

# PERPETUAL HIGH GRADE TREASURY FUND

November 2018



## FUND FACTS

**Investment objective:** The Fund aims to provide investors with regular income and outperform the Bloomberg AusBond Bank Bill Index\*\* by actively investing in deposits, money market, fixed interest and debt-like hybrid securities.

- Benchmark:** Bloomberg AusBond Bank Bill Index\*\*
- Inception date:** October 2001
- Size of fund:** \$337.3 million as at 30 September 2018
- APIR:** PER0265AU
- Mgmt Fee:** 0.226% pa\*
- Benchmark Yield:** 1.836% as at 30 November 2018
- Suggested minimum investment period:** Three years or longer

## FUND BENEFITS

Provides investors with the potential for regular income, above cash returns and lower volatility than other income strategies through an actively managed and liquid investment.

## TOTAL RETURNS % (AFTER FEES) AS AT 30 November 2018

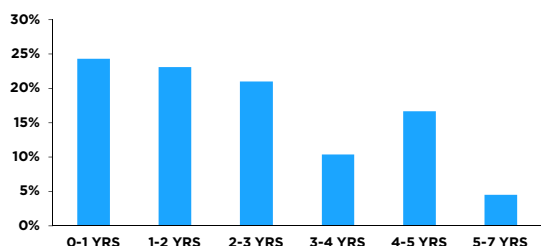
	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS PA	3 YRS PA	5 YRS PA	7 YRS PA	INCEPT PA
Perpetual High Grade Treasury Fund	0.14	0.62	1.31	2.54	2.94	3.05	3.29	4.02	4.82
Bloomberg AusBond Bank Bill Index**	0.15	0.48	0.99	1.91	1.83	1.93	2.17	2.55	4.24

Please note: Performance for Perpetual's complete list of investment funds is available on [www.perpetual.com.au](http://www.perpetual.com.au). Past performance is not indicative of future performance.

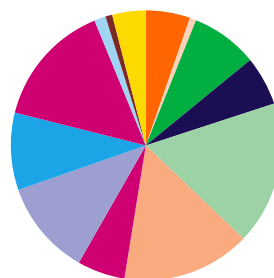
## POINTS OF INTEREST

- Credit spreads widen sharply, particularly pronounced in offshore banks and financials
- RBA remain on hold, bank bills rally higher, ACGB curve flattens; Swap spreads widen
- Elevated A\$13.8 of domestic issuance; 7 new securitisation deals price in November
- The outlook for credit has turned negative

## MATURITY PROFILE

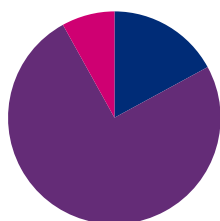


## PORTFOLIO SECTORS



- ABS, 11.7%
- SUPRA, 1.4%
- STRUCTURED, 1.9%
- BANK, 21.9%
- CMBS, 2.2%
- CORPORATE, 1.7%
- FINANCE, 7.3%
- OS BANK, 13.5%
- PROPERTY, 3.6%
- RMBS, 16.7%
- RMBS NC, 6.9%
- UTILITIES, 2.1%
- WRAPPED, 1.1%
- CASH, 8.0%

## FIXED AND FLOATING RATE BREAKDOWN



- FIXED, 17.1%
- FLOATING, 74.9%
- CASH, 8.0%

## PORTFOLIO COMPOSITION

	BREAKDOWN
Senior Debt	82.39%
Subordinated Debt	17.61%
Hybrid Debt	0.00%
Running Yield	2.90%
Portfolio Weighted Average Life	2.33 yrs
Modified Duration	0.06
No. Securities	170

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

## MARKET COMMENTARY

November was a volatile month for risk assets. Fears of potential policy error by the US Federal Reserve, geopolitical uncertainties and negatively biased idiosyncratic events underpinned fragile investor sentiment. Although having appeared resilient early in the month, spreads of domestic cash bonds pushed wider as time progressed, following the trend observed in offshore equivalents earlier in the period.

Broadly positive employment and economic data announcements early in the month were tempered by a variety of headwinds. Continued US-Sino trade tensions remained in focus, while political uncertainty associated with the midterm elections in the US occupied investors' minds. Markets grappled with ongoing concerns over the global economic growth outlook, Italy's budget clash with the European Commission and Brexit related risk. Concerns around the volume of lower quality corporate bonds outstanding (primarily in the US) also served to compound nervousness.

While offshore cash bonds succumbed to widening pressures early in the month, domestic spreads were initially relatively resilient. This was in part attributable to diminished volumes of local market new issuance holding spreads firm. However, as primary market activity increased, lacklustre demand for the significant volumes of supply resulted in significant new issuance concessions relative to where comparable secondary market equivalents were pricing.

Although domestic employment data was robust and Australia's terms of trade higher, evidence of less favourable dynamics in the housing market served to temper sentiment regarding domestic economic conditions. This prompted the Reserve Bank of Australia (RBA) to maintain their ongoing dovish tone, leaving interest rates at 1.5% while indicating that current monetary conditions are appropriate for the growth objectives of the domestic economy. Domestic cash bonds outperformed their synthetic iTraxx equivalents, which were more volatile as a result of dynamics in broader risk assets generally.

## PORTFOLIO COMMENTARY

The portfolio continued to collect running income in excess of the benchmark across all corporate and collateralised sectors. This contribution from positive carry was mainly associated with portfolio exposure to securitised products alongside both domestic and offshore banks and financials.

Credit spread widening detracted from performance. Offshore spreads pushed wider throughout the month with dynamics driven by a myriad of concerns including geopolitical uncertainties, US-Sino trade tensions and fears associated with potential policy error in the US. Although diminished new issue volumes in the Australian market early in the period provided support for domestic spreads, as primary market activity increased, spreads pushed wider. The proposed change by the Australian Prudential Regulation Authority (APRA) for tier two debt to form a substantial part of the major banks Total Loss Absorbing Capacity (TLAC) resulted in spreads of domestic bank sub-debt to push significantly wider following the proposal.

In terms of positioning, sector allocation was actively managed while maintaining a focus on risk and relative value in opportunities seen. The defensive bias of the portfolio has been bolstered, with exposure to securities higher up the ratings structure being built upon. Portfolio exposure to securitised products was increased, with primary market purchases including Bank of Queensland's 'Reds EHP 2018-1' ABS deal. Higher rated tranches of securitised products are viewed as attractive allocations given the credit enhancement and loss protecting nature of the AAA rated tranches alongside the attractive liquidity profile presented which is related to the amortising nature of the underlying loans. Weighted average life has been reduced in line with the softening outlook. The running yield at month end was approximately 2.9% with the spread measured at 1.1% above the benchmark.

## OUTLOOK

The credit outlook has turned negative. Despite the prevalence of a supportive macroeconomic environment, deteriorating market driven metrics alongside unbalanced supply and demand dynamics underpin the negative bias observed.

Valuation indicators are modestly negative. From a relative valuation perspective, spread differentials between domestic and offshore paper remain mostly tight. Despite recent spread widening, both domestic and offshore cash bonds continue to trade tight of their long-term averages in investment grade and high yield spaces. However, given an elevated basis swap, a slight divergence in spreads relative to US equivalents have been observed.

Support from market metrics continues to deteriorate on the back of recent increased volatility in both equity and bond markets. This has caused some credit buyers to pull back and raise cash in anticipation of buying at better technical levels. In addition, intermediary appetite for credit appears to have waned recently.

Supply and demand dynamics have also become less supportive. A combination of elevated volumes of primary issuance in the past month and reduced upcoming maturities has put a floor under any meaningful near-term tightening expectations. Recent demand for primary issuance has become somewhat lacklustre, where new issue concessions relative to secondary market equivalents have been present.

Somewhat tempering the negative biases observed is strength in the macroeconomic outlook. This is driven by strength in economic indicators, including the recent US manufacturing ISM survey print alongside PMI prints and the recent decline in the crude oil price in US dollar. Credit fundamentals in both the investment grade and high yield spaces remain robust.

Although the fundamentally strong economic environment remains positive for credit, we remain vigilant regarding the fragility of the geopolitical landscape. Trade friction is appearing to dampen the outlook for global economic growth. Uncertainty around potential policy error in the United States, Brexit related volatility and the pace of unwind of quantitative easing in place is also apparent. We continually monitor information flows that may influence market sentiment and, in such situations, retain sufficient flexibility to appropriately and actively manage portfolio risk exposures.

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Total return shown for the fund(s) have been calculated using exit prices after taking into account all of Perpetual's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry or exit fees or taxation (except in the case of superannuation funds).

Past performance is not indicative of future performance.

\*\* UBS Australian Bond Index changed to Bloomberg AusBond Bank Bill Index effective 26 September 2014

## MORE INFORMATION

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