PERPETUAL ESG AUSTRALIAN SHARE FUND (MANAGED FUND)

ASX code: GIVE

February 2023

FUND FACTS

Investment objective: Aims to provide long-term capital growth and regular income through investment predominantly in quality Australian shares that meet Perpetual's ESG and values-based criteria. 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 represent the best investment quality, are appropriately priced and meet Perpetual's ESG and values-based 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
Insurance Australia Group Ltd	7.2%
National Australia Bank Limited	5.6%
Brambles Limited	5.6%
Medibank Private Ltd.	4.6%
Telstra Group Limited	4.3%
Bapcor Ltd	4.2%
Orora Ltd.	4.1%
ANZ Banking Group Ltd.	3.9%
Helia Group Limited	3.8%
Healius Limited	3.7%

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

NET PERFORMANCE - periods ending 28 February 2023

	Fund	Benchmark	Excess
1 month	0.34	-2.55	2.88
3 months	3.38	0.17	3.21
FYTD	14.04	13.54	+0.50
1 year	4.09	6.54	-2.46
2 year p.a.	-	-	-
3 year p.a.	-	-	-
Since incep.	2.92	3.77	-0.86

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

PORTFOLIO FUNDAMENTALS^

	Portfolio	Benchmark
Price / Earnings*	14.8	14.6
Dividend Yield*	4.7%	4.5%
Price / Book	1.8	2.0
Debt / Equity	34.2%	32.6%
Return on Equity*	12.6%	13.9%

^ 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 portfolic and does not reflect the distributions to be determined for the fund.
* Forward looking 12-month estimate.

MARKET COMMENTARY

The Australian equity market ended February lower, remaining on the back foot throughout the month as early-year optimism gave way to concerns of a more drawn-out interest rate tightening cycle stemming from a loss of traction behind the disinflation narrative. A mixed set of first-half corporate earnings contributed to the ASX's weakness. Sector performance was varied, with Utilities the strongest performer, while Materials recorded the largest decline.

RBA Governor Philip Lowe reiterated that further rate hikes are to be expected but noted that the extent of the tightening will depend on global economic developments, the evolution of household spending, and the outlook for the labour market and inflation. The prospect of a longer tightening cycle was seen as increasing the risk of a bumpier landing for the Australian economy. Markets are now factoring in at least three more RBA rate increases, further stoking the recessionary narrative. Westpac revised its terminal cash rate forecast upwards, noting that a 4.1% cash rate would be deeply contractionary and lead to economic stagnation in the second half of 2023.

PORTFOLIO COMMENTARY

A feature of this Fund is that it applies Perpetual's ESG process and values-based investment criteria. The Fund's largest overweight positions include Insurance Australia Group Ltd, Medibank Private Ltd, and Brambles Ltd. Conversely, the Fund's largest underweight positions include CSL Ltd, BHP Group Ltd (not held), and Commonwealth Bank of Australia.

The overweight position in lenders mortgage insurance business Helia (previously Genworth Mortgage Insurance) (+23.2%) contributed to relative performance. The company delivered a strong result during February on the back of favourable claims outcomes. New delinquencies are still very favourable, but this will ultimately deteriorate despite banks being proactive on stressed loans. Nevertheless, the company's capital position remained strong, and we believe the firm has applied an element of conservatism to provisioning, which already allowed for a higher frequency of delinquencies.
Not holding iron ore miner BHP Group (-8.5%) contributed to relative performance. The miner disappointed investors after reporting a 16% year-on-year decline in revenue to US$25,713M for the six months ended 31 December, reflecting lower average realised prices for iron ore, copper, and hard coking coal. However, this was partially offset by higher prices for weak coking coal, thermal coal, and nickel. In addition, management noted that significant wet weather impacted coal production and unit costs, as did challenges in securing sufficient labour, resulting in a 28% decline in underlying EBITDA from H1 FY2022.
The overweight position in supply chain services provider Brambles (+7.3%) contributed to relative performance. Brambles reported H1 underlying NPAT (from continuing operations) of $334.5M (vs consensus $321.9M), and an underlying profit of $548.8M (vs consensus $511.4M). Management guided full-year sales revenue (to June 2023) of 12% to 14% year-on-year (at constant currency) and an underlying profit guidance of 15% to 18% year-on-year at constant currency. Free cash flow after dividends is expected to improve in FY22 but remain a net outflow with a dividend payout ratio of 45-60% of underlying profit after finance costs and tax.

The overweight position in household consumer products distributor GWA Group Limited (-16.3%) detracted from relative performance. The firm reported a first-half normalised NPAT of $21.3M (down 5% year-on-year). Management noted that demand in its Commercial new build and renovation segment is expected to continue, with its Commercial forward order book remaining strong (up 6.5%) in Australia since June 2022. This is expected to drive its strategic agenda in the second half of FY2023 with a focus on profitable volume growth targeting new markets and customers, as well as continued focus on cost management.
The overweight position in healthcare technology solutions provider Healius (-14.3%) detracted from relative performance. The stock fell short of expectations after reporting a first-half revenue of $864.1M (vs preliminary report $889.3M), underlying EBIT of $40M (vs $373.1M from a year ago), and underlying NPAT of $8.1M (vs year-ago $244M). However, management noted that in late January/early February daily revenues began returning to pre-Christmas levels and expects BAU trading in second-half 2023 to be materially stronger than first-half 2023 as the recovery in BAU testing continues.

OUTLOOK

Economic conditions will continue to evolve, and uncertainty will continue to manifest in markets. The central banks' aggressive attempt to rein in inflation expectations will cause unintended consequences in both economies and the markets. Because central banks have no influence on the supply of goods and materials, they also cannot influence the willingness of companies to invest in expanding supply in response to higher prices. This hesitancy is mostly due to companies seeing this as a significant pull forward of demand from fiscal and monetary largesse. We see the only influence central banks can have is on demand, and to achieve a reduction in demand, we will see a tightening in liquidity and financial conditions. This will force many companies to face up to this new reality with many early phase/profitless companies not surviving.

We have long believed that markets are poised for further rotation to a more value-oriented investment environment as COVID-19 disruptions, waning stimulus, and war combine to keep consumer price inflation at high levels. However, we must also be willing to pivot the portfolio when the markets are pricing in overly aggressive rate expectations. With fear of a deep and long recession, this will be factored into markets, providing opportunities to redeploy capital. In these conditions, our focus on value-style investing and buying quality companies with strong balance sheets trading at reasonable valuations should continue to do well and offer attractive opportunities for investors.

MORE INFORMATION

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