Perennial Yield Plus Conservative Trust

Perennial Partners

Monthly Report October 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	Since Inception^ (%)
Perennial Yield Plus Conservative Trust (Net)	0.7	2.0	2.7	5.6	0.7
RBA Cash Rate Total Return Index	0.3	1.0	1.4	3.7	2.0
Value Added	**0.4**	**1.0**	**1.3**	**1.9**	**-1.3**

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

Overview

Markets were somewhat softer again in October, as US 10-years breached the 5% level. However, by the second half of the month it began to look like rates might be done with this rally and markets stabilized. Implied volatility was marked up through the month, though still remains at low levels.

The Trust delivered another strong performance, with a gain of 0.74% for the month, net of fees - once again driven by gains on the Core Income strategy, with a further 0.10% gain on the Option Strategy.

High coupon receipts combined with a narrowing of credit spreads were the main drivers of returns. Duration positioning was kept low, dampening volatility and preserving capital.

The Option Strategy gained from both the Put Write and Protection sleeves through the month, as implied volatility was marked higher.

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 $27.1 million

Distribution Frequency
Quarterly

Minimum Initial Investment
$50,000

Trust Inception Date
June 2021

Fees
0.6% p.a.

APIR Code
WPC3204AU

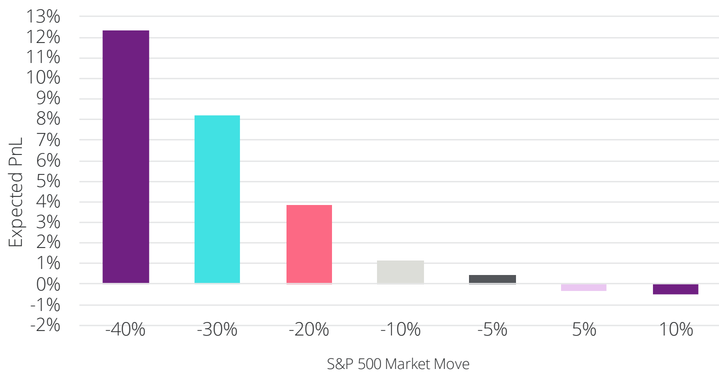
Expense Recovery
Capped at 0.1% p.a.

Portfolio Characteristics	
Modified Duration (Yrs)	-0.01
Spread Duration (Yrs)	2.40
Portfolio Yield (%)	6.74
Average Credit Quality	A

Source: Perennial Value Management. As at 31 October 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

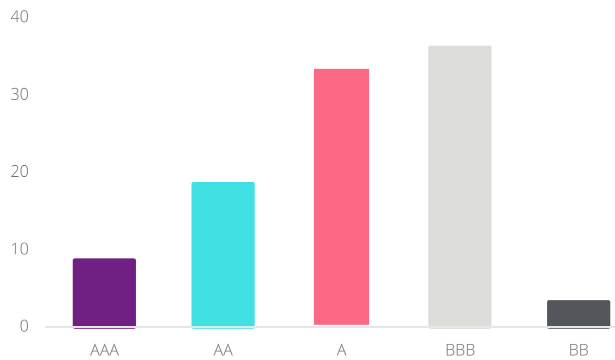


The chart provides the total expected portfolio PnL given a high velocity move in the S&P500.

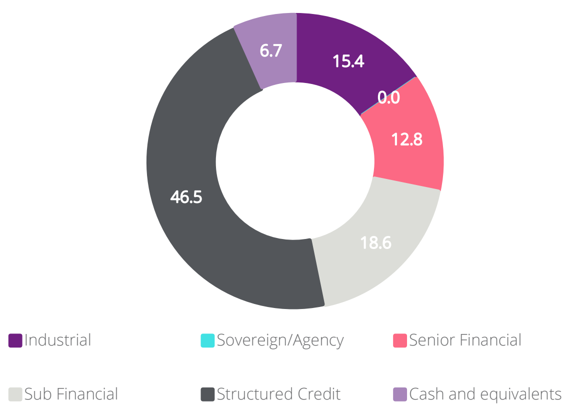
Source: Perennial Value Management. As at 31 October 2023.

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 and limited performance impact. Overlay and hedges were neutral contributors for the month.

Credit markets remained resilient amidst rising geopolitical tensions. Based on recent spread performance, credit investors remain more focused on solid corporate fundamentals and a supportive technical backdrop as year-end approaches.

Yield curves continued to steepen, driven by the re-establishment of term premium as the size and scale of the funding challenges facing most governments becomes a focus point for markets.

The Option Strategy managed to produce a gain on both the Put Write and Protection strategies – the former as equities were only down modestly for the month, and the latter as implied volatility was marked up, and the Option Strategy is overall “long volatility”.

At the end of the month the overall defensiveness of the trust was as high as it has ever been. Put Write notional has been kept low, in keeping with the view that interest rate risk is not being fully priced by equities, though the velocity of the change in rates appears to have shifted.

Trust Activity

The Fund was very active in purchasing new issuance, identifying opportunities from banks, other financials, infrastructure, and a range of securitised assets.

Protection was topped up this month and last, to bring total spending into line with an increased FUM size for the trust. Trailing 12-month alpha to cash is now around levels where we will likely start increasing protection spending, up to double normal levels, in line with the “spending ratchet” that increases protection when there are excess gains in the strategy.

Outlook

Events in the Middle East captured the world’s attention on 7 October, adding a new dimension of risk to global growth and inflation narratives. However, by the end of the month, expectations of further interest rate increases had subsided (except in Australia where the data has driven an increase in November) and financial conditions had eased (driven by rising risk asset valuations).

Risks to the already fragile growth outlook from conflict between Israel and Hamas include disruption to energy markets, given that so much global supply emanates from the region. This risk will become more meaningful if hostilities spill over into a wider regional conflict. Iran, and its proxies in Lebanon, Syria and Yemen have voiced their support for the Palestinians but have refrained from major physical engagements to date. Given oil futures closed the month lower, energy traders do not share our level of concern for potential supply disruptions.

Geopolitics notwithstanding, inflation concerns continue to abate, leading traders to dust off their predictions on the timing of interest rate cuts. There are two scenarios that could lead to a central bank pivot. The first would be in response to growing and widespread conflict across multiple regions as a response to expected trade and economic shocks. The second scenario would see growth materially slow, employment conditions soften, widespread corporate defaults and/or corporate profitability severely weakening. Given the resilience of the global economy over 2023, we see both scenarios as quite unlikely, and thus hold fast to our view that interest rates are most likely to remain at our around current levels for the time being.

While not capturing the headlines, we believe developments in Japan warrant consideration. In response to the first credible signs of inflation in close to 40 years, the Bank of Japan made further (modest) tweaks to their Yield Curve Control (YCC) programme, allowing the yield on the 10-year government bond to trade more freely within a defined range. While we know the goal of the BoJ is to eventually extricate themselves from YCC altogether, the sheer value of assets at stake means that the transition will occur gradually. Exporters are taking advantage of a depreciating yen in the short term, but the greater risk is higher local bond yields attracting capital back to Japan, with implications for bond markets globally. An unwinding of the yen carry trade becomes more likely with each month that inflation persists above target and would be influential on interest rates across developed markets.

Credit spreads were resilient in October against an uncertain backdrop. Credit markets seem to be looking through the geopolitical tensions and short-term market noise and focusing on strong corporate fundamentals. Indeed, primary issuance markets have been lively for several months, with October seeing the strongest activity so far this year. We cannot rule out further spread widening as the current economic cycle matures, but we are confident that the investment grade segment of the market is well placed to navigate near-term challenges. 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.

Contact us

Level 27, 88 Phillip Street
Sydney NSW 2000

1300 730 032

invest@perennial.net.au

www.perennial.net.au