PERPETUAL ETHICAL SRI FUND (MANAGED FUND)

ASX code: GIVE

December 2021

FUND FACTS

Investment objective: Aims to provide long-term capital growth and regular income through investment predominantly in quality shares of Australian ethical and socially responsible companies. Aims to outperform the S&P/ASX 300 Accumulation Index (before fees and taxes) over rolling three-year periods.

FUND BENEFITS

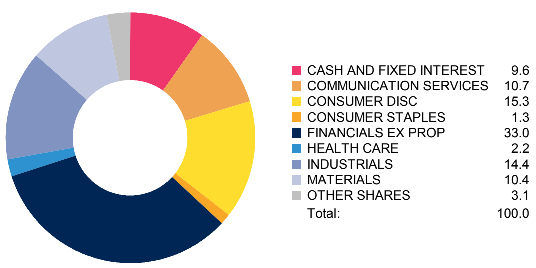
We seek to invest in quality companies that have satisfied our range of ethical and socially responsible investment criteria. Perpetual is also a signatory to the United Nations-supported Principles for Responsible Investing (PRI), and in relation to this fund, use research from external specialists to analyse socially responsible practices of companies listed on the Australian and overseas exchanges.

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.

Benchmark: S&P/ASX 300 Accum. Index
Inception date of strategy: April 2002
ASX commencement date: 29 November 2021
Distribution Frequency: Half-Yearly
Management Fee: 0.65%*
Performance Fee: 15 % of outperformance*
Investment style: Active, fundamental, bottom-up, value
Suggested minimum investment period: Five years or longer

PORTFOLIO SECTORS



TOP 10 STOCK HOLDINGS

	% of Portfolio
National Australia Bank Limited	7.2%
ANZ Banking Group Ltd.	6.5%
Orora Ltd.	5.2%
Insurance Australia Group Limited	5.2%
HT&E Ltd	4.0%
Ferguson Plc	3.6%
Brambles Limited	3.6%
Premier Investments Limited	3.5%
Medibank Private Ltd.	3.5%
AUB Group Limited	3.5%

*Information on management costs is set out in the relevant PDS

NET PERFORMANCE - periods ending 31 December 2021

	Fund	Benchmark	Excess
1 month	3.69	2.65	1.04
3 months	-	-	-
FYTD	-	-	-
1 year	-	-	-
2 year p.a.	-	-	-
3 year p.a.	-	-	-
Since incep.	3.50	2.93	+0.56

Past performance is not indicative of future performance. Returns may differ due to different tax treatments.

PORTFOLIO FUNDAMENTALS^

	Portfolio	Benchmark
Price / Earnings*	17.1	18.1
Dividend Yield*	4.1%	3.8%
Price / Book	2.0	2.2
Debt / Equity	33.9%	39.6%
Return on Equity*	12.0%	12.8%

^ Portfolio Fundamentals are compiled using our methodology and provided only for the purpose of illustrating the Fund's investment style in action. These figures are forecast estimates, calculated based on consensus broker estimates where available, and should not be relied upon. Dividend Yield is a dividend forecast of underlying securities for the portfolio and does not reflect the distributions to be determined for the fund.
* Forward looking 12-month estimate.

MARKET COMMENTARY

The Australian equity market ended the December quarter higher, assisted by value stocks, which dominated growth stocks, and by the "reopening" stocks, which outperformed as state governments relaxed restrictions after surpassing vaccination targets. Cyclical stocks performed well early in the quarter, while commodity producers extended gains, spurred by attention on the energy crunch as coal, gas, and crude oil prices scaled record highs.

The ASX returned part of its earlier gains midway through the quarter as underlying inflation climbed to its highest level in six years and pushed above the bottom end of the RBA's target range. The Reserve Bank, however, left policy settings unchanged and reiterated its caution for any interest rate rises until inflation is sustainably within its 2-3% target range and wages growth is materially higher than its current level. The ABS highlighted fuel and housing market strength as the key drivers against a backdrop of supply chain disruptions, translating into higher prices for consumer durables, and reinforcing the view that interest rates will rise sooner than previously guided. Market losses were further exacerbated as global risk sentiment fell amidst concerns from the impact of the Omicron variant.

By the end of the quarter, the market had shaken off its pandemic-related apprehension following the government's narrative of pivoting towards a 'living-with-Covid' strategy. This was reinforced as isolation requirements were eased despite mask mandates and density quotients being reinstated. Investor risk appetite further rebounded after studies confirmed initial suggestions that Omicron symptoms were less severe and led to lower hospitalisation rates despite its increased transmissibility when compared to previous variants. Market sentiment was further supported by strengthening employment figures, showing a record bounce in jobs growth after recovering from the dip created by the recent lockdowns. The recovery more than absorbed a higher participation rate which translated into a sharp drop in the unemployment rate and assisted the market in its solid finish to the quarter.

PORTFOLIO COMMENTARY

A feature of this Fund is that it invests in a screened universe enforced by strict ethical and socially responsible (SRI) investment criteria. The Fund’s largest overweight positions include Orora Ltd, Insurance Australia Group Ltd, and HT&E Ltd. Conversely, the Fund’s largest underweight positions include CSL Ltd. (not held), BHP Group Ltd. (not held), and Commonwealth Bank of Australia.

The overweight position in furniture retailer Nick Scali (+38.2%) contributed to relative performance. The stock rallied after announcing it had entered into a binding agreement to acquire specialist Australian sofa retailer Plush Think-Sofas for a total cash consideration of $103 million. The acquisition will be funded through a combination of cash on hand and new debt facilities and is expected to be completed in the fourth quarter of 2021. However, it still remains subject to closing conditions. Management noted the deal is expected to be earnings per share accretive in the first full year of ownership, excluding the realisation of estimated synergies, which will flow post-integration.
The overweight position in Australia and New Zealand media and online publishing company HT&E (+28.0%) contributed to relative performance. The stock rallied sharply after announcing that it had settled an ongoing taxation dispute with the ATO relating to a New Zealand branch of the company between the period from December 2009 to December 2016. The stock was further supported during the quarter after reporting that it has completed the partial divestment of its 7.26% equity interest in Lux Group.
Not holding Westpac Bank (-15.7%) contributed to relative performance. The stock declined on the back of broker downgrades from the likes of Goldman Sachs, Morgan Stanley, and Credit Suisse. The downgrades were triggered by the Bank’s net interest margin outlook. Westpac commented that loan growth is expected to be sound as the economy rebounds, although net interest margins will remain under pressure due to the low-interest-rate environment and from competition.

The overweight position in insurance provider Insurance Australia Group Ltd (-13.4%) detracted from relative performance. The stock fell after the company increased its FY2022 net natural perils claim costs expectation due to adverse weather events impacting South Australia and Victoria between 27 and 29 October and in South East Queensland on 30 October, leading to a reduction in its FY2022 reported insurance margin guidance. The stock price was also impacted as Morgan Stanley and UBS both downgraded their target price for the stock. The brokers cited margin headwinds and a rising cost of capital as well as concerns of civil proceedings launched by the ACCC due to overcharging allegations.
The overweight position in salary packaging and fleet management services provider Smartgroup Corporation (-18.4%) detracted from relative performance after TPG Global and Potentia Capital withdrew their non-binding, indicative and conditional proposal to acquire the company at an offer price of $10.35 per share. As a result, discussions with the consortium have ceased, and their exclusivity provisions have been terminated. The consortium has expressed their interest in a revised cash proposal of $9.25 per share, however, Smartgroup's Board has unanimously concluded not to proceed with discussions at this price.

OUTLOOK

The rotation to economic recovery that favours value stocks remains firmly on track. Looking beyond shorter-term disruptions, it is clear that economic momentum, both home and abroad, remains strong. Admittedly, business and consumer confidence have fallen off recent highs, but the Australian recovery remains one of the most advanced in the world.

Companies we talk to are less concerned by shorter-term lockdowns and focused heavily on longer-term challenges, including the potential for higher embedded inflation. This, however, bodes well for value stocks, especially those in the resources sector. Many value stocks are only just rising above previous 2007 peaks, while some growth stocks continue to trade at valuation-multiples many times higher than their levels of just a few years ago. We think a combination of all the factors described above suggests a return to sustained global recovery, with higher inflation, higher bond yields, but also a longer and more sustained swing to value. Our focus will remain on screening out balance-sheet, management, earnings, and business risks to ensure our clients are invested in high-quality businesses at reasonable prices.

MORE INFORMATION

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