Perennial Yield Plus Conservative Trust

Monthly Report September 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.5	1.9	1.9	4.4	0.4
RBA Cash Rate Total Return Index	0.3	1.0	1.0	3.6	1.9
Value Added	**0.2**	**0.9**	**0.9**	**0.8**	**-1.5**

^Since inception: June 2021. Past performance is not a reliable indicator of future performance. Performance is shown to 29 September 2023, which was a public holiday in Melbourne. Since our unit registry is based in Melbourne, no unit price was struck for this day. An indicative unit price was calculated so that the performance of the Fund may be compared to that of the market (the ASX was open on 29 September 2023). No reliance should be placed on the indicative unit price for 29 September 2023.

Overview

Markets were softer in September, finally spooked by rampaging yields and oil prices. Consequently, the VIX, and implied volatility in general, were marked higher through the month though are still at low levels versus history.

The Trust delivered another strong gain of 0.58% for the month, net of fees - once again driven by gains on the Core Income strategy, but also bolstered by a 0.13% gain on 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 gained as markets moved lower and implied volatility was marked higher, with a small offsetting loss from the Put Write strategy.

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 $22.0 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

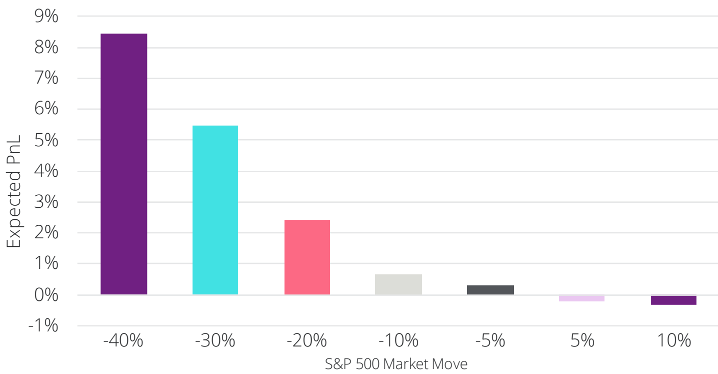
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	0.19
Spread Duration (Yrs)	2.42
Portfolio Yield (%)	6.45
Average Credit Quality	A

Source: Perennial Value Management. As at 30 September 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

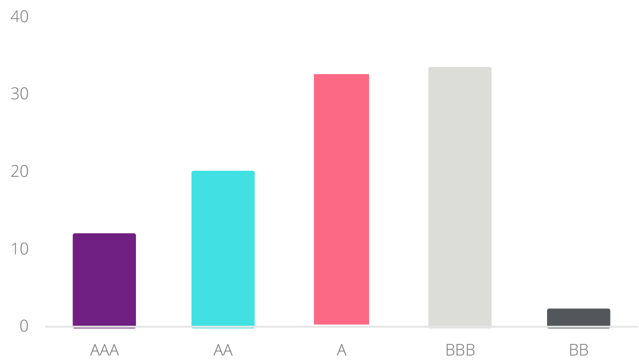


The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.

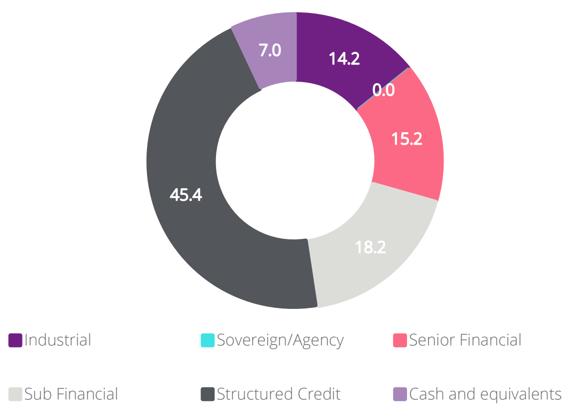
Source: Perennial Value Management. As at 30 September 2023.

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 - performance was supported by coupon income and credit spreads. Duration exposure was kept low which reduced volatility, but the quantum of yield moves still created some drag on performance as yield curves steepened considerably. Overlay was a slight positive contributor for the month.

Credit markets remained resilient amidst the uncertainty created by rising interest rates. Based on recent spread performance, credit investors remain sanguine about the medium-term outlook.

The US 10-year yield rallied 0.46 percentage points through the month, an outsized monthly move. Given this backdrop equity markets were saggy, and implied volatility reverted to higher (but still low) levels, particularly at shorter tenors. The Option Strategy therefore benefitted both from falling markets, and from higher implied volatility.

Trust Activity

The Fund participated in selected new issuance, identifying opportunities from toll road operators and a range of securitised sectors.

For the Option Strategy - the Put Write component had been kept at zero notional for much of the month, as premiums were not attractive, but was re-initiated in small size at the end of the month. Protection strategy rolls were carried out during September at still-attractive levels, with Protection notional remaining at high levels.

Outlook

Financial conditions tightened materially in September, with higher longer-term interest rates the chief culprit. Long yields are being driven higher by a reassessment of expected future central bank actions. Adding to the upheaval is dysfunction in the US Congress, where another government shutdown is possible and, in a first for the US, the Speaker was ousted after just eight months in the job.

One interesting thing about this move in yields is what it was not driven by – pricing for inflation expectations remained reasonably stable along the curve. Therefore, the higher bond yields have been driven by higher real yields. Historically, changes to longer-term expectations around monetary policy (whether conventional or unconventional) have been responsible for similar abrupt shifts in real yields, for example via shifts lower in the weeks after QE program announcements. The reversal of yield curve control in Japan seems to have had the opposite impact more recently, with yields shifting higher since July, but the latest iteration of the Federal Reserve "dot plot" is the main recent driver. It showed a hawkish shift in the governors' outlook over the longer-term, and markets have come to the view that the US economy, having dealt with a higher Fed Funds rate for some time now without mishap, can also deal with higher rates over the longer-term. This has seen the market's view of longer-term distribution for real rates shift higher. A growing realisation of the budgetary position of the United States, where large (and growing) fiscal deficits look to be the norm for the remainder of the decade, is another driver of higher yields that remains on the minds of market participants.

Higher yields are likely attracting capital at the margin to the large and liquid treasuries market, driving the US dollar higher, even as the fiscal outlook is deteriorating quickly and interest costs alone will soon exceed US$1tr per year. Hyper-partisanship in the houses of government is stymying any chance of finding sensible fiscal solutions. Throw in the upcoming presidential election in late 2024 and the chances of any budgetary reform occurring are exceedingly slim. Therefore, while investors are attracted to rising yields or reflexively favour USD as a haven from global growth concerns, we believe this comes with higher-than-normal risk that domestic fundamentals may eventually exert a contrary influence on the world's reserve currency.

Even Japan has not been immune to the march higher of interest rates. However, this comes at the expense of a weakening yen, which has fallen to its lowest levels in a year and back to the psychologically important 150 per USD level. The Bank of Japan showed its hand with multiple interventions to defend that level in 2022, and despite having eased its yield curve control programme and allowed long-end yields to vary within wider bands, we expect further interventions if yen re-tests the lows of last year.

Oil prices continue to pose a threat to the orderly return of inflation to target levels. 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.

Despite pausing for a fourth month, a weakening AUD, solid immigration and employment outcomes, and resilient coal and LNG prices will keep pressure on the RBA board to hike further in coming months, possibly as early as Melbourne Cup day. However, financial markets are growing in their conviction that the cash rate has peaked, expecting the impacts of prior increases to be widely felt, particularly in the mortgage belt. We believe the odds are more finely balanced than what markets suggest.

Credit spreads held up well in September against a tumultuous backdrop. Corporates have low gearing in comparison to long-term averages, and cash balances that are benefiting from higher interest rates. Limited refinancing needs are insulating well-rated companies from higher interest rates, although higher funding costs will create an increasing headwind into 2024 and 2025 as cheap pandemic-era debt is repaid or refinanced. 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 will remain the foundation of the return profile over time.

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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