Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

November 2018

FUND FACTS

Investment objective: To provide investors with regular income and consistency of return by investing in a diversified range of income generating, socially responsible assets.

Benchmark: Bloomberg AusBond Bank Bill Index
Inception date: June 2018
Size of fund: $25.3 million as at 30 September 2018
APIR: PER1744AU
Mgmt cost: 0.70%pa
Benchmark Yield: 1.84% as at 30 November 2018
Suggested minimum investment period: Three years or longer

FUND BENEFITS

Provides investors access to an actively managed fund that more closely matches their personal social and ethical beliefs or preferences, without compromising investment returns over the long term.

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 Ethical SRI Credit Fund	-0.02	0.44	0.86	-	-	-	-	-	0.86
Bloomberg AusBond Bank Bill Index	0.15	0.48	0.99	-	-	-	-	-	0.99

Please note: Performance for Perpetual's complete list of investment funds is available on 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

ETHICAL EXCLUSIONS AND SRI SCREENING

There are two main steps to the process, namely ethical exclusions and socially responsible investments (SRI) screening.

ETHICAL EXCLUSIONS

We don't invest in issuers or counterparties that derive a material proportion of their revenue from:

- the manufacture or sale of alcohol or tobacco
- the operation of gambling facilities or the manufacture of gambling equipment
- fossil fuels (upstream)
- uranium and nuclear
- animal cruelty (cosmetic testing)
- genetic engineering
- pornography
- armaments (including weapons).

SRI SCREENING

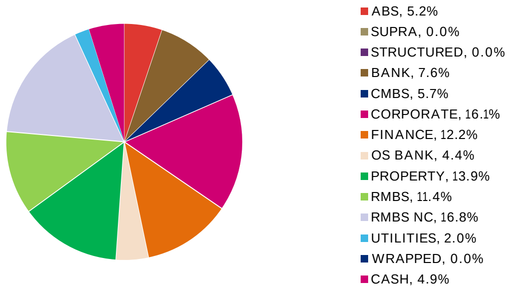
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment. while other companies become allowable investments.

SOVEREIGN ISSUERS

Governments will be analysed on ESG factors, based on a scoring system utilising research from external specialists. This may include, but is not limited to, considering any unethical practices such as corruption, rule of law and political instability of the sovereign.

For further details on the Ethical Exclusions or SRI screening please refer to the PDS.

PORTFOLIO SECTORS



PORTFOLIO COMPOSITION

	BREAKDOWN
Senior Debt	71.32%
Subordinated Debt	22.90%
Hybrid Debt	5.78%
Running Yield	3.62%
Portfolio Weighted Average Life	3.50 yrs
No. Securities	50
Modified Duration	-0.385

* 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 collected 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, property, corporates and the significant exposure to 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. Within the "core" investment grade allocation, exposure to securities higher up the ratings structure was increased in line with a preference for higher rated, more defensive exposures, while the weighted average life of the portfolio was modestly reduced in line with a softer outlook. Portfolio exposure to both property and offshore banks was decreased while allocation to securitised products and domestic banks was increased.

The fund applies both ethical and socially responsible investment (SRI) screens relating to what the company is in the business of and the way business operations are conducted respectively. Upon application of the ethical and SRI screens, several bond issuers have been screened out - including for example, some banks and financials for corporate misconduct, companies involved in the extraction of fossil fuels or companies whose revenues are significantly associated with socially questionable products or services. The running yield at month end was approximately 3.62% with the spread measured at 1.72% above the benchmark.

OUTLOOK

The outlook for credit has softened to neutral. A strong macroeconomic outlook is being tempered by less supportive market metrics. Valuations alongside supply and demand dynamics also have a modestly negative bias.

Strength in the macroeconomic outlook remains a key support for the prospect of tighter spreads, with economic indicators continuing to print positively. Credit fundamentals in both the investment grade and high yield spaces remain robust, supported by constructive global economic data. However, support from market metrics has diminished. A spike in volatility alongside an associated weakness in equity markets are both negative for credit spread dynamics. The continued appearance of diminished cash levels across aggregate domestic accounts is also less supportive for market demand.

Supply and demand dynamics are modestly negative. Recent primary market dynamics have resulted in broader spread dynamics being range bound. Elevated volumes of primary issuance in previous months had put a floor under any meaningful near-term tightening expectations, however the prospects of wider spreads has also been dampened given lighter levels of supply to the domestic market in October. More recent demand for primary issuance has become somewhat lacklustre whereas secondary demand remains robust. Upcoming supply expectations and maturities due are at normal levels.

Valuation indicators have a modestly negative bias. From a relative valuation perspective, spread differentials between domestic and offshore paper remain mostly tight. 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, instances of slight divergence in spreads relative to US equivalents have been observed.

Although the fundamental backdrop of a robust economic environment remains positive for credit, we remain vigilant regarding the fragility of the geopolitical landscape. Rising trade friction typically threatens to dampen global economic growth. Uncertainty around rising interest rates 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.

MORE INFORMATION

Adviser Services 1800 062 725
Investor Services 1800 022 033
Email investments@perpetual.com.au
www.perpetual.com.au