Perennial Yield Plus Conservative Trust

Perennial Partners

Monthly Report August 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.7	1.6	1.3	3.7	0.1
RBA Cash Rate Total Return Index	0.3	1.0	0.7	3.5	1.8
Value Added	**0.4**	**0.6**	**0.6**	**0.2**	**-1.7**

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

Overview

Markets paused in August, waiting to see how China might choose to manage its slowdown, and also digesting yields that reached multi-year highs through the month (the last time the US 10-year reached such levels was prior to the GFC).

The Trust delivered a gain of 0.69% for the month, net of fees - another strong performance once again driven by gains on the Core Income strategy, and an essentially flat performance from the Option Strategy.

High coupon receipts combined with a narrowing of credit spreads were the main drivers of returns, as credit markets continued their positive year.

The Option Strategy was flat as the markets experienced a minor pullback, but not enough for the Protection strategy to gain.

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 $17.5 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

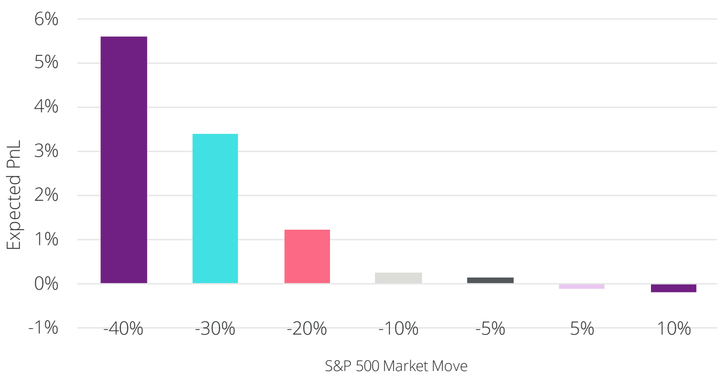
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.25
Spread Duration (Yrs)	2.39
Portfolio Yield (%)	6.23
Average Credit Quality	A

Source: Perennial Value Management. As at 31 August 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

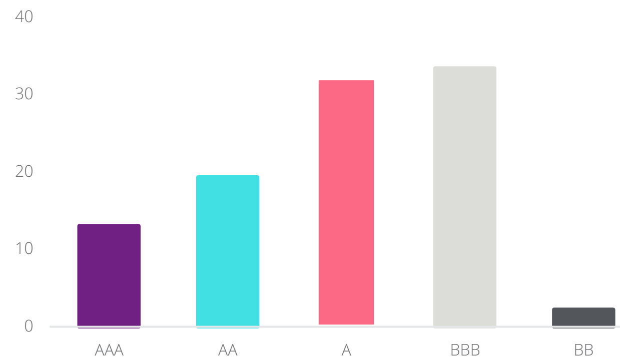


The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.

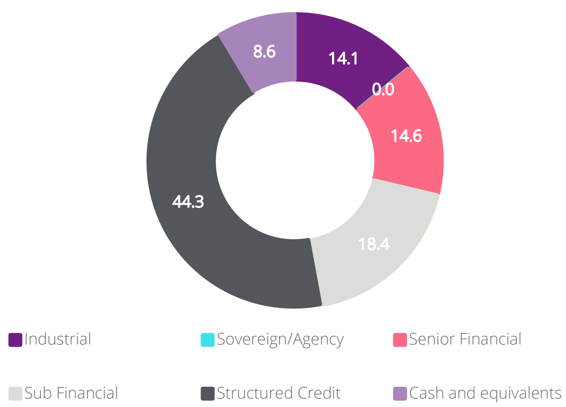
Source: Perennial Value Management. As at 31 August 2023.

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

For the Core Income strategy - Overlay was slightly positive for the month, but high coupon receipts combined with a narrowing of credit spreads were the main drivers of returns as credit markets continued their positive year. Economic conditions have exceeded expectations, and this has seen credit spreads tighten. Credit investors, based on recent spread performance, remain sanguine about the short-to-medium term outlook.

Implied volatility tried to rally through the month, from extremely low levels, but finished basically unchanged despite the small pullback in equities. Arguably the options market is being overly sanguine with respect to macroeconomic and earnings risk, given the elevated yield (in spite of moderating inflation).

The Protection component of the Option Strategy saw a minor drag as the modest decline in equities was more than offset by option decay through the month. This minor drag was offset by a small gain on the Put Write. Option premiums remain unappealing for the Put Write, and a modest notional is held. Expiry of the Put Write positions is coming up next month.

Trust Activity

The Fund participated in selected new issuance, identifying opportunities from Lloyds Group and a range of securitised sectors.

No trades were made in the Option Strategy through the month, though the Put Write is coming up for rolling in September. In addition, quarterly Protection rolls are coming up next month, and cheap options should mean larger notional can be bought than in the past.

Outlook

More evidence emerged during August that current interest rate settings are having the desired effect on inflation without disruptively impacting growth expectations. Markets have been skillfully climbing the wall of worry, even if the breadth of performance in some markets is quite narrow.

There are still real risks on, or just over, the horizon. A growing cohort of central banks are settling into extended pauses with regards to cash rates while continuing with quantitative tightening, leading money supply growth to dip into negative territory in the US and falling under considerable pressure elsewhere. Given close correlations observed recently between money supply growth and asset prices, an extended money supply disinflation could eventually spill over into equity and credit markets.

It is not just developed markets facing these issues. China has been making headlines again for the wrong reasons, as its property market faces further turmoil among developers, one of which was late in paying bond investors last month. Persistent youth unemployment and an unwillingness to deploy significant debt-fueled stimulus to kick start activity suggest Chinese authorities have deep structural challenges to face with a limited remedial toolkit. Therefore, investors should not expect the Chinese miracle to save markets as they did in 2008.

Oil prices continued to rise in August. 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.

Amidst a transition to a new governor this month, the RBA has now held the cash rate steady for three consecutive meetings, while maintaining flexibility to respond to conditions as they evolve. A modest rise in unemployment and moderating monthly inflation data should give the RBA the confidence to take additional time to assess how prior cash rate movements affect economic conditions over coming months. Interest rate futures markets have subsequently shifted from possible further increases to the next move now being a cut, despite the RBA's wariness of inflation.

Credit spreads once again tightened in August, which in our view reflects the strong fundamentals that we have been discussing now for some time. Fundamentals were reinforced locally by a solid Australian profit results season. Corporates have low gearing in comparison to long-term averages, and cash balances that are benefiting from higher interest rates. 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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