Perpetual Investment Funds

PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS W

30 June 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:	$734.4 million as at 31 March 2024
APIR:	PER0556AU
Management Fee:	0.85% pa ^^Refer to PDS for Management Costs
Investment style:	Diversified risk budgeting, active, value

Suggested minimum investment period: Five years or longer

FUND BENEFITS

Provides investors with access to a broadly diversified portfolio that weights asset classes according to their overall risk contribution to the total portfolio rather than capital allocations.

Provides a more efficient portfolio that seeks to reduce the uncertainty of investment outcomes and protect returns against inflation.

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 30 JUNE 2024

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	-0.06	-0.28	2.51	4.86	3.04	4.48	6.31
Perpetual Diversified Real Return Fund (Net)	-0.13	-0.49	2.07	3.98	2.17	3.60	5.41

VOLATILITY^	3 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund	2.53	3.22
Mercer Balanced Growth Median	8.46	7.81

FUND OBJECTIVE OUTCOME AS AT 30 JUNE 2024

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

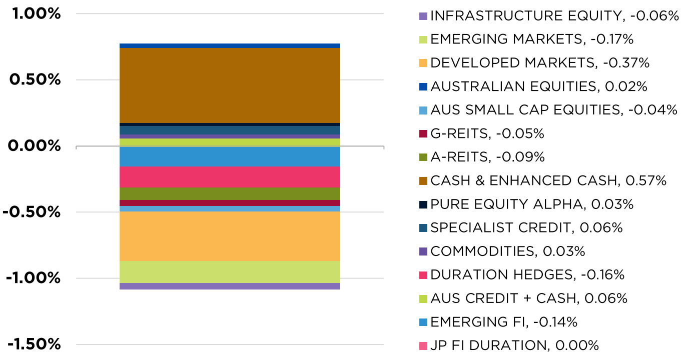
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	4.5	6.3
CPI plus 5%	8.9	7.8

Past performance is not indicative of future performance.

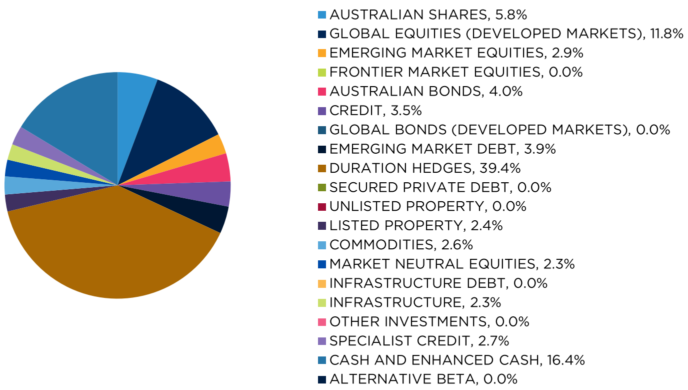
^^ Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS

^ Volatility and Mercer Balanced Growth Median data is lagged by 1 month

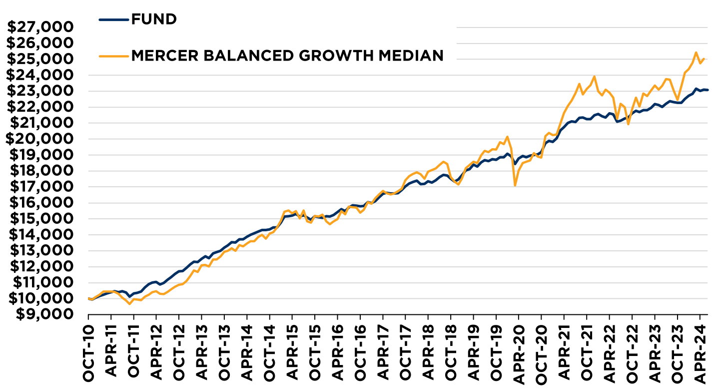
CONTRIBUTION TO 3MTH PERFORMANCE (GROSS)



PORTFOLIO SECTORS



GROWTH OF $10.000 SINCE INCEPTION



CHANGES IN ASSET ALLOCATION (%)

	3 MTHS	6 MTHS	1 YR
Australian Shares	-0.3	0.2	0.2
Global Equities (Developed Markets)	0.2	5.7	10.1
Emerging Market Equities	-0.3	-0.1	-0.1
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	0.2	0.5	-2.3
Credit	0.3	0.5	0.7
Global Bonds (Developed Markets)	0.0	0.0	0.0
Emerging Market Debt	0.1	0.3	0.4
Duration Hedges	2.3	7.1	37.4
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	0.0	0.0	0.0
Listed Property	0.0	0.0	0.1
Commodities	-0.2	-0.3	-4.1
Market Neutral Equities	0.2	0.4	0.4
Infrastructure Debt	0.0	0.0	0.0
Infrastructure	2.3	2.3	2.3
Other Investments	0.0	0.0	0.0
Specialist Credit	0.2	0.4	0.5
Cash and Enhanced Cash	-4.9	-16.9	-45.4
Alternative Beta	0.0	0.0	0.0

FUND PERFORMANCE

The Diversified Real Return Fund returned -0.3% (gross) in the June quarter. Over the past year, the Fund has returned 4.9% (gross) and over the past 5 years the Fund has returned 4.5% (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%*).

Global equity allocations contributed positively to performance over the quarter led by US large cap tech which delivered continued priced gains underpinned by rising expected earnings in 2024 and the valuations investors are willing to pay to receive those earnings. In addition, the Fund's cash exposure, most notably its US Dollar allocation, continued to contribute to returns given its elevated running yield.

In contrast, global stock selection alpha weighed on performance as growth-style equity sectors outperformed traditional value sectors despite a slight steepening of the US yield curve. The narrowness of the global share market's advance this year has sparked concerns about the sustainability of the rally as a small number of US tech stocks are contributing the entire market returns, with most other stocks weighed down by a slower global economy and higher for longer rates (especially in the US). This small handful of stocks are already trading on valuation multiples which are rarely seen and never sustained over the long-term. Elsewhere, the fund's modest exposure to Australian equities also weighed on performance fears around the impact of higher domestic interest rates on the subdued domestic economy weighed on investor sentiment. Lastly, our fixed interest exposures marginally underperformed given concerns about higher for longer US rates

*All groups CPI measured and published by the ABS as at 31 March 2024

1. RETURN SEEKING ASSET CLASSES

Beginning of the Quarter: Low Allocation
End of the Quarter: Low Allocation

Equity market performance has been very strong thus far in 2024 led by growth-style equities in the IT, communication services and consumer discretionary subsectors. Increased confidence in the view of both a soft landing for the global economy with extended rate cuts has culminated in a lot of good news being priced into markets with the MSCI World Index now trading at a 90th percentile valuation relative to the past 20 years. With so much good news priced in and long-run valuation adjusted expected returns at levels which usually see US equity losses over the next five years, we maintain caution. Our equity exposures are primarily in high quality markets where valuations are attractive relative to history, earnings growth has the potential to rise, and where firms with cashed-up balance sheets pay attractive dividends and have the potential to undertake buybacks.

The Fund's return seeking opportunities include;

- Global equities in addition to exposures in emerging markets and Australian equities all with a value and quality style bias;
- Global and Australian listed property; and
- Australian credit and a small position in emerging market .

2. DIVERSIFYING OPPORTUNITIES

Beginning of the Quarter: Medium Allocation
End of the Quarter: Medium Allocation

With the Fund's cautious positioning with regards to return seeking assets, diversifying opportunities remain a key focus for risk management.

A feature of the extended rally in global equities has been the extreme level of concentration as large cap tech and AI-related names dominate performance. The S&P 500 returned 4.3% over the quarter, whereas the S&P 500 ex-Magnificent 7 declined -1.5% and global equities ex-US fell by the same amount. While concentrated gains in expensive tech stocks have been challenging for active managers to generate alpha, it has presented opportunities with increasingly attractive valuations in other parts of the broad market index.

The Fund retains:

- Stock selection alpha (through the Australian Share Fund, Australian Small Cap Fund and Global Share Fund) where equity holdings are concentrated in high quality 'value' companies which have strong balance sheets and highly resilient operating models. Notwithstanding the resurgence of growth-style equities throughout 2023 and early 2024, we expect value and quality factors to be rewarded in a prolonged environment of restrictive interest rates.
- A range of FX exposures including the US Dollar and some emerging market currencies;
- The Fund also added exposure to a select group of sustainable infrastructure stocks which are leveraged to the broader trend towards sustainability, while trading at a significant discount to NAV.

3. DOWNSIDE PROTECTION

Beginning of the Quarter: Medium Allocation
End of the Quarter: Medium Allocation

Elevated valuations have been driven by expectations of both accommodative economic conditions and a significant easing in global monetary settings over the next 18 months, but recent economic weakness and higher for longer rates could precipitate a pull-back in equity markets. Furthermore, the increasing concentration of stock indices is likely to increase the volatility of index returns and 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 options which are quite cheap to implement.

The Fund has put options on the S&P 500, a call option on the USD versus the Hong Kong Dollar and Chinese Renminbi (which is a low-cost downside protection for tail risks around China), a put option on the USD against the Japanese Yen and a call option on the NASDAQ Index, where we have already rolled up the strike to lock in profits.

The Fund also has exposure to 2-year US government bonds and modest exposures to 10-year Australian and US bonds. These defensive positions are supported by a modest cash allocation, which like bonds have an attractive running yield which also provides significant optionality as it enables us to quickly allocate to take advantage of mispricing in the event of a market selloff.

4. INFLATION PROTECTION

Beginning of the Quarter: Low to Medium Allocation
End of the Quarter: Low to Medium Allocation

The portfolio has a low (direct and indirect) sensitivity to higher interest rates which should provide resilience if persistent inflation extends the current monetary policy tightening cycle.

The portfolio also maintains a small allocation to a basket of commodities (which includes gold, grains, livestock, silver, palladium, platinum and copper).

MARKET COMMENTARY

- Developed market equities generated positive returns (+3.2%) over the quarter, recovering from elevated volatility in April. Performance was led by the US (+4.3%) where large cap tech companies continued to drive performance, benefitting from strong corporate earnings results. The Magnificent 7 collectively (+14.2%), and Nvidia (+36.7%) especially, continued to substantially outperform the broader market which declined (-1.5%) outside these 7 names.
- The UK Market also rose (+3.8%), with investors responding well to increased share buybacks, and were not concerned about a likely change in government at the July election. Across the Channel, European equities (-2.1%) saw mixed performance with France (-6.6%) the notable laggard after President Macron called a snap election which could see any of three parties in control of the legislature. Market sentiment here weakened as a sharp rise in French government bonds weighed on sentiment and investors fretted over the earnings impact of an unfavourable election outcome including super-profit taxes on French banks.
- In contrast, the S&P/ASX 300 (-1.2%) trailed the broader market, reflecting increasingly hawkish expectations for RBA rate settings later this year, and a very soft Q1'24 national accounts which signalled that the Australian economy barely grew (+0.1%Q).
- Meanwhile, emerging market equities rose strongly (+6.6%), given upbeat gains in Taiwan (+14.1%) given their AI chip exposures, and China (+6.4%) where supportive government policy provided a floor to the market which investors were able to take advantage of.
- In other asset classes, US 10-year government bond yields (+20bps) ended the quarter considerably higher after markets unwound some highly optimistic pricing for Fed policy easing in 2024. Domestic 10-year yields (+35bps) also rose over the quarter as higher than expected monthly inflation print raised the possibility of further policy tightening from the RBA.
- Lastly, commodity markets were mixed with base metals (+7.8%) and Gold (+4.3%) performing well whereas thermal coal (-5.1%) sold off.

The key swing factor driving markets throughout the quarter remained near-term expectations for the path of monetary policy. In April, expectations of near-term central bank rate cuts were unwound in response to solid US growth data and resilient core inflation. Over the remaining months, these concerns eased in the face of softening economic data, which saw markets price in almost two rate cuts in 2024, and the expectation of soft-landing was resurgent. While equity valuations recommenced their rally during May and June, there remains elevated uncertainty given US core inflation remains quite a distance above the Fed's 2% target.

Although expectations for monetary policy easing have been scaled back over the year to date, some central banks have commenced their cutting cycle. Indeed, the ECB cut rates in June in a move that was widely expected following dovish guidance, but there appears limited space for a deep cutting cycle in the world's largest trading bloc as core inflation bounced strongly after the rate reduction which again saw expectations wound back, with the ECB flagging that the length and depth of its easing cycle ultimately being driven by the data. In Australia, elevated core inflation is proving quite stubborn with successive monthly above consensus monthly CPI releases, and the June quarter result will be pivotable for upcoming RBA rate deliberations, with futures markets pricing in an even chance of a rate increase at the August meeting.

Meanwhile, the global growth outlook has broadened somewhat with US growth moderating from a high base and the World ex-US accelerating from a low level. Some of the growth tail risks highlighted at the start of the year appear to have subsided and what's left is a more mundane cycle of trend growth (circa 2.75% to 3.25%) with persistent and above-target inflation also around 3%.

Despite recent improvements in Europe and resilient US data, it remains hard to see a significant global growth acceleration this year, as the fiscal impulse is negative, there is very little spare capacity, restrictive monetary policy remains a headwind, employment growth is slowing, and the global credit impulse is at a post-GFC low. While trend growth is supportive for equities, the soft-landing scenario with sizable rate cuts in 2024 and 25 have already been priced in which increases the vulnerability to downside surprises from earnings, geopolitical shocks and any re-pricing in global fixed interest markets or of central bank expectation.

Despite circa trend growth, the uncertain path of inflation and central bank policy alongside high starting valuations provide a challenging backdrop for markets to experience another major leg up in prices for 2024. 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.

MORE INFORMATION

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