Perpetual Investments

PERPETUAL WHOLESALE ACTIVE FIXED INTEREST FUND CLASS A

November 2018

FUND FACTS

Investment objective: To outperform the Bloomberg AusBond Composite Index by 0.50% to 1.00% p.a. (before fees) through actively investing in fixed interest securities, primarily corporate bonds.

FUND BENEFITS

Active management of credit risk through sector and sub sector rotation, curve positioning and relative value trading. Strategically maintain duration at benchmark, tactical overlay at extremes.

Benchmark: Bloomberg Ausbond Composite Index
Inception date: February 2017
Size of Strategy: $350.1 million as at 30 September 2018
APIR: PER8045AU
Management fee: 0.45%*
Suggested minimum investment period: Three years or longer

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 Wholesale Active Fixed Interest Fund Class A [1,3]	0.12	0.12	1.59	2.24	-	-	-	-	3.85
Perpetual Wholesale Active Fixed Interest Fund Class W [2,3]	-	-	-	-	3.74	4.00	4.95	5.49	6.04
Bloomberg Ausbond Composite Index	0.24	0.30	1.76	2.45	3.23	3.30	4.47	4.60	-

[1] Class A of the Perpetual Active Fixed Interest Fund (Fund) has been operating since February 2017. This row represents the actual past performance of Class A of the Fund.

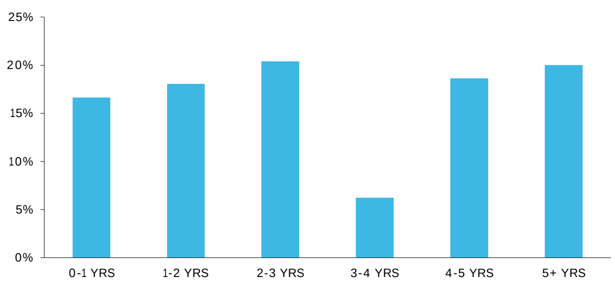
[2] To give a longer term view of the performance of the Fund, the returns for Class W, which has been operating since July 2004, are shown. Class W has identical investments to Class A. We have adjusted the return of Class W to reflect the fee applicable to Class A (a 0.45% Management Fee). This has been calculated by subtracting the fees for Class A from the actual gross past performance for Class W.

[3] Past performance is not indicative of future performance.

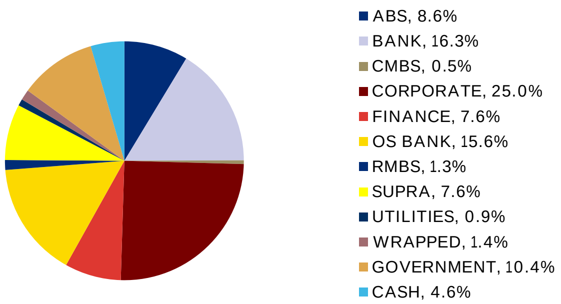
POINTS OF INTEREST

•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

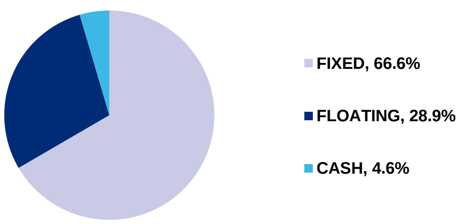
MATURITY PROFILE



PORTFOLIO SECTORS



FIXED AND FLOATING BREAKDOWN



PORTFOLIO COMPOSITION

	BREAKDOWN
Senior Debt	94.51%
Subordinated Debt	5.49%
Hybrid Debt	0.00%
Running Yield	2.91%
Portfolio Weighted Average Life (yrs)	4.07
No. Securities	123
Modified Duration	4.78

* 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. The proposed change by the Australian Prudential Regulation Authority (APRA) for tier two to form a substantial part of the major banks Total Loss Absorbing Capacity (TLAC) requirements also prompted spreads of major bank sub-debt to shift significantly wider following the proposal.

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.

A$13.8bn printed across both corporate and SSA issuers. Westpac printed a multi-tranche A$4.25bn deal, the five year FRN component pricing at three month BBSW +95bps. JPMorgan Chase were also active with their A$450m dual-tranche callable deal, while Toyota Australia were in the market with a dual tranche A$575m deal. Activity in the domestic securitised market saw seven primary deals, which included Bank of Queensland pricing its dual tranche A$1bn 'REDS EHP 2018-1' ABS transaction and Bluestone launching its 'Sapphire 2018-3' RMBS deal. 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. This contribution from positive carry was mainly associated with large portfolio exposures to non-financial corporates and banks, both domestic and offshore.

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.

Duration was actively managed over the course of the month. Duration exposure was tactically built upon at the short end very early in the period following a sell off in bonds, before being managed back to broadly neutral with the benchmark midway through the month as positive domestic economic data was tempered by offshore geopolitical related volatility. Through some tactical positioning, the portfolio had a modest duration underweight relative to the benchmark as short end bonds rallied further on continued volatility in equity markets.

Portfolio allocation was actively managed while maintaining a focus on risk and relative value in opportunities seen and positions sold. In line with the negatively biased outlook for credit, portfolio weighted active life remains at a shortened level. Exposure to credit higher up the ratings structure has been increased. Primary market participation included taking a position in the fixed rate tranche of Westpac's A$4.25bn five year deal. Exposure to domestic banks and securitised products was built upon, while portfolio allocation to corporates was decreased. The running yield at month end was approximately 2.9% with the spread measured at 0.8% 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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