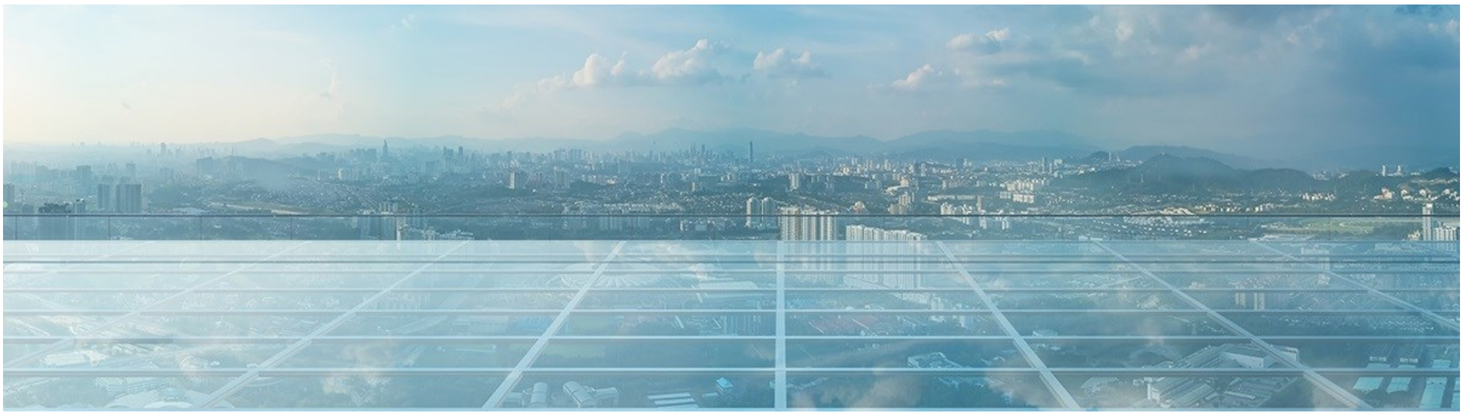
CREDIT MARKET REVIEW: GROWTH OUTLOOK CONSTRUCTIVE FOR SPREADS



PERPETUAL ASSET MANAGEMENT
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Financial markets continued to gain ground during May with developed market equities and global credit supported by continued strong economic activity. Slowing global COVID case numbers and the continued vaccine rollout also contributed. Inflation was a key focus for financial markets during the month. Domestically, core inflation and wage growth remain low in spite of the RBA's expansionary monetary policy settings and strong economic growth expectations. Fiscal policy also remains in an expansionary mode following a federal budget that included a higher level of stimulus than initially anticipated.

The domestic credit market was quiet in May with spreads remaining stable and primary issuance subdued. Aggregate spreads remained in range of recent averages across corporate and financial credit. Securitised sectors outperformed with further tightening consolidating recent gains.

Primary market issuance was subdued following two busy months. While there was a dearth of non-financial corporate issuance, year to date issuance remains in line with expected volumes. Domestic bank issuance activity was robust with NAB and Westpac coming to market with tier 2 deals priced in USD and EUR respectively. Most notably, Westpac issued US$2.75B of senior paper which represented the return of major bank senior issuance following a lengthy absence. The primary market for major bank senior paper has been impacted significantly by access to funding via the RBA's Term Funding Facility. The facility remains available until the end of June.

Global yields fell moderately during May remaining stable following the spikes observed in late February and March. Global yields proved resilient to increasing inflation concerns, staying in range of recent levels. Domestic yields were mixed, with the short end and ten year falling slightly while other tenors rose. The RBA maintained policy settings at their June meeting with a decision on the continuation and benchmark bond of their yield curve control policy expected in July.

Credit Outlook

Valuation indicators are neutral to the overall credit outlook. Investment grade credit spreads have tightened significantly over the last year with spreads below their pre-COVID levels on aggregate. Domestic spreads are broadly in line with offshore peers. The growth outlook remains very constructive for credit spreads. Growth expectations remain high as the recovery from the COVID pandemic continues. Leading activity indicators continue to support the credit outlook with a raft of global manufacturing PMIs in the high 50s and early 60s, signalling strong growth albeit from a reduced base. The ratio of credit upgrades to downgrades remains constructive with credit ratings supported by strong earnings recovery and economic growth.

Demand and supply indicators have continued to support the overall credit outlook. The subdued primary market over the last month combined with a reduced issuance pipeline are expected to be supportive for spreads. On the other side, market demand has cooled slightly and is no longer positively contributing to the credit outlook.

Technical indicators have improved, remaining strongly positive for the overall credit outlook. Reduced broker inventories and increasing demand from intermediaries have improved the technical score over the latter half of May. Tightening US credit spreads alongside robust equity valuations and volatility are all supportive for domestic credit. The sustained rally in credit spreads continues to be supported by positive leading and trailing macroeconomic indicators, supply and demand conditions and technical factors. The team remains well positioned to benefit from further spread contraction offered by the current conditions.

In a context of low interest rates and tight credit spreads, active portfolio management is essential to defending capital and generating yield. While performance has been unambiguously strong and the outlook is promising, the team maintains its selective approach to investing, seeking out attractive relative value opportunities from quality issuers. Perpetual's credit and fixed income strategies are either predominantly floating rate or heavily leveraged towards corporate credit and remain well positioned to perform through an environment of higher inflation and rising rates.