

Perpetual Investment Funds

PERPETUAL ESG REAL RETURN FUND

28 February 2025



FUND FACTS

Investment objective: Aims to target a pre-tax return of 5% per annum above inflation (before fees and taxes) over rolling five-year periods, while minimising downside risk over rolling two-year periods.

Inception date: May 2021
Size of fund: \$38.1 million as at 31 December 2024
APIR: PER0761AU
Management Fee: 0.85% pa ^{^^}Refer to PDS for Management Costs
Investment style: Diversified risk budgeting, active, value, ESG
Suggested minimum investment period: Five years or longer

FUND BENEFITS

True alignment to investors real return objectives; Diversification of risk; Active management of the Asset Allocation; Access to an increased amount of investment opportunities; ESG integration through Perpetual and Trillium Funds.

FUND RISKS

All investments carry risk and different strategies may carry different levels of risk. The relevant product disclosure statement or offer document for a fund should be considered before deciding whether to acquire or hold units in that fund. Your financial adviser can assist you in determining whether a fund is suited to your financial needs.

TOTAL RETURNS % AS AT 28 FEBRUARY 2025

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA	VOLATILITY [^]	3 YRS PA	INCEPT PA
Perpetual ESG Real Return Fund (Gross)	0.89	1.58	2.57	5.98	2.53	-	2.24	Perpetual ESG Real Return Fund	-	-
Perpetual ESG Real Return Fund (Net)	0.83	1.37	2.14	5.09	1.66	-	1.37	Mercer Balanced Growth Median	8.55	7.94

Past performance is not indicative of future performance. ^{^^} Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS. Volatility and Mercer Balanced Growth Median data is lagged by 1 month

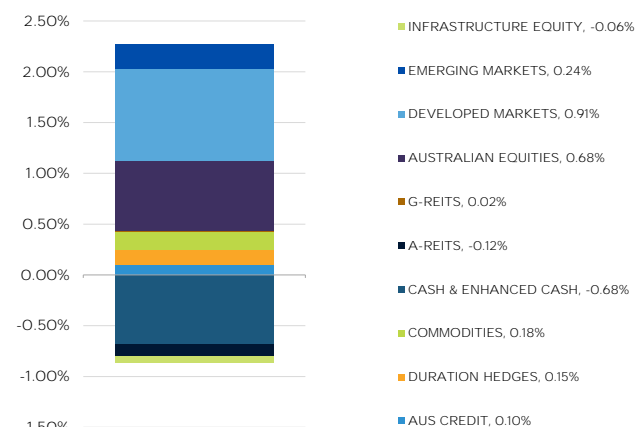
CHANGES IN ASSET ALLOCATION (%)

	CURRENT	3 MTHS	6 MTHS	1 YR
Cash	39.3%	-0.5%	-0.4%	13.6%
Fixed Income & Credit	39.4%	1.5%	1.8%	-10.2%
Australian Equities	2.3%	0.6%	0.2%	-3.9%
International Equities	9.3%	-1.4%	-0.8%	-4.3%
Commodities	3.2%	0.5%	0.3%	0.6%
Property	2.1%	-0.3%	-0.3%	-0.3%
Other Investments	4.4%	-0.4%	-0.8%	4.4%

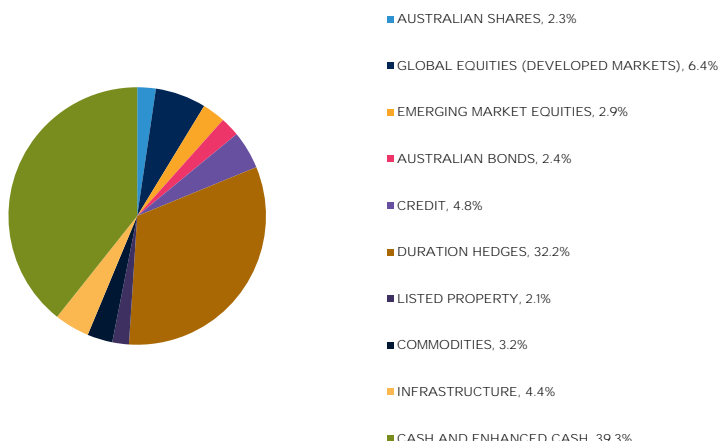
ESG APPROACH

As a real return fund, the Fund applies a dynamic asset allocation approach, which is designed to allow the portfolio manager the greatest flexibility to achieve the fund's objective. **There is no universal, consistent approach to ESG across every asset class in the Fund due to practical and fundamental issues of investing in each asset class. The Fund's approach to ESG screening will vary across asset classes and by investment strategy within each asset class where applicable.** Please refer to the Perpetual Investment Funds PDS for further information.

3MTH CONTRIBUTION TO RETURN (GROSS)



PORTFOLIO SECTORS



FUND PERFORMANCE

The ESG Real Return Fund returned 0.8% (net) in February. Over the past 12 months, the Fund has returned 5.1% (net).

The Fund's defensive positioning, low exposure to equity beta and bias towards quality and value were rewarded with the Fund generating positive performance during a month where domestic and developed market equities declined.

Australian equity stock selection was the most substantial contributor to performance with manager alpha from the Perpetual Australian Share Fund and Strategic Capital Fund more than offsetting the impact of the broader decline in Australian Equities. Developed market equity stock selection was also constructive. **The Fund's deep value strategy outperformed, contributing strongly to returns.**

Fixed income exposures were also constructive with the Fund's allocation to 2-year US government bonds performing well as US yields declined reflecting growth concerns.

In contrast, stock selection alpha within emerging markets was fractionally negative, reflecting the fund's underweight allocation to Chinese equities. Strong performance of Chinese equities also impacted the contribution of the emerging market ESG premia which detracted. Our exposure to a diversified basket of metals and soft commodities also detracted marginally from performance, as did the allocation to domestic REITs (-6.2%) which was among the worst performing ASX sectors.

MARKET COMMENTARY

In February, global markets softened, driven by concerns over a mix of weakening US economic data, stubborn inflation and growing unease about U.S. trade and immigration policies which fuelled elevated market volatility. Importantly, a number of market trends that have been prevalent over the past 24 months including US exceptionalism and the outperformance of growth over value were challenged.

- In the US, the S&P 500 (-1.3%) reached a record high before declining over the second half of the month, weighing on the broader developed market (-0.9%). The rotation towards value intensified with the Russell 1000 Value (+0.4%) in positive territory while its growth variant (-3.6%) declined sharply underpinned by concerns about softer-than-expected US tech earnings growth and broader economic growth, in addition to stickier inflation - factors we anticipate will persist as the dynamics around US trade policy, and potential retaliation, are revealed.
- European shares (+3.5%) advanced in February in response to sign of growth momentum picking up after an 18 month stall. In addition, the impact of geopolitical uncertainty was evident in sub-sector performance with defence stocks rising strongly on expectations that European governments will have to lift military spending.
- UK Equities rose over the month with returns concentrated among large cap stocks (FTSE 100 +3.0%). Sterling strengthened during a month where the UK avoided US trade tariffs however the fiscal outlook continues to weigh on markets, exacerbated by PM Starmer's announcement of increased defence spending.
- Australian Equities (-3.8%) fell led by losses in cyclical sectors, most notably technology (-12.3%). Large cap stocks fell initially on mixed reporting season results and declines accelerated in the last half of the month in sympathy with the US market selloff.
- Emerging markets outperformed, led by China (+11.6%) which advanced on the back of positive momentum in the technology sector, increased fiscal stimulus and the weakening US dollar.
- Global bonds rallied led by US 10 year which declined -35bps as investors shook off a higher-than-expected February inflation print and instead on softening economic data – both hard data and surveys. Australian 10-year yields also rallied (-13bps) reflecting both falling US yields and the commencement of the RBA's monetary easing cycle which we suspect will have little follow-through in the near-term.
- Gold (+0.8%) rose reflecting continued demand for safe haven assets in an increasingly challenging geopolitical and international trade environment.

2025 thus far has been characterised by the reversion of recent outperformance of growth stocks over value. The US tech sector has moderated following the reveal of DeepSeek in January and this impact was compounded by softening tech earnings growth in the US reporting season and uncertainty around the outlook for growth and inflation. For some time we have warned about the risks associated with the increasingly concentrated equity returns exacerbated by the rise of passive investing. Regarding the Magnificent 7, there has been deteriorating performance for their legacy businesses at the same time we see reason to doubt that capital expenditure will result in a corresponding boost in their respective return on investment over medium term. We expect that 2025 will see large cap US tech earnings measured against two years of extremely fast growth and high profit levels, whereas the rest of the market will experience more favourable comparisons to two years of profit recession. Stretched valuations, elevated market concentration and the preponderance of passive investment all continue to contribute to elevated sensitivity of equity markets.

Key to the recent volatility in equity markets has been the uncertainty around US trade policy. The announcement and subsequent pausing of punitive tariffs against key trading partners sparked a rise in uncertainty and drove negative equity returns in the second half of February. The impact is observable in consumer confidence and inflation expectation survey data which have worsened since the Trump inauguration. Meanwhile, weakening PMIs and softer housing data also contributed to concerns that US growth is decelerating and which sparked declines in both bond yields and equity prices. Our primary concern remains the unsustainable fiscal deficit, which stands at 6.4% of GDP will persist as temporary tax cuts from 2017 becoming permanent (although this can be changed by subsequent Congresses) which combined with lower corporate taxes, raises concerns about the long-term trajectory of fiscal policy and its potential impact on bond market term premia and equity valuations.

In Europe, the focus of the month was squarely on geopolitics. The prospect of increased fiscal spending firmed following the results of the German election and the need for increased defence spending. European growth indicators remained finely balanced with the composite PMI (50.2) remaining in very marginal expansionary territory but overall we suspect that the European economic growth should improve in 2025, in contrast to the US

Meanwhile, the domestic monetary easing cycle commenced with the RBA lowering the cash rate by 25 basis points to 4.10% in February. The RBA's next move will be data dependent with the Governor noting that the market is too confident in pricing further rate cuts in the near-term. The strength in the labour market continued in January, with employment growing by a better than expected 44,000 jobs. **We are cognisant of Australia's persistently declining GDP per capita and that the economy has only remained in expansion territory due to large population growth and a large fiscal expansion which is adding to price pressures. Australia's economy is projected to grow at a faster pace in 2025, driven by large increases in state and federal government spending, tax cuts and lower interest rates.**

The macroeconomic outlook and the uncertain path of inflation and monetary policy given changes to US trade policy represent a difficult environment for investors to negotiate. This challenge is exacerbated by sustained elevated valuations in both the US and Australia. As always, our focus remains on identifying investments that can generate returns of CPI plus 5% per annum over a five-year horizon while maintaining an asset allocation that ensures that no individual position or cluster of positions will risk the medium-term investment objective.

CURRENT POSITIONING

The portfolio is positioned for the three potential outcomes for markets in 2025.

1. **A broadening out of economic growth supporting “value” and/or rotation away from Magnificent 7.** This scenario is supported by Trump’s de-regulation, robust employment, lower taxes and domestic manufacturing strategies. We have observed EPS growth catching up to the Magnificent 7 and the Fund’s value and quality biases – which have been unrewarded in recent periods – would contribute strongly in this scenario.
2. **A market selloff led by US tech.** The Fund’s low exposure to US equity beta, in addition to its quality bias within equities, and explicit downside protection and convexity positions would perform well in this scenario. The uncertainty surrounding Trump’s trade policy has increased the likelihood of this scenario, observable in negative equity returns through early March.
3. **A continuation of Mag 7 centric valuation expansion.** Whilst we expect to deliver positive returns under this scenario, the portfolio’s low equity beta and focus on value and quality would be expected to underperform the broader market.

The underperformance of US equities and crucially, large cap tech names reinforced the risks of momentum-based passive strategies in an increasingly concentrated market and the importance of diversity in regional and sector allocations within the return seeking quadrant. The Fund retains exposure to value and deep value global equities, UK equities (which continue to offer solid dividend income and buybacks as well as potential for some valuation re-rating) alongside allocation to Australian value and strategic capital strategies.

We continue to manage downside risks by maintaining little or no exposure to the most expensive parts of equity and credit markets and complementing this with sizable option protection where it has been attractively priced to implement. These include put options on the S&P 500 and a put spread on the FTSE 100, call options on the GBP against the US dollar, USD versus the Hong Kong Dollar and the Chinese Yuan (which are low-cost downside protection for tail risks around China) and a put option on the USD against the Japanese Yen.

The Fund’s defensive posture is supplemented by fixed income exposures which are centred on the short end of the US yield curve reflecting its high running yield and its higher sensitivity to further easing of official interest rates by the US Fed.

In addition, the Fund’s cautious asset allocation is supported by a notable cash allocation, which provides solid income and significant optionality in the event of a market selloff.

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MORE INFORMATION

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