Perpetual Asset Management Australia

INSTITUTIONAL UPDATE

October 2023

AUSTRALIAN EQUITIES STRATEGIES

The S&P/ASX300 fell -3.8% in October. Rising bond yields was the continuing theme through October as the Australian 10 year extended its run from 4.50% to 4.96%, raising concerns for financial conditions and growth. Hamas' attack on Israel on 7 October sparked renewed geopolitical fears, although the worst expectations for markets were contained and oil fell. RBA Minutes for October noted a low tolerance for slow progress on inflation & Governor Michelle Bullock became more hawkish as October dragged on. Inflation for the September quarter came in hot at 1.2% vs expectations of 1.1% and 0.8% in June, unemployment fell from 3.7% to 3.6% and retail sale rose 0.9% vs 0.3% expected leading all the major banks to predict a rate hike on Melbourne Cup day. Most sectors finished in the red with IT, Healthcare, Industrials, Real Estate and Energy all taking the heaviest hits.

Gross Performance	1M%	3M%	6M%	1Y%	2Y%	3Y%	5Y%	7Y%	10Y%
Perpetual Australian Share Fund	-4.9	-8.9	-8.4	1.0	0.7	11.7	7.7	7.4	6.4
S&P/ASX 300 Accumulation Index	-3.8	-7.3	-5.4	2.5	-0.1	8.7	7.2	7.7	6.6
Excess	-1.1	-1.6	-2.9	-1.5	+0.8	+3.0	+0.6	-0.3	-0.2
Perpetual Concentrated Equity Fund	-4.4	-7.5	-6.3	2.9	4.0	14.8	7.6	8.2	7.1
S&P/ASX 300 Accumulation Index	-3.8	-7.3	-5.4	2.5	-0.1	8.7	7.2	7.7	6.6
Excess	-0.6	-0.2	-0.9	+0.4	+4.1	+6.1	+0.5	+0.5	+0.5
Perpetual ESG Australian Share Fund	-5.9	-8.5	-5.3	2.9	0.3	13.1	8.5	7.3	7.8
S&P/ASX 300 Accumulation Index	-3.8	-7.3	-5.4	2.5	-0.1	8.7	7.2	7.7	6.6
Excess	-2.1	-1.2	+0.1	+0.4	+0.4	+4.4	+1.4	-0.4	+1.2
Perpetual Pure Equity Alpha Fund – Class A	0.3	-1.0	-1.0	2.9	6.7	12.1	8.9	9.0	9.0
RBA Cash Rate Index	0.3	1.0	2.1	3.7	2.2	1.5	1.3	1.3	1.6
Excess	-0.1	-2.1	-3.1	-0.9	+4.5	+10.6	+7.6	+7.7	+7.4
Perpetual Share-Plus Long-Short Fund	-2.7	-6.3	-5.2	0.7	6.2	16.7	9.9	9.9	9.4
S&P/ASX 300 Accumulation Index	-3.8	-7.3	-5.4	2.5	-0.1	8.7	7.2	7.7	6.6
Excess	+1.1	+1.0	+0.2	-1.9	+6.2	+8.0	+2.8	+2.1	+2.8
Perpetual Smaller Companies Fund	-5.6	-8.4	-7.0	-3.4	-1.0	11.7	10.3	9.9	9.5
S&P/ASX Small Ordinaries Accumulation Index	-5.5	-10.5	-10.3	-5.1	-12.0	0.5	2.5	4.2	4.3
Excess	-0.1	+2.1	+3.3	+1.7	+11.0	+11.2	+7.7	+5.7	+5.3

GLOBAL EQUITIES STRATEGIES

Markets entered the fourth quarter following the downtrend of the prior month with the MSCI World and MSCI All Country World indexes both down approximately 3%. Although markets were down in October, there appeared to be more breadth in the month compared to the prior quarter during which only a few sectors were able to outpace the broader markets. However, that breadth was better within non-U.S. markets, in which seven of the eleven sectors in the MSCI EAFE Index and six of the eleven sectors in the MSCI Emerging Markets Index outpaced their broader markets. The U.S. did not follow this trend; only four of the eleven sectors outpaced the broader Russell 1000 Index.

Gross Performance	1M%	3M%	6M%	1Y%	2Y%	3Y%	5Y%	7Y%	10Y%
Barrow Hanley Global Share Fund - Class A	-0.3	-2.8	1.7	12.5	7.9	17.0	12.6	13.4	-
MSCI World Net Total Return Index ($A)	-1.0	-3.5	2.7	11.6	3.4	11.9	10.7	12.1	-
Excess	+0.7	+0.7	-1.0	+0.9	+4.5	+5.1	+1.9	+1.3	-

CASH & FIXED INCOME STRATEGIES

Bond markets continued to selloff in October with the sharp increase in bond yields reflecting investors adjusting to the expectation of a higher-for-longer interest rate regimes in recognition of resilient economic data and intransigent inflation print. The continued selloff in long-term bond yields, alongside the evolving crisis in the Middle East, also precipitated a widespread selloff in global equities.

Australian 10-year yields rising above 5% during the month before receding to end October 44 basis points higher. US 10-year yields marked their sixth successive monthly increase following better than expected growth data. Rising yields impacted the Bloomberg Ausbond Composite bond index which declined 1.85% during the month.
While traditional fixed rate bonds extended their recent selloff, floating rate bonds were resilient. Domestic credit spreads traded in a relatively tight range during October, consolidating following an extended period of tightening.

Primary market issuance was active throughout October and the month was notable for elevated investor demand with a number of large deals oversubscribed multiple times and spreads tightening sharply ahead of the issue date. Commonwealth Bank issued $1.25B of tier 2 subordinated 10NC5 paper. Woolworths issued a $450m seven-and-a-half year fixed rate bond which built a book more than 4x issue size. In the infrastructure space, Port of Brisbane ($200m) and Transurban Queensland ($250M) came to market, meeting robust demand.

Gross Performance	1M%	3M%	6M%	1Y%	2Y%	3Y%	5Y%	7Y%	10Y%
Perpetual High Grade Floating Rate Fund	0.5	1.7	3.3	6.2	3.1	2.6	2.7	2.8	3.1
Bloomberg AusBond Bank Bill Index	0.3	1.0	2.0	3.7	2.2	1.5	1.3	1.5	1.7
Excess	+0.2	+0.6	+1.3	+2.5	+0.9	+1.2	+1.3	+1.4	+1.4
Perpetual Credit Income Fund	0.2	1.4	3.8	7.7	3.4	3.7	3.5	3.8	4.0
Bloomberg AusBond Bank Bill Index	0.3	1.0	2.0	3.7	2.2	1.5	1.3	1.5	1.7
Excess	-0.1	+0.4	+1.8	+4.0	+1.2	+2.2	+2.2	+2.4	+2.3
Perpetual Active Fixed Interest Fund	-1.6	-2.1	-4.0	1.2	-3.6	-3.7	0.6	1.4	3.0
Bloomberg AusBond Composite Index	-1.8	-2.6	-5.2	-1.2	-4.3	-4.6	-0.1	0.6	2.1
Excess	+0.2	+0.5	+1.2	+2.4	+0.6	+0.9	+0.8	+0.9	+0.9
Perpetual ESG Credit Income Fund	0.4	1.4	3.4	8.0	3.7	3.9	3.5	-	-
Bloomberg AusBond Bank Bill Index	0.3	1.0	2.0	3.7	2.2	1.5	1.3	-	-
Excess	0.0	+0.4	+1.4	+4.3	+1.5	+2.5	+2.2	-	-
Perpetual Pure Credit Alpha Fund - Class W	0.6	2.2	5.0	9.6	5.3	5.7	4.9	5.2	5.8
RBA Cash Rate Index	0.3	1.0	2.1	3.7	2.2	1.5	1.3	1.3	1.6
Excess	+0.2	+1.2	+3.0	+5.9	+3.0	+4.2	+3.6	+3.9	+4.3

MULTI-ASSET STRATEGIES

Volatility spiked in October as the US Federal Reserve continued to reinforce its higher for longer guidance and investors assessed both the appropriateness of asset valuations and expected earnings for 2024.

- Global equities fell (-2.7%) in October led by losses in emerging markets (-3.6% in local currency terms) which responded negatively to rising US bond yields and the appreciating US Dollar. Meanwhile, price declines in developed markets were led by the UK (-3.7%) and Europe (-3.4%) as the ECB increased official interest rates to a fresh record high of 4.0% and lead economic indicators suggested the European economy likely contracted in Q3'23. Meanwhile, the US market fell (-2.1%) during the month but outperformed its regional peers as its large cap tech names (Microsoft, Apple, Nvidia, Amazon, Meta, Tesla and Alphabet) rallied a collective 2.1% and buttressed declines in other sectors. These stocks have demonstrated loss resilience during the GFC and pandemic but are expensive relative to the remainder of the index.

- Australian equities (-3.3%) underperformed their developed market peers in response to the quarterly CPI data which came in sizably above published RBA forecasts and sparked expectations that the Bank would increase its target cash rate at its November meeting. This occurred against a backdrop where Australian earnings have declined -7.6% over the past year as firms have struggled with continued pressures from higher labour costs, rising electricity prices, increased rents and rising technology expenditures which are absorbing free cashflow. Cost pressures are also mounting on the household sector which is constraining the ability of businesses to pass their cost increases onto customers, thereby crimping margins.

- US 10-year yields (+36 bps) rose sharply, but the yield on the Fund's exposure to US 2Yr bonds was little changed (+4 bps) which meant that the US yield curve slope steepened (+32 bps) by its largest amount in 7 months. Meanwhile, our modest holdings of Australian 10Y bonds detracted from performance as investors priced in the risk of another hike by the RBA into government bond prices which sent to 10Y yield higher (+44 bps) which sparked a catch up trade with its US equivalent after three consecutive months of price outperformance.

The market environment remains challenging as elevated equity valuations and highly optimistic earnings expectations for 2024 has the market priced for a strong economic recovery. However, elevated uncertainty remains about whether such an environment would produce enough tightening in financial conditions to bring core inflation rates back to typical 2% target. Our concern remains that the US economy would have to record above trend growth to be able to deliver on earnings expectations, but this world would be inconsistent with the below trend growth the US Fed needs to have wages growth and inflation trend lower, and in doing so provide the room for official US rates three times by end 2024. Indeed, most lead indicators in the US including the inverted yield curve, manufacturing and services PMIs, slower hiring in cyclical sectors, tighter lending standards and ongoing de-leveraging in the commercial and industrial space, are pointing to economic moderation. If these indicators are indicative of how the US economy evolves in 2024 it would help lower core inflation, but it would represent a challenging backdrop for corporates to deliver on highly optimistic earnings expectations.

The impact of Fed policy on the US economy is study of pressure and time. Some apparent softness in parts of the October labour market survey and lower core inflation has reduced the pressure on the Fed to continue hiking interest rates. However, this risk is still not zero and investors should be mindful that the latest summary of the Fed's economic projections still has one hike in its forward guidance. While overall core inflation has declined, it has been primarily a goods deflation story and core inflation remain double the typical 2% target. As such, it's hard to imagine that any developed market central bank would preparing to cut rates any time soon especially as monetary policy operates with a long and variable lag. That said, the full impact of 18 months of sustained monetary tightening is clear in a handful of regions – Europe looks increasingly weak, the UK and Australia appear stagflationary and China could have sustained deflation unless considerably more stimulus is provided.

While the US economy continues to exhibit resilience to the policy tightening so far, we sense risks of a sustained credit contraction are gradually building. For some time, we have been warning about the build-up of excesses in financial markets and the global financial system and we expect to see more of these excesses wash out through time. Firms is the commercial and industrial property sector are especially vulnerable as they are highly leveraged, and many were funded when US interest rates were at 150-year lows in 2020/21. Current interest rate levels and the Fed's higher for longer guidance means more of these firms will face rollover risk onto much higher interest rates when this debt matures, and the typical high-debt nature of their balance sheets will see the value of projects being repriced quite violently with bank bad debts likely to rise as a result. Stronger bank balance sheets and the Fed's willingness to provide almost unlimited liquidity in the event of funding market dislocation should prevent a re-run of the events of 2008, but this is likely to have distributional effects particularly for small business which are the US economy's predominant employer.

Meanwhile, there is little doubt that China will achieve its near-5% growth objective in 2023, but the economy faces a vast array of challenges, including structurally slowing growth, ongoing deflation, very high debt levels relative to living standards, poor demographics and the ongoing property malaise. The People's Bank of China (PBoC) has cut rates and increased reserves in the banking sector, but these funds are not being drawn down by the private sector as animal spirits are moribund given the regulatory crack down over the past five years. In the end, a structurally weaker China has implications for global growth and inflation.

For some time, our view has been that the biggest risk in markets is the lack of risk being priced in. in relation to equities, markets are priced for perfection with double digit earnings growth from an economy the Fed needs to get to a significantly sub-trend pace. with a strong bounce in earnings growth, and the central banks easing rates within 9 months. While the US economy has shown resilience thus far, other regions are clearly struggling in response to higher rates, and these are likely to be sustained for a while yet.

Gross Performance	1M%	3M%	6M%	1Y%	2Y%	3Y%	5Y%	7Y%	10Y%
Perpetual Balanced Growth Fund	-1.6	-2.8	-2.2	2.0	3.2	9.6	7.5	7.5	7.2
Balanced Growth Index	-2.6	-5.5	-3.3	3.7	-1.5	4.9	5.5	6.3	6.4
Excess	+0.9	+2.6	+1.1	-1.6	+4.7	+4.7	+2.0	+1.2	+0.8
Perpetual Diversified Growth Fund	-1.4	-2.1	-2.3	1.5	2.0	6.5	5.8	6.0	6.0
Moderate Growth Index	-2.2	-4.5	-3.4	2.6	-1.9	2.5	4.0	4.8	5.2
Excess	+0.9	+2.3	+1.1	-1.1	+3.9	+4.0	+1.8	+1.2	+0.8
Perpetual Diversified Real Return Fund - Class W	-0.1	0.4	0.4	3.1	2.4	5.1	4.9	5.0	5.4
Australian CPI +5% (Target Objective)							8.7	8.2	
Perpetual ESG Real Return Fund	-0.5	-1.5	-1.5	0.6	-1.5				
Australian CPI +5% (Target Objective)							-	-	

MORE INFORMATION

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Total returns shown have been calculated using gross performance and assuming reinvestment of distributions. No allowance has been made for fees or taxation. Past performance is not indicative of future performance.

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* Due to CPI data being released by the Australian Bureau of Statistics later in the month after quarter end, CPI figures reported are lagged by one month.

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