

# Perpetual Investment Funds

## PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS W

### 31 October 2024



#### 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:** October 2010  
**Size of fund:** \$633.0 million as at 30 September 2024  
**APIR:** PER0556AU  
**Management Fee:** 0.85% pa <sup>^^</sup>Refer to PDS for Management Costs  
**Investment style:** Diversified risk budgeting, active, value  
**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

#### 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.

#### FEE OPTION

Class W is the standard fixed fee class

#### TOTAL RETURNS % AS AT 31 OCTOBER 2024

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA	VOLATILITY <sup>^</sup>	3 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	-0.32	0.59	2.89	6.25	3.67	4.84	6.34	Perpetual Diversified Real Return Fund	2.66	3.21
Perpetual Diversified Real Return Fund (Net)	-0.39	0.38	2.46	5.36	2.79	3.96	5.44	Mercer Balanced Growth Median	8.46	7.73

#### FUND OBJECTIVE OUTCOME AS AT 31 OCTOBER 2024

**Objective: Gross returns of CPI plus 5% over rolling 5 year periods**

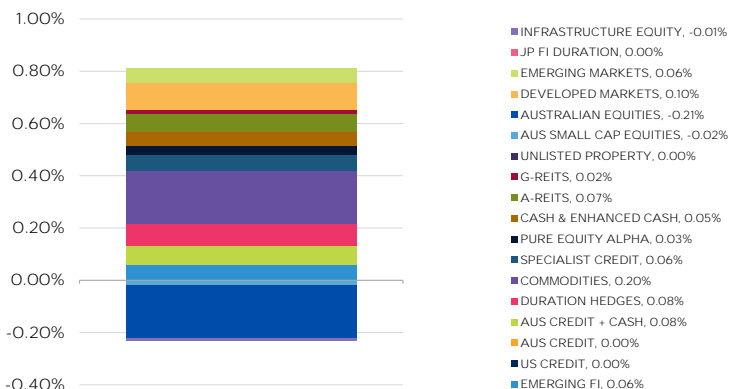
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	4.8	6.3
CPI plus 5%	9.1	7.9

Past performance is not indicative of future performance.

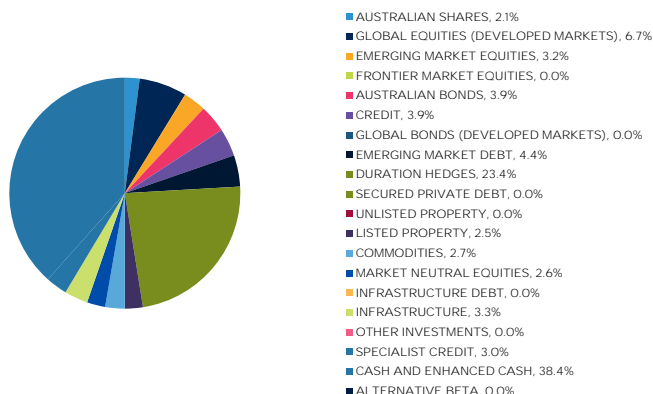
<sup>^^</sup> Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS

<sup>^</sup> Volatility and Mercer Balanced Growth Median data is lagged by 1 month

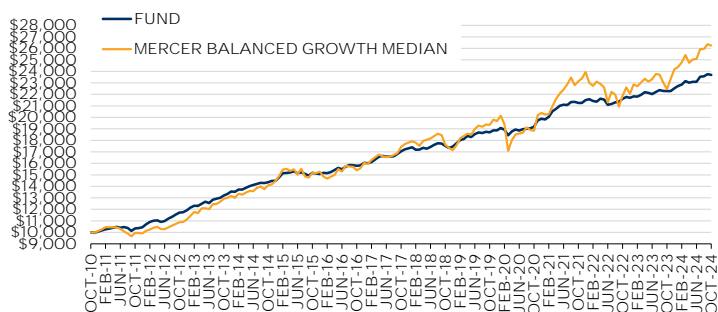
#### CONTRIBUTION TO 3MTH PERFORMANCE (GROSS)



#### PORTFOLIO SECTORS



#### GROWTH OF \$10,000 SINCE INCEPTION



#### CHANGES IN ASSET ALLOCATION (%)

	3 MTHS	6 MTHS	1 YR
Australian Shares	-0.1	-3.9	-3.0
Global Equities (Developed Markets)	2.4	-0.5	2.1
Emerging Market Equities	0.3	-0.1	0.2
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	-0.2	0.0	-2.4
Credit	0.4	0.5	0.9
Global Bonds (Developed Markets)	0.0	0.0	0.0
Emerging Market Debt	0.3	0.6	0.9
Duration Hedges	-16.7	-14.1	7.8
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	0.0	0.0	0.0
Listed Property	0.0	0.2	0.5
Commodities	0.3	0.1	-0.4
Market Neutral Equities	0.2	0.3	0.6
Infrastructure Debt	0.0	0.0	0.0
Infrastructure	0.2	3.3	3.3
Other Investments	0.0	0.0	0.0
Specialist Credit	0.3	0.4	0.7
Cash and Enhanced Cash	12.7	13.1	-11.4
Alternative Beta	0.0	0.0	0.0

## FUND PERFORMANCE

The Diversified Real Return Fund returned -0.3% (gross) in October. Over the past year, the Fund has returned 6.3% (gross) and over the past 5 years the Fund has returned 4.8% (gross) per annum compared with the objective of 9.1% (CPI plus 5%\*) over rolling 5 years. Since inception (in 2010) the Fund has returned 6.3% (gross) per annum compared with the objective of 7.9% (CPI plus 5%\*).

The Fund's defensive positioning and elevated cash position mitigated the impact of capital losses in both bonds and equities during October. US and Emerging Market currency exposure performed well as US bond yields climbed 50bps. A call spread on the Japanese Nikkei 225 also contributed to returns as that index was one of the few markets where returns were positive, as it continued its recovery from the early August selloff. In addition, the fund's allocation to gold and other precious metals contributed positively to performance.

Meanwhile, the Fund's allocation to 2-year US government bonds detracted from performance as yields climbed 52bps on the back of waning rate cut expectations amid strong economic activity and resilient core inflation.

Similarly, the fund's allocation to Australian and non-Japan global equities detracted during the month as investors increasingly worried about extended valuations as bond yields rose. It was another tough month for manager alpha as value continued its underperformance.

\*All groups CPI measured and published by the ABS as at 30 September 2024

## MARKET COMMENTARY

October was a challenging month for equity and fixed-income markets, as the US presidential election became a primary market focus, and a series of stronger-than-expected US economic data raised concerns about the trajectory of both inflation and the amount of rate cuts priced in:

- European equities (-3.3%) led the pace of losses in regional developed markets as concerns grew intensified around the state of the world's largest trading bloc as a round of weak activity data and rising concerns around upcoming elections in Germany weighed on sentiment. France (-3.7%) was the regional laggard as sustained weakness in the service sector weighed on sentiment, and while the UK (-1.5%) and Germany (-1.3%) performed slightly better, the economic outlook for the latter is far from upbeat.
- US equities (-0.9%), posted their first negative month since April in response to moderating expectations of monetary policy easing as a series of strong economic data for the labour market, consumer spending and general business activity saw investors reduce expectations for another large rate reduction at the upcoming November FOMC meeting and also sparked a wind-in of expectations for the size of the current easing cycle.
- Australian equities (-1.3%) fell from their recent intra-month high domestic bond yields rose in response to global trends. In addition, the rising prospect of a second Trump presidency and the potential ramifications for Chinese commodity demand from his proposed tariffs weighed on domestic stocks at a time when the RBA had already ruled out rate reductions until 2025.
- In contrast, Japan (+1.9%) was a lone positive performer among major developed markets as a large -7.2% depreciation of the Yen boosted demand for Japan's export-oriented market which continued to recover from its August rout.
- In the bond markets, government yields surged globally led by the U.S. and Australia which rose +0.50% to 4.28% and +0.53% to 4.51%, respectively – both of which were among the largest 10 individual month of losses this decade for both bond markets. The losses simply reflected a re-pricing of central bank expectations amid signs that both that hiring growth and core inflation remained too elevated to warrant a deep cutting cycle which, again, highlighted bonds waning ability to diversify equity risk during inflationary times.
- While US credit weakened as bond yields rose, with investment grade and high yield spread widening, domestic credit was resilient with credit and swap spreads extending their rally.

The global macroeconomic outlook is mixed. While US economic data has firmed market expectations of a soft landing underpinned by strong and resilient employment data robust (but increasingly dominated by government), corporate earnings growth and a vibrant consumer. However, 12 month forward equity market valuations remain at 97th percentile relative to the past 20 years which is extreme, and suggests that the good news is mostly priced in. The increasing likelihood of a soft landing also provides optionality to the Fed to slow or pause monetary policy easing, particularly if inflation fails to progressively decline to 2% as detailed in the Fed's guidance. This would likely weigh on valuations.

Meanwhile, growing likelihood of a second Trump presidency impacted market sentiment during October. While both candidates' policy platforms were expected to culminate in another sizable rise in US government debt, Trump's planned tariffs on foreign imports have sparked fears of higher inflation, but we suspect this is likely to be modest, and should not impact growth too much, nor weigh on Fed policy debates. The U.S. budget deficit grew to \$1.8 trillion for the fiscal year ending 30 September as \$4.9 trillion of revenue was outweighed by 6.75 trillion of spending despite the economy being at full employment. The level of fiscal deficit relative to GDP (6.4%) is already at levels commensurate with recessions and the incoming administration is expected to contribute to the deficit via tax cuts and concessions. We remain cognisant of the unsustainable path of fiscal policy and its potential impact on bond markets, and its flow-on effect to equity market valuations.

Outside the US, the economic outlook is challenging in several regions. In Europe, concerns about growth have intensified, with incoming business survey data and European Central Bank (ECB) communications suggesting only a modest rebound is expected in FY25 after a very weak FY24. The European Central Bank (ECB) elected to cut rates by 25 basis points in October and president Lagarde attempted in her press conference to assuage fears that the region was heading towards recession. Meanwhile sentiment in the UK was mixed, with positive inflation data and a pro-growth UK Federal Budget offset by concerns around the global situation.

In Asia, China's economic outlook remains quite fraught. The People's Bank of China followed up September's policy announcements with more modest initiatives such as raising the debt ceiling rather than delivering support which could alleviate waning private sector activity. While recent economic data showed some modest improvement, the outlook for China continues to be challenged by the property sector overhang, sustained deflation, high debt and weak private sector confidence.

Meanwhile, the Australian economy has struggled in the wake of higher inflation and sustained elevated interest rates which have sparked six consecutive quarters of contracting GDP growth per capita. While labour market data remains robust – unemployment remained at 4.1% in the third quarter – and households received large tax cuts and government energy subsidies, spending remains sluggish as high inflation and higher for longer interest rates are sapping household confidence. The challenges here have been camouflaged by strong population growth and

another year of significant public sector spending growth at a time when the RBA is trying to slow economy-wide spending. While third quarter headline CPI continued to moderate and fell within the target band for the first time in 42 months, (+0.2%Q, +2.8%Y) the RBA's preferred measure of inflation, the trimmed mean, (+0.8%Q, +3.5%Y)–remained stubbornly outside the target range.

The challenging economic outlook for ex-US markets and the uncertain path of inflation and monetary policy provide a difficult environment for investors to negotiate, especially given sustained elevated valuations in both the US and Australia – with investors believing that the former's 12-month forward EPS growth can top +15%. 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

Elevated equity valuations are underpinned by expectations of a soft landing for the global economy and supportive central bank action on policy rates. With so much good news already priced in, we maintain some caution. We recently undertook a review of “return seeking” opportunities to help identify markets/regions/sectors which have a high probability of achieving CPI+5%p.a. over 5 years, resulting in a continue move away from market cap beta. During the month, the Fund's allocation to global deep value equities was increased by +5% as the stocks in this part of the global universe are trading on low valuations, have solid dividend yields, and good prospects for undertaking buy-backs.

Elsewhere, 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 equity put option protection when its cheap to implement. These include put options on the S&P 500 puts and a call option on the USD versus the Hong Kong Dollar (which is a low-cost downside protection for tail risks around China) and a put option on the USD against the Japanese Yen.

The Fund also maintains its exposure to 2-year US government bonds alongside modest exposure to Australian and emerging market fixed income and US 10-year government bonds. Our focus on the short end of the US yield curve reflects its high running yield and its higher sensitivity to further easing of official interest rates by the US Fed, and it benefits from lower sensitivity to any upside risk in US inflation.

In addition, the Fund's cautious asset allocation is supported by a notable cash allocation, which provides solid income and significant optionality as it enables us to quickly allocate capital to take advantage of mispricing in the event of a market selloff.

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## MORE INFORMATION

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