Perennial Yield Plus Conservative Trust

Monthly Report July 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.6	1.2	0.6	3.0	-0.2
RBA Cash Rate Total Return Index	0.3	1.0	0.3	3.3	1.7
Value Added	**0.3**	**0.2**	**0.3**	**-0.3**	**-1.9**

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

Overview

Markets carried on rallying in July despite some wobbles after Fitch downgraded the US. The fact that this occurred against a backdrop of US 10-year yields testing 4% once again, is testament to the current appetite for risk.

The Trust delivered a gain of 0.62% for the month, net of fees, driven by strong gains on the Core Income strategy, and an essentially flat performance from the Option Strategy.

With investor interest in credit continuing, fund performance was again supported by coupon income and credit spreads. Credit spreads have been a positive contributor to returns over the last 12 months.

The Option Strategy was flat as the market rally slowed down somewhat, compared to June, and implied volatility found a bid.

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 $16.8 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

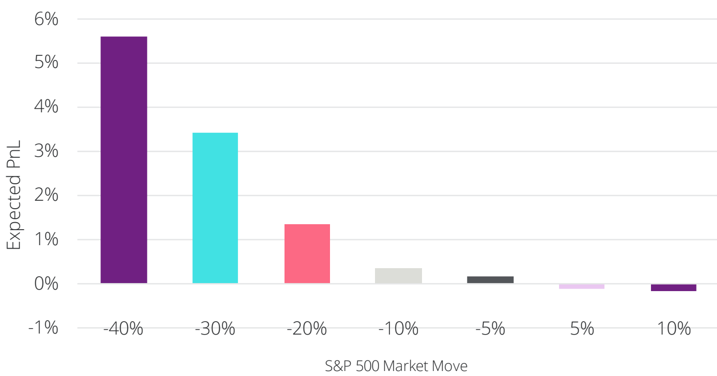
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.16
Spread Duration (Yrs)	2.48
Portfolio Yield (%)	6.35
Average Credit Quality	A

Source: Perennial Value Management. As at 31 July 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

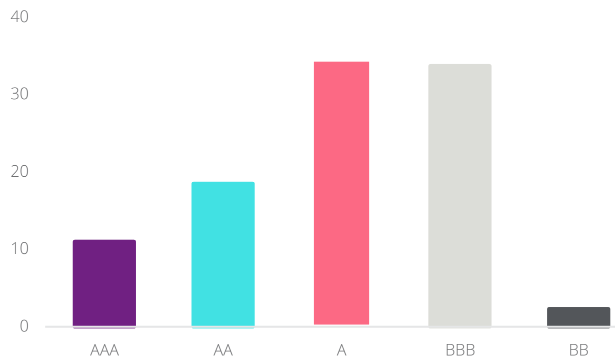


The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.

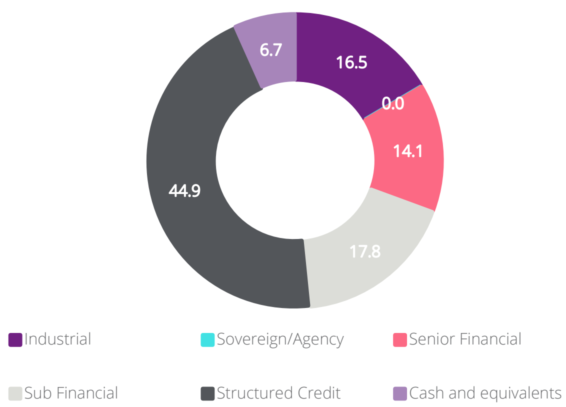
Source: Perennial Value Management. As at 31 July 2023.

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 0.70% for the month, net of fees. The fund's performance was supported by coupon income and credit spreads.

Credit markets continued their positive year, with economic conditions exceeding expectations and pushing credit spreads tighter. Credit investors, based on recent spread performance, remain sanguine about the short-to-medium term outlook.

Interest rates were volatile, with the shorter end of the curve rallying as the market debates whether the RBA tightening cycle has now concluded. We believe it is too early to make this determination and keep our duration positioning close to zero.

Implied volatility found something of a floor during the month, though still remains low. It seems likely if US 10-year yields continue their march higher, or even maintain current levels, that we may see more volatility in equity markets, and therefore higher implied volatility. This would benefit the Put Write program, though Protection notional has also been increasing due to the availability of cheap options.

Trust Activity

The Fund did not participate in any new primary issuance in July, having taken significant steps during the first half of the year to reposition toward optimal coupon income generation.

In the Option Strategy both tranches of Put Write were rolled out for two months. With implied volatility so low we opted to reduce the overall Put Write notional somewhat, whilst the risk-reward to selling options is diminished.

Outlook

Growing belief in a soft landing for the global economy saw investors take a glass-half-full approach in July. Continued progress in moderating core inflationary impulses provided space to embed the prospect of a cyclical peak in rates into asset prices. Reduced volatility further supported the bullish tone, including in rates markets which have endured elevated uncertainty for more than a year.

Data dependent central banks will be tempted to slow their hiking plans as they seek to achieve "immaculate disinflation" - bringing prices to heel without causing significant damage to labour markets or output. If they can engineer such a scenario, it will be accompanied by sustained pauses across developed markets. However, the strength of underlying fundamentals will make the justification for near-term rate cuts harder, absent an unexpected or severe downturn in the economy or in financial conditions. We continue to believe a "higher-for longer" rates scenario is most likely through 2024.

Oil prices have jumped in recent weeks back to levels last seen in November 2022. This will filter through to transportation fuel prices in due course and if sustained could risk causing new ripples in headline inflation. Core inflation measures strip out volatile elements such as these, but energy is an essential input across the value chain and could complicate efforts to square inflation data with inflation messaging, where the dominant narrative remains a steady return to target over the medium term.

The Bank of Japan took markets by surprise, announcing a change to its Yield Curve Control (YCC) programme. While not a common topic of discussion when considering the outlook, the implications are important. The changes will allow yields on Japanese government bonds to trade in a wider band, giving the BoJ more flexibility to implement its policy agenda. The wider trading band risks creating volatility in the world's second largest sovereign bond market, including spillover effects into the currency arena. Japanese investors have significant direct and financial investments offshore, including the carry trade, thus uncertainty in the yen should not be underestimated as an influence on risk assets.

Artificial intelligence, a prominent feature in the market dialogue of 2023, has wider implications than the performance of a narrow array of technology majors. At a geopolitical level, tension continues to bubble between the great powers of the United States and China. Political engagement is occurring at senior levels across a wide range of issues, including AI and in particular the input materials crucial to its growth. Here also, investors are interpreting this denouement of sorts in a positive light. But as Australia has found with China in recent months, translating dialogue to action is not always easy, and arguably the interdependency between the US and China means there is much more at stake than just trade.

Amidst a transition to a new governor in September, the RBA paused its hiking cycle in July, extending that pause to August in concert with other global central banks as evidence emerged that the much-anticipated moderation in local consumption activity was beginning to bite. Construction activity is slowing, and insolvencies are rising in this important sector of the economy. More homeowners are reaching their fixed-rate mortgage cliff, but Westpac recently noted that among its 12 million customers only 700 have made hardship requests so far in 2023.

Credit spreads continued their positive momentum in July even as expectations for tighter financial conditions rose at the margin. Demand remains strongest for investment grade securities, which is obscuring some more mixed results in segments such as leveraged loans, where defaults are being noted at an elevated rate. Concerns linger in the commercial real estate space and banks are becoming 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. Strong coupon income is well placed to provide a buffer to mild spread volatility 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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