Quarterly Market Update

ONE-YEAR ANNIVERSARY OF COVID-19:

A RESURGENT ECONOMY TEMPERED BY DOWNGRADED GROWTH FORECASTS

MARCH 2021

Perpetual

Contents

Snapshot

The end of the March 2021 quarter marks one year on from the most rapid sell-off we've ever seen in markets, reacting to an emerging pandemic crisis. Markets reached their bottom on 23 March 2020, before the swift intervention of central banks and governments supported credit and equity markets, which have been on the rise ever since.

The first quarter of 2021 saw equity markets continue to rally strongly as the rollout of vaccines and loosening of lockdowns has seen economies reopen. Record fiscal stimulus from the Biden administration, including the announcement of a 2 trillion USD infrastructure program, has seen another round of growth upgrades for almost all developed economies.

However, despite global optimism, we have seen growth forecasts being downgraded in some emerging economies, as a resurgence of infections, new virus mutations and a lack of access to vaccines point towards COVID-19 continuing to be an issue for months, or even years, to come.

Australian equities

The Australian equity market continued to climb, as the S&P/ASX 300 Accumulation index rose 4.2% over the three months to March 2021. Over 12 months, the index has climbed a whopping 38.3% out of the depths of the crisis in March 2020. Financial stocks were the clear winners, returning 12.1% for the quarter, followed closely by Communication Services (9.0%) and Consumer Discretionary (8.9%). Tech stocks underperformed, returning -10.3%, whilst Healthcare and Utilities also posted negative returns, at -2.1% and -1.8%, respectively.

International equities

Global equity markets advanced in Q1, with the MSCI All Country World Index rising 5.9% in AUD terms. Commodities were the top performing asset class, driven by a 19.2% return in energy. Financials also had a strong quarter with a 12.9% gain, followed by Industrials (8.9%) and Communication Services (8.0%). Consumer Staples and Utilities were the laggards with a 0.5% and 1.9% return respectively. North America continued to outperform (6.9%), followed by the Europe, Australasia and Far East ("EAFE") group of developed countries (4.8%) with Emerging Markets lagging (3.6%).

Real estate

Australian Real Estate Investment Trusts (as measured by the S&P/ASX300 A-REIT index) fell 0.6% over the quarter, with 'long weighted average lease term' assets underperforming against the backdrop of rising bond yields. Global Real Estate Investment Trusts (G-REITs) gained 8.4%, as measured by the FTSE EPRA/NAREIT Developed Index, with Hotels/Hospitality rebounding and Self-storage being the best performing sectors.

Fixed income

In the domestic bond market, the Bloomberg AusBond Composite Index returned -3.2% during the March 2021 quarter. The Australian 10-year bond yield rose significantly in February and March 2021, finishing the quarter with yield of 1.83% from January's 1.092%, leading to falls in bond prices across the curve. On the global front, the Bloomberg Barclays Global Aggregate Bond Index (Local Currency) returned -4.5% for the period. Credit fared a little better with the ICE Bank of America Global Corporate Index (Local Currency) returning -3.3% over the same period.

Alternatives

Alternatives across both growth and defensive asset classes have started to recover as private assets are conservatively marked up as economies start to reopen. Opportunities to deploy capital in less efficient markets continue to present themselves, with specific opportunities in credit as fiscal stimulus is withdrawn and redirected, as well as absolute return funds as pockets of momentum build in previously unloved industries and undervalued sectors start to outperform.

Cash rate

The Reserve Bank of Australia ('RBA') reaffirmed its 0.1% target for the cash rate over the quarter and left their policies on yield curve control unchanged. The RBA is holding true to its narrative of keeping rates on hold for at least the next three years in order to support the economic recovery and ensure that employment and inflation targets are met before considering a change in policy.

Aussie dollar

The Australian dollar fell -1.3% against the US dollar over the quarter, notwithstanding the significant 19.6% increase over the last twelve months as global 'safe-haven' currencies have depreciated as markets and commodities surge on global optimism. In the 12 months to 31 March 2021, the AUD has appreciated 13.9% and 10.6% against the Euro and British pound respectively.

Global economic overview

What a difference a year makes

It is hard to believe, given the recent rallies in markets over the last two quarters, that a year ago we were witnessing the fastest sell off ever seen and on the verge of entering a historic recession. Today, the outlook for global growth continues to improve, powered by the swift development and rollout of vaccines and massive fiscal stimulus packages by governments, supporting business and pushing economies back on track.

At the start of April, more than 620 million vaccines for COVID-19 had been administered worldwide – the speed of both the development and the rollout of the vaccine has been a major global scientific accomplishment, well ahead of even the most optimistic forecasts, however the challenge of distributing vaccines fairly and equitably has already been seen, with 'vaccine nationalism' playing out in Europe and India, as promised vaccine shipments have been retained or delayed in favour of their own citizens.

As the virus runs through unvaccinated populations, the risk of new variants and reduced vaccine efficacy grows – the need to update and keep rolling out new vaccines for new mutations means that, despite the amazing success we've seen in parts of the world today, we will most likely be living with COVID-19 for many years to come.

However, with the level of stimulus and reopening of economies, optimism in corporate performance and equity markets is rampant. Earnings momentum, both in Australia and abroad, has rebounded with recent reporting seasons seeing a large proportion of companies beating estimates and surprise to the upside relative to analyst forecasts. More cyclically exposed companies, such as financials, resources and industrials, have benefitted from the improving outlook, which has seen a style rotation as these 'value' stocks have benefitted – the gap to 'growth' stocks over the last two quarters has been the widest margin seen since the tech wreck of 2000.

Stimulating reading

Given the level of stimulus being pumped into markets around the world, concerns of inflation are back on the agenda - we saw the 'breakeven' inflation rate in the US reach its highest level since 2013. It's been a source of much debate, with arguments on both sides as to the implications of unprecedented money printing and unchecked government spending.

There is no doubt with the level of fiscal and monetary stimulus, the increase in 'cheap money' could lead to excess demand and shortages in supply. Continued trade tensions, border closures and migration coming to a stand-still adds fuel to the fire – however, current unemployment levels and the absence of wage growth both remain significant headwinds to the higher inflation scenario.

Central banks are disregarding inflation as a risk for now, restating commitments to keep cash rates anchored at zero until employment recovers and inflation returns to their target 2-3%. This has been a challenging environment for bond investors, as increased optimism and just the return to 'normal' inflation levels has led to bond yields rising back to pre-pandemic levels, causing bonds to drop in value as prices re-adjust for higher rates. Investors saw Australian and global bonds deliver negative total returns over the quarter.

Despite the odd container ship getting stuck in the Suez Canal (the full implications of which are yet to be determined), the global recovery does appear to be well on track, with upgrades to economic projections across the board. The International Monetary Fund (IMF) has upgraded its forecast of global growth in GDP for 2021 from 5.5% at the start of the quarter to 6% at the start of April. We need to remember, however, that these growth projections come off the back of a global -3.3% contraction last year.

Of further concern over the quarter were isolated incidents of excessive leverage, with the collapse of Greensill Capital, including its leveraged financial products, as well as the spectacular demise of Archegos Capital Management, a New York based family office and hedge fund. Both caused disruption to markets in certain names and sectors, however the contagion appears to be contained for now. These failures were facilitated by easy money and opaque investment structures, it once again reminds investors of the need to look beyond the offer document and into the underlying strategy to understand the nature of what they're investing in.

USA

The US economy grew at an annualised rate of 4.3% in the March quarter – and is forecast to grow 6.4% this year, the strongest amongst major developed economies according to the IMF, which forecasts the Euro area at 4.4%, UK at 5.3% and Japan at 3.3%.

The quarter saw the Biden administration sign into law a USD1.9trn stimulus package in March, followed by the announcement of a USD2.3trn infrastructure spending plan, to be partially funded from an increase in the corporate tax rate, albeit only back to pre-Trump levels.

The US has been, and continues to be, the best performing equity market in the world. However, despite high valuations, it is also the best performing and strongest Western economy in the world, somewhat justifying its outperformance. While we are seeing strong rotations between sectors and industries as investors move into better value investment ideas, what should be a rotation from 'expensive' US equities to 'value' non-US has yet to occur.

If there were any hopes of a quick repair in the US-China trade relationship, these were dashed in March during a relatively heated exchange between trade representatives at a meeting in Alaska. If anything, the Biden administration has turned up the heat on China, through a more cohesive and coordinated approach, focusing on additional leverage through allies. This was evidenced by recent sanctions placed on Chinese officials by a group of Western democracies, associated with the treatment of Uighars in Xinjiang province. China retaliated by putting in place its own sanctions as well as endorsing boycotts of Western businesses in China.

UK and Europe

The UK finalised a trade deal with Europe that saw Britain markedly worse-off in terms of its relationship and access to the European single market. While there are still some notable gaps in coverage, in particular financial services, it provides some modicum of certainty for UK businesses and allows the UK to pursue trade deals with other global economies.

A resurgence in infections saw the UK reinstitute lockdowns, in January and then again in March. However, when it has come to rolling out the vaccine, the UK continues to lead all major economies with almost half of the population receiving at least one dose. UK GDP is also recovering with 1.3% quarter on quarter growth in the fourth quarter, ahead of expectations.

Europe has been struggling with the rollout of vaccines while also experiencing a third wave of infections and lockdowns across the major economies in the Eurozone, in particular France and Germany. It's a two-speed recovery, with manufacturing forward orders reaching record highs, while services remain in contractionary territory. Eurozone GDP declined 0.7% in the fourth quarter, with European earnings also falling 18% relative to the fourth quarter of 2019.

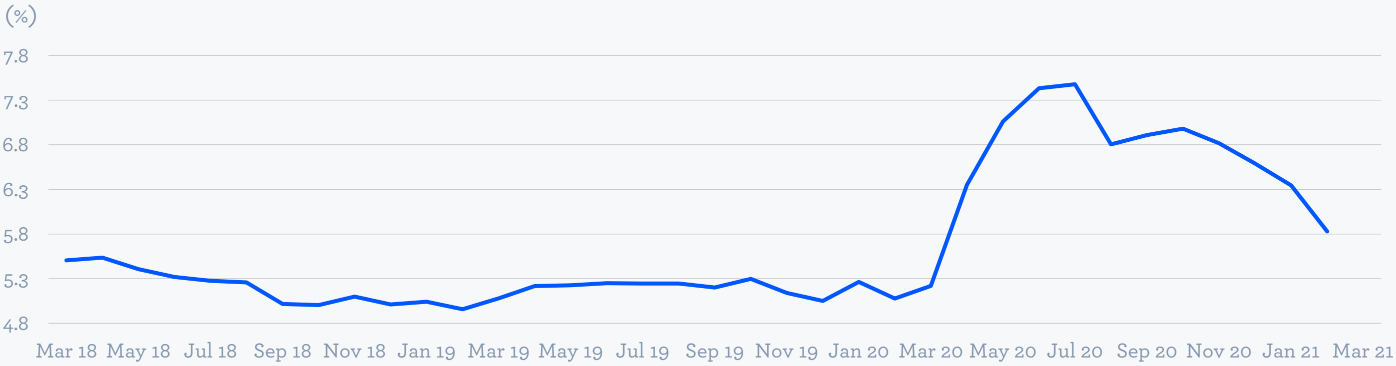
China

Scanning down the column of 2020 GDP outcomes for major economies, China stands out notably as the only economy that generated positive growth over the year, growing 2.4%. China's harsh but effective handling of COVID-19 has allowed the economy to get back on track and come through the Covid crisis arguably better than any other major economy globally.

Concerns of rising asset bubbles, particularly real estate, has caused the central bank to act and actually cool the economy, withdrawing liquidity from the financial system after loan growth hit 16% during the first two months of the year.

China is attracting significant foreign direct investment ('FDI') in 2020, becoming the largest recipient of FDI over the US for the first time. Chinese exports continue to surge as global economies reopen and demand for consumer goods and raw materials recovers. The Chinese communist party met during March, reinstituting an economic growth target of 6% for 2021, the first such target to be set since the pandemic began.

Figure 1. The Australian Unemployment Rate



Source: Factset, Perpetual Private

Downunder

Australia's economy is reopening with the overall economy being supported by a commodities boom and no significant lockdowns of prolonged duration in any part of the country since the start of the year. As the economy reopens, the Australian market has outperformed vs foreign markets in AUD terms. Ultra low cash rates has seen property prices accelerate at their fastest pace since the early 1980s, and while the RBA has expressed concerns, it remains committed to keeping interest rates low until unemployment levels recover.

Unemployment has declined over the year since the peak in June 2020, with a higher than expected drop from 6.3% to 5.8%. Elevated joblessness remains in certain sectors, however the number of jobs in the economy is now higher than pre-pandemic levels, with labour shortages being experienced in certain industries, such as agriculture, building and construction, as net inwards migration to Australia has essentially come to a standstill.

The Australian government has started to withdraw stimulus, with the JobKeeper program ending in March. The Treasury estimates that up to 150,000 jobs could be impacted and acknowledges that a number of businesses could collapse without government support. However, despite this, most economists see Australia's growth trajectory continuing, with the IMF recently upgrading Australia's growth expectations to 4.5% in 2021.

Australia's vaccination rollout has encountered some stumbling blocks, with a slower than expected pace of delivery and new concerns over the AstraZenaca vaccine and associated blood clotting issues. However, Australia has proven adept at managing outbreaks over recent months and further signs of positive momentum, such as the reopening of international borders with New Zealand and earning upgrades for Australian and global corporates point towards a strong positive momentum for the economy.

Over the last year, Australian companies raised capital and cut costs in response to the crisis – now that the recovery is underway, companies are reporting better than expected financial results and are in a position to deploy that capital, be it through acquisitions, investment or returning capital to shareholders.

Assuming that inflation remains under control and notwithstanding any exogenous shocks from a possible virus variant resurgence or geopolitical issue, the environment for investment looks to be relatively positive. Much of this has been built into valuations for many parts of the market, however there are still opportunities to pick and choose mispriced stocks and securities in order to deliver good risk-adjusted returns for investors.

Australian cash rate and dollar

The RBA maintained its cash rate at 0.1% and left its quantitative easing programs unchanged, with Governor Lowe saying in February that “The Board remains committed to maintaining highly supportive monetary conditions until its goals are achieved… The Board does not expect these conditions to be met until 2024 at the earliest.”

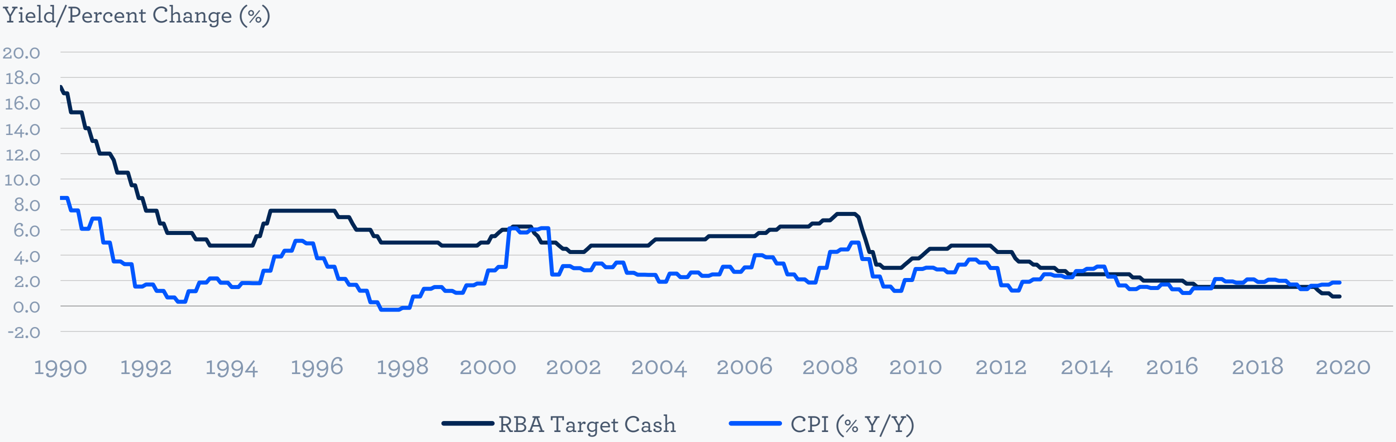
The governor, in both stance and timing, is in line with his global central bank counterparts, however markets are starting to price in higher expectations. Indeed, US bond markets are pricing in an anticipated Fed rate hike in 2023 vs the Fed’s stated commitment to the 2024 schedule.

If offshore markets start to move in response to rising inflation and lower unemployment, the RBA may be forced to respond in kind. However, with many variables on the horizon, such as the impact from the withdrawals of JobKeeper and other forms of stimulus still in force, the needed success in vaccine rollouts both here and abroad, and recovery to full employment and normal inflation levels, the RBA has time on their hands for now.

The Australian dollar as at 31 March was a shade under USD0.76, which is at or around its long-term historic average. Over the March quarter, the Australian dollar declined 1.3% against the US dollar, appreciated 2.7% vs the Euro and depreciated 2.3% against the British pound. Whilst mixed in the three months to March, the appreciation of the Australian dollar against major currencies over the last 12 months has been significant, gaining 19.6% against the US dollar as commodities prices have surged, economies reopened and markets rallied.

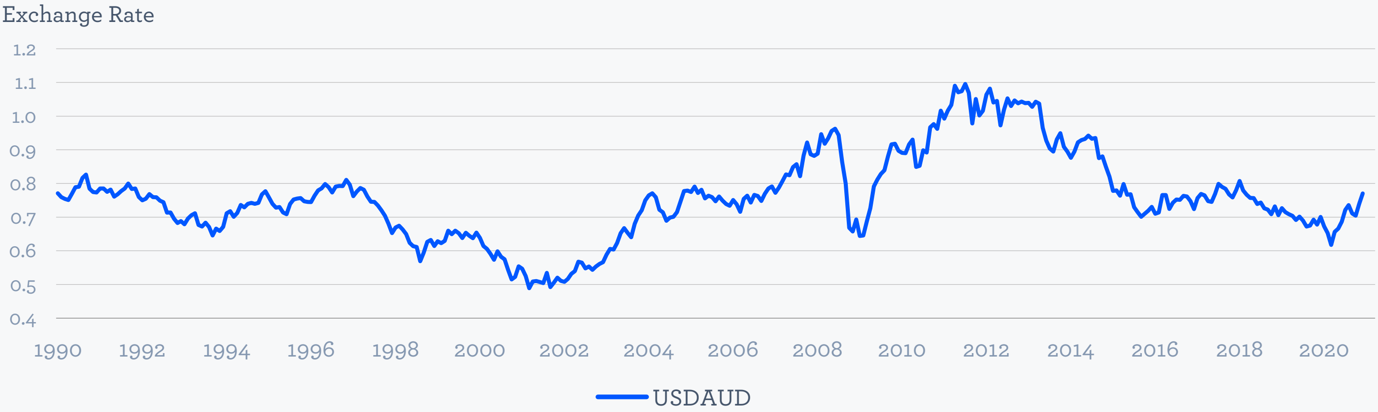
Figure 2. Australian long-term interest rates

Long-Term Cash Rate VS Inflation



Source: FactSet, Perpetual Private

Figure 3. Australian Dollar U.S. Dollar (Daily) Long Term
USD Per AUD Long-Term Exchange Rate



Source: RBA Chart Pack, January 2021

Australian Dollar Outlook

The Australian dollar, as a 'risk-on' currency, seems poised to continue to outperform through 2021, in line with global equity and commodity markets. Australian bonds have returned to their long-term historic position of trading at a yield premium to US Treasuries, which adds support to the AUD. A rotation out of defensive 'safe-haven' positions into riskier parts of the market should also support the AUD as the economic reopening continues.

Australian and international equities

Australian equities

The Australian equity market surged higher in Q1, with the S&P/ASX 300 Accumulation Index delivering a 4.2% return in AUD terms, albeit a far cry off the Q4 2020 return of 13.8%. It was not enough to outperform global markets however, with the MSCI All Country World Index returning 5.9% in AUD terms for the first quarter of the year. Financial stocks were the clear winners, returning 12.1% for the quarter, followed closely by Communication Services (9.0%) and Consumer Discretionary (8.9%). Tech stocks had a woeful quarter, returning -10.3%, whilst Healthcare and Utilities also posted negative returns, at -2.1% and -1.8%, respectively. Value stocks (9.2%) beat growth stocks (-0.4%) as momentum around global economic recovery and reopening benefited the more cyclical areas of the market.

Figure 4. Australian Shares
Australian Shares – Large Companies

Source: Factset, Perpetual Private

The Australian economy entered 2021 on remarkably strong footing, despite contracting 2.4% in 2020 as international and state borders shut and COVID-19 restrictions were put in place. Large fiscal and monetary support massively reduced the impacts from the pandemic, and helped to elevate household saving ratios, increase momentum within the property market and driving robust building and construction pipelines. The IMF is forecasting the economy will expand 4.5% over this year. What is most stark is that between March 14th 2020 (when the pandemic first officially kicked off in Australia) to February 27th 2021, payroll jobs are down just 0.2% while total wages paid has increased by 1%.

Australian equities outlook

The accommodative fiscal and monetary backdrop, widespread vaccine distribution and increasing merger and acquisition activity will propel Australian equity markets higher in 2021, particularly cyclical stocks and those sensitive to economic growth. This bodes well for value style strategies, and we expect this rotation away from growth oriented strategies to continue this year. There will be bouts of volatility, however. The ASX 200 is trading at lofty valuations relative to anytime in the last 30 years; JobKeeper officially ended in March, which is likely to have impacts on unemployment numbers; and record low interest rates have seen huge surges in property prices. Any disruption to the economic or earnings recoveries could shake current buoyant investor confidence. Our preference for bottom up, fundamental stock pickers has not changed, and we believe they are best placed to navigate the uncertain waters and identify fruitful, long term opportunities.

Figure 5. International Shares (Local Currency Terms)

Source: Factset, Perpetual Private

International equities

Global equity markets advanced in Q1, with cyclically sensitive equities receiving the greatest benefit from the improved outlook, paving the way for a style rotation with value stocks beating growth stocks. Developed market equities outpaced emerging market peers, with the US continuing to outshine other 'developed ex-US' stocks in major currency terms.

The MSCI All Country World Index delivered 5.9% in AUD; MSCI North America 6.9%; MSCI EAFE 4.8%; and MSCI EM 3.6%. Commodities were the top performing asset class, driven by a 19.2% return in energy. Financials also had a strong quarter with a 12.9% gain, followed by Industrials (8.9%) and Communication Services (8.0%). Consumer Staples and Utilities were the laggards with a 0.5% and 1.9% return, respectively. Gold suffered its worst quarterly decline since 2016. Among major currencies, UK sterling and US dollar mostly advanced, while the euro generally declined.

International equities outlook

We expect continued strength in global equity markets, in particular cyclical stocks pegged to economic reopenings, the key drivers being further fiscal stimulus, continued monetary policy support and escalation of the vaccine rollout. That said, we are mindful of potential bouts of volatility in the year ahead: Recent spikes in bond yields incited mini taper tantrums in stocks, particularly large cap tech, which reap the greatest benefit from low rates. These stocks had a very strong 2020 so we are also mindful of their valuation risk. While investors began considering inflationary pressures early in the quarter, we think its unlikely central banks will react until the economic and job market recovery is complete. This environment bodes well for value versus growth stocks, and we thus position the portfolio accordingly.

Our long-standing bias towards active bottom up stock picking managers across the portfolio remains unchanged, which we feel is suited to the current situation, where risk can be actively managed and long-term opportunities created.

A-REITS and G-REITS (Listed property securities)

In AUD terms, Global Real Estate Investment Trusts (G-REITs) rose 8.4% over the quarter to the end of March 2021 (as measured by the FTSE EPRA/NAREIT Developed Index). On a currency hedged basis, the FTSE EPRA/NAREIT Developed Index rose by 8.3%. Earnings season largely confirmed the resilience of the self-storage, logistics, data centres, and life science sectors. However, 2021 guidance from companies across these sectors failed to exceed the market's high expectations. Over the quarter, Hotels / Hospitality and Self-Storage were the best performing sectors.

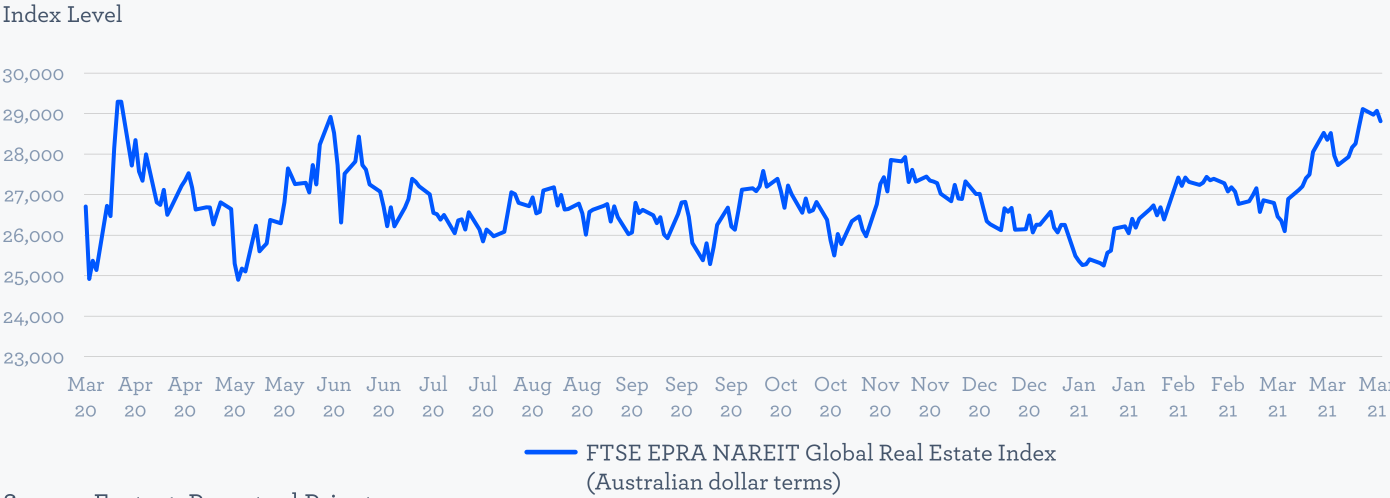
In Australia, A-REITs fell 0.6% over the quarter, underperforming the broader equity market (S&P/ASX 300 Accumulation Index) which rose 4.2%. Through the middle of the quarter we saw 'growth' REITs and REITs with large funds management arms fall as bond yields rose. Additionally, some of the 'long weighted average lease term (WALE)' REITs (ie Bunnings) underperformed as investors moved out of assets with fixed growth in the face of inflation and higher bond yields. Meanwhile, Retail REITs stocks such as Scentre Group and Vicinity Centres rallied on the back of expectations of an improvement in cyclical earnings.

Figure 6. Australian Real Estate Investment Trusts (A-REITs)

Property

Source: Factset, Perpetual Private

Figure 7. Global Real Estate Investment Trusts (G-REITs)
Property



Source: Factset, Perpetual Private

REITs outlook

The COVID-19 pandemic continues to result in significant disruption, and uncertainty in the global economy. Despite the market rally post March 2020, COVID-19 and government policy responses continue to create uncertainty across real estate markets. Until markets have 'certainty' around government policy (e.g. travel restrictions, vaccinations) and an economic recovery becomes self-sustaining, we expect markets to be less focused on company and real estate fundamentals and more focused on having exposure to less affected sectors (eg industrial).

Operating conditions have changed meaningfully for sectors like Hotels, Retail and Office, with the operating and earnings environment unclear. For companies with shop front real estate, it's likely that management teams will use this crisis to further 'right-size' their footprints. Interestingly, we are now beginning to see 'private capital vehicles' being raised to acquire 'distressed' retail assets. Many corporates have embraced 'working from home' for their staff, and this will lead to a shift in thinking around office space requirements. We expect a meaningful change in usage habits, some right-sizing, and a reduction in space requirements, however we expect this to be at least partially offset by an increase demand for 'collaborative space'. This trend is likely to play out for years - rather than weeks/upon lease expiry. Of note, there appears to be an increase in CEO's calling for staff to return to the office across many major financial centres. It will be interesting to see how this dynamic pans out. For Hotels, while domestic travel may pick up in some regions, those hotels which are heavily reliant on business or international leisure travel will likely remain under pressure for the foreseeable future.

REITs are well placed to benefit once the economic recovery begins to take hold. Furthermore, we expect the accommodative monetary policy and quantitative easing (QE) to remain a feature of markets for some time to come, supporting real estate valuations. Despite central banks globally insisting that short term rates will be anchored at historical lows via QE, volatility elsewhere in bond markets will likely trigger volatility in REIT markets.

As with all market crises, those assets with weak balance sheets or severely negative earnings prospects are sold off the most, and typically don't benefit from 'relief rallies'. We remain of the view that 'quality' real estate with strong balance sheets and access to capital remain the most attractive investments at this time. The outlook for REITs varies meaningfully by sector and investors should be circumspect on the robustness of short-term earnings underpinning current sector level valuations and the valuations ascribed to individual assets. The current environment should provide an opportunity for our managers whose focus is on 'stock-picking' to generate excess returns.

Fixed income

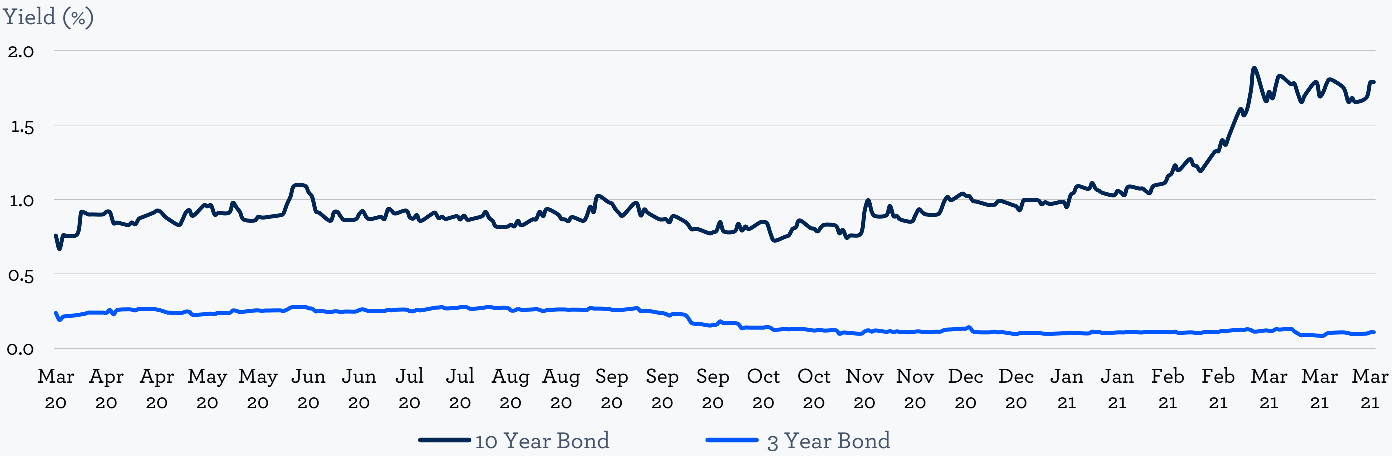
In the domestic bond market, the Bloomberg AusBond Composite Index returned -3.2% during the March 2021 quarter. The Australian 10-year bond rose significantly in February and March 2021, finishing the quarter with yield of 1.83% from January's 1.092%. The sharp increase in yields was the main contributor to the Bloomberg AusBond Composite Index's negative return, with the market pricing in higher inflation estimates in the future. The RBA's buying program of government bonds with maturities of 5 to 10 years did little to dissuade the market.

The RBA held their target cash rate at a historically low 0.10% for their last 4 meetings. In their April statement, the RBA noted that the unemployment rate fee to 5.8% in February and GDP increased 3.1% in the December quarter. The RBA still believes that unemployment is still too high and that after the recovery from COVID-19 related discounting, the inflation rate is expected to be below 2% for the next few years.

On the global front, the Bloomberg Barclays Global Aggregate Bond Index (Local Currency) lost -4.5% for the period. Credit fared a little better with the ICE Bank of America Global Corporate Index (Local Currency) returning -3.3% over the same period. High yield debt as measured by the ICE Bank of America High Yield Index (Local Currency) provided a flat return during the quarter, higher coupons offsetting losses from sensitivity to rising rates.

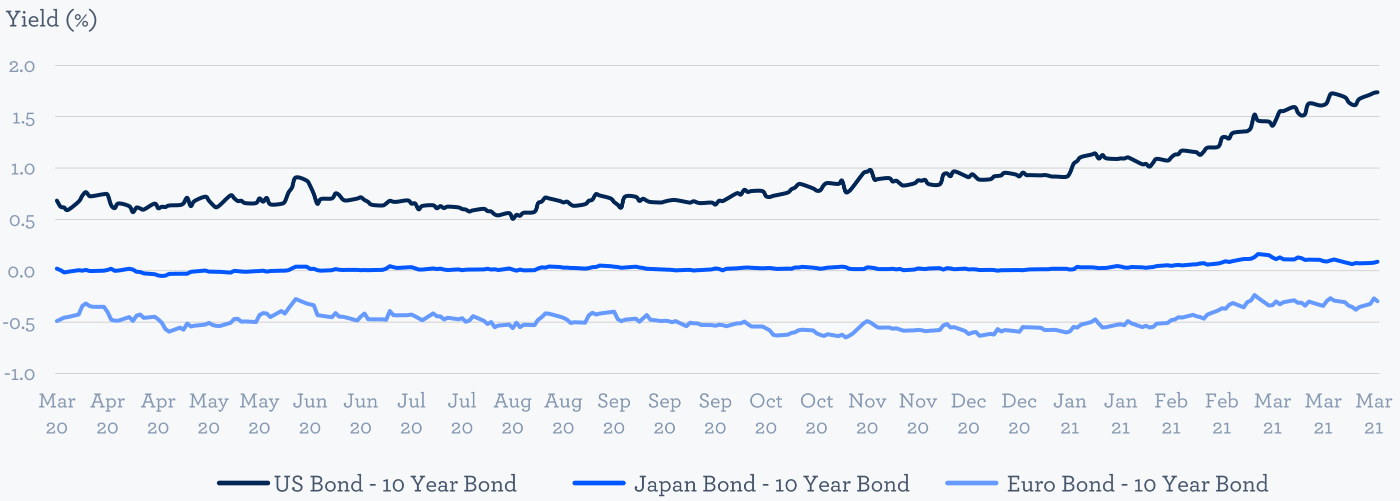
US Inflation rose to 1.7% in February, the highest annual rate since February 2020. Combined with a strong outlook for economic growth and President Biden's planned $1.9 trillion recovery package, the inflation expectations in the US improved dramatically. The US 10-year Treasury yields increased accordingly, the yield closing at 1.74% in March 2021 from 0.92% at the end of December 2020. The Fed Reserve maintained its target range of 0-0.25% and according to some recent comments from Fed officials, they are unlikely to change monetary policy any time soon.

Figure 8. Australian Government Bonds



Source: Factset, Perpetual Private. * Note: Bond prices are inversely correlated with bond yields

Figure 9. Global Government Bonds



Source: FactSet, Perpetual Private. * Note: Bond prices are inversely correlated with bond yields

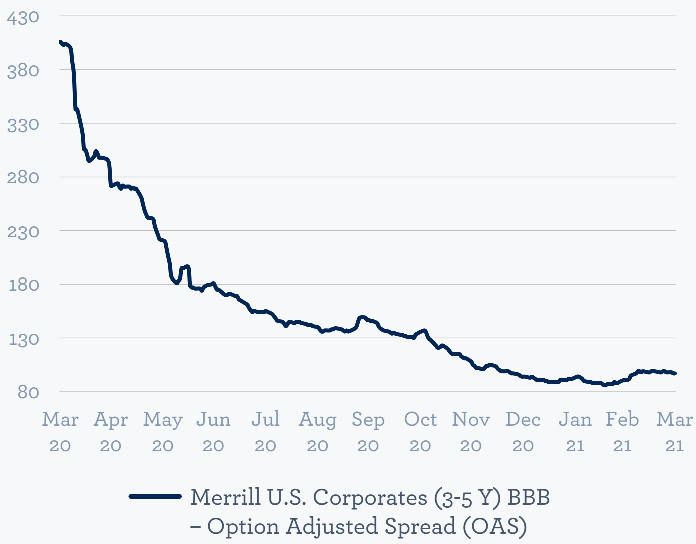
Fixed income outlook

After some very good economic news at the start of 2021 and the strong fiscal support proposed by most developed market governments, the inflation expectations in February and March drove government bond yields to post COVID-19 highs. The Fed Reserve seemed happy for the market to set the yield while the RBA's buying program was treated as too small by the market. Inflation expectations have moderated slightly but we expect continued volatility in government bonds.

We have a positive view on investment grade credit. After the short spike in credit spreads in March 2020 last year, spreads have fallen to pre-crises levels. Central bank buying prevented the worst-case scenario from happening and then the investor appetite for yield took over driving the compression in spreads. The flow of credit to the consumer and businesses have contributed to the improved outlook in the US and Australia.

There are some potential risks that may change our positive view of credit. These include a further deterioration in economic activity from COVID-19 and the deterioration of US-Chinese relations.

Figure 10. Global Credit Markets



Source: FactSet, Perpetual Private. * Note: Bond prices are inversely correlated with bond yields

Alternatives

Growth alternatives

Through the final quarter of 2020, we saw the pace of asset mark downs slow dramatically. As we moved into the first quarter of 2021, and the economic recovery gains momentum, we have begun to see valuations across Real Estate, Infrastructure and Private Equity recover. These valuations have been supported by unprecedented and coordinated fiscal and monetary policy action, the reopening of economies and the improving outlook.

Demand for Infrastructure remains strong, with institutional investors placing a premium on consistent and stable cash flows amongst the volatility created by COVID-19 and low interest rate environment. Within Unlisted Infrastructure, regulated and contracted assets remain well bid and valuations have remained stable, with demand from institutional investors remaining strong. We continue to see relative value in volume-linked infrastructure assets, across both private and public markets.

The opportunity set for Distressed Debt has been less than expected, due to policy actions of governments and central banks globally. Distressed Debt exposures with 'tradable' securities have seen a rebound in net asset valuations as liquidity continues to flood markets.

We expect the environment for Special Situations strategies to improve given COVID-19 is impacting different business models in different ways. With the reopening of economies, the Northern hemisphere summer approaching and borrowing costs remaining low, we are optimistic that the transaction environment will improve.

Within Real Estate markets, sector dispersion has been wide with Industrial and Logistics assets well bid, while valuations for Retail and Hotel/Hospitality assets remain uncertain. Similar to Private equity, capital is beginning to flow more freely, supporting acquisition activity. However, the nexus between availability of capital and valuations remains our focus. On a relative value basis, we see opportunities in income producing assets across major sectors (multi-family, office) in secondary markets.

In line with our views within credit and equity markets, the environment appears to be ripe for managers who emphasise security selection. As such, we are more positive on the outlook for certain hedge fund strategies than we have been for some years, particularly long/short equity and credit-focused strategies.

Income alternatives

Generally speaking, debt focused alternatives strategies have performed in line with our expectations. A number of exposures which had been marked down through COVID-19 have been marked back towards par. The COVID-19 recession has been very different compared to the GFC, with relatively fewer defaults and restructurings, and far more forbearance and loan holidays. Those sectors where issues are prevalent appear to be concentrated in Retail and Hospitality, Energy and Materials sectors.

Our expectations of an uptick in default rates have moderated in recent weeks and months, supported by continued fiscal stimulus and the desire of governments globally to underwrite the economic recovery. Despite an improving outlook, we continue to look for opportunities and yield across investment grade, sub-investment grade and high yield bonds as well as structured credit, where we continue to see attractive relative yields. In such an environment, we remain focused on managers where we have the highest confidence in the manager's credit analysis and security selection. One jurisdiction we do see potential risks on the horizon is Australia, where the government is actively winding back certain stimulus measures. Forecasted impacts on the economy remain varied, and we are keenly focused on official data.

We continue to monitor the Leveraged Loan market. Pricing has stabilised in recent months, however after adjusting for higher expected default rates and lower expected recovery rates, the yield remains relatively attractive.

The slowing pace of investment across corporate private debt strategies continued into the first quarter. It would appear the tick up in pace we saw immediately after the COVID-19 lockdowns was a result of pent up demand, rather than a sustained recovery. We hope to see deployment return trend by late 2021. Similarly, we have seen the pace of deployment moderate across Real Estate debt markets, with spreads tightening, particularly for development lending. Infrastructure debt remains challenging from an expected return perspective with demand from European financial institutions pushing pricing to a point where do not see value.

Published in April 2021.