did overlay and hedging.

Credit markets were resilient with spreads holding firm or modestly tightening. A paucity of significant data allowed recent trends to continue, with higher yields enticing a broader investor base.

Interest rates rose over the month, but having reduced duration toward the beginning of May, the impact on performance was minimal.

Option markets continue to discount any imminent risk. Implied volatility was somewhat supported by concerns over the US debt ceiling drama but remained at levels within the post-COVID lows. This is an attractive market structure for upcoming Protection strategy rolls in June, meaning attractive levels of notional coverage should be achievable.

The flipside of lower implied volatility is that the premiums available on the Put Write are lower than they have been for some time. Combined with our active approach to keeping Put Write notional on the low side, thereby maximizing the defensiveness of the Option Strategy, means that we are generally seeing flat to small drag each month in the Option Strategy as the Protection decay outweighs the Put Write carry.

Trust Activity

In the Core Income Strategy we continue to prudently add risk, which includes selective participation in primary issuance across financial, corporate and securitised transactions.

In the Option Strategy both tranches of Put Write were unwound at a profit, towards the end of the month. Only one tranche was re-initiated, with the other tranche held back on the slight chance that the US failed to resolve its political differences in order to enact an expansion of the debt ceiling. Should the issue fully resolve we would expect to re-initiate early next month, though overall are maintaining a defensive exposure in the Option strategy, in terms of Put Write notional held.

Outlook

We are faced with a number of unusual occurrences as we approach the mid-point of 2023, making the formation of a short-term outlook challenging. For example, while recession expectations in the US remain high, unemployment is at the lowest level since 1968. Falling money supply and healing supply chains have quickly moderated goods inflation, but services (including property and rent costs) will prove recalcitrant without major disruption to employment outcomes. Monetary policy remains a blunt tool to address this conundrum. The recent debt ceiling agreement contains little real spending cuts and barely shifts the needle on inflation, in our view.

The debt ceiling debate created large distortions in the yield curve as investors sought to avoid exposure to a debt default. Nonetheless, the incoming data suggests some further tightening is warranted, likely attenuated by temporary pauses. Market pricing suggests further increases are also expected in Australia, driven by higher minimum wages and a surprise upswing in residential property markets in recent months. This has likely given the RBA pause for thought around whether financial conditions are tight enough to bring inflation back to target over the forecast period.

Meanwhile, European inflation surprised on the downside, raising questions about how much further tightening may be required on the Continent. In another rare occurrence of the times, European inflation break evens now exceed the US for the first time since 2012, suggesting it may still be too early to declare victory over European inflation. The ECB continues to walk a fine line between creating sufficiently tight financial conditions and disrupting employment, (unemployment is already higher than other developed markets), and growth, which remains fragile and exposed to external factors. Weaker commodity prices are offering a welcome respite to households, and this is helping to support demand.

With the Chinese economy now fully reopened, focus has shifted to the property market, estimated to be the largest single asset market in the world. Sentiment remains fragile after several high-profile developers failed in recent years. Concern is growing that further support measures will be required to protect buyer confidence and asset values, as recent data suggests lending demand for newly built properties has fallen to levels last seen in 2013. Thawing trade tensions between China and Australia is a positive for both, allowing Chinese authorities to focus on a robust and broad-based growth strategy against a backdrop of normalising commodity prices.

Credit spreads continued their positive momentum in May even as expectations for tighter financial conditions rose at the margin. Demand remains strongest for investment grade securities, which is obscuring some mixed results in segments such as leveraged loans, where defaults are being noted at an elevated rate. Credit availability is a key theme that we believe warrants close attention as the US Treasury resumes debt issuance, with concerns lingering in the commercial real estate space while banks become more selective about lending, particularly in the leveraged loan and high yield markets. We cannot rule out further spread widening as the current economic cycle matures, but a strong corporate sector will limit the impact, particularly in the investment grade segment where Daintree portfolios are heavily biased. With yields and risk compensation now much more favourable, the attractiveness of coupon income will be a more effective buffer to 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.

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Signatory of:

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