Quarterly Market Update

KEEPING THE BOAT STEADY – INVESTMENT CONSIDERATIONS INTO THE END OF 2020

SEPTEMBER 2020

Perpetual

Contents

Snapshot

The September quarter was one which was typified by a gradual improvement in conditions, albeit with clear divergences between sectors and regions. Authorities have maintained the flow of significant stimulus to the economy, as the health crisis continues to impact economies by way of lockdown. The initial fear generated in early March has somewhat dissipated, leading to a broad rally in risk assets prices globally.

Australian equities

Shares in Australian companies were broadly unchanged over the quarter losing 0.1%. Despite this, the experience for the underlying sectors was markedly different with clear winners and losers, as restrictions on mobility and social distancing continue to shape the commercial landscape. Despite relative success in the handling of the pandemic, domestically focused businesses will be forced to navigate social distancing impediments and behavioural changes. For those with business interests abroad, challenges will remain as global logistics chains are strained by varying and evolving containment measures. Commodities producers (outside the Energy complex) are in an enviable position, benefiting from the combination of China's more advanced recovery and their extensive fiscal programmes.

International equities

Global equity markets saw gains, as the Information Technology sector retained its position as primary driver for the asset class. Having been direct beneficiaries of mobility restrictions, large tech companies and Consumer Discretionary stocks (think online shopping) are seeing renewed demand as infection rates climb around the world. This is likely to be ever more challenging as the northern hemisphere enters winter because recent studies show the virus can survive on surfaces for many days, particularly in cold weather. Stock markets are still seeing significant divergence between industries and geographies.

Fixed income

Bond markets continued to benefit from both fiscal and monetary support. As interest rate expectations remain anchored against a dovish monetary policy impulse, we saw government securities gaining value. Additionally, as the initial panic from the depths of March subsides, credit spreads have narrowed favouring corporate bonds. Given the stimulative impetus of governments and central banks, we expect these trends to continue for the foreseeable future, keeping the asset class well supported.

Real estate

Australian Real Estate Investment Trusts have benefited from calmer market conditions, gaining 7.4% over the quarter. Despite an impressive return of 29.1% since the end of March, significant sell-offs during the crisis see them trading 15.8% below their value 12 months ago. On the other hand, Global Real Estate Investment Trusts saw an almost flat quarter, as the changing environment led Retail, Office and Hotel & Resorts sectors to drag on returns.

Cash rate

The Reserve Bank of Australia (RBA) made no changes to its cash rate target over the quarter, holding it at 0.25%. Governor Lowe held his line given uncertainty as to whether negative interest rates actually work, thus continuing to focus efforts on other non-traditional monetary tools. Current bank actions suggest rates will be held at the current all-time low, for the next three years.

Aussie dollar

The Australian dollar recovered as market conditions calmed. Underpinned by robust trade demand from China, the dollar is near its long-term average in U.S. dollar terms. As we await meaningful new trends to emerge in economic data, major currency pairs appear to be dominated by factors of sentiment rather than fundamentals.

Alternatives

The current environment of reduced economic visibility, low interest rates and the potential for market inefficiencies, is beneficial for the prospects of alternative return sources. As a result, we are observing an increased opportunity set from which we are seeking to further improve the positioning of these strategies.

Global Economic Overview

> **"Keeping the boat steady is even more important in turbulent waters"**
> Christine Lagarde, President,
> European Central Bank (October 2020)

What Happened?

The September quarter was arguably the calmest of 2020. This should not be a surprise given the stress financial markets had experienced, first by the recognition of COVID-19 as a global pandemic in late February and subsequently by the extraordinary policy responses initiated by authorities globally.

Indeed, if we use Australian equities as the barometer, we note a relatively benign environment which returned -0.1%[1] for the three months. Internationally, when calculated in their local currencies, major markets showed more differentiation. The UK, dogged by fractious Brexit negotiations and a significant increase in virus transmission, lost 3.5%[2] and remains 19.1% below where it was at the end of March. In contrast, Germany gained 4% as its economy benefited from robust management of virus transmission in society. Whilst both countries have experienced a resurgence of cases, the UK is currently seeing new cases at a rate of three times the peak it saw in April, whereas Germany is currently tracking at only half of its April peak. More broadly, European markets were consistent with Australia's experience, delivering a tepid 0.4% return. Japan enjoyed a strong quarter, with a gain of 4.2%[3]. Hong Kong, having been caught in the crossfire of US/China diplomatic tensions and the impact of new national security laws, gave up 6.5%[4]. Globally, equities delivered gains of 3.9%[5], though this is largely explained by the large technology companies, predominantly in the U.S. The tech heavy Nasdaq index reflects this clearly, gaining 6.9%, driven by the likes of Apple, Microsoft, Amazon and Facebook who are amongst the prime beneficiaries of life under the Great Lockdown.

Bond markets extended gains, as central bank support drove interest rate expectations lower and credit spreads narrowed reflecting a greater confidence in the resilience of corporate borrowers.

This picture was consistent across the asset classes we observe, as the spike of fear that had arisen in the first half of the year, continued to subside. Reflecting this, was the VIX index (a measure of market anxiety) which fell a further 13.3% towards its long-term average.

Where are we?

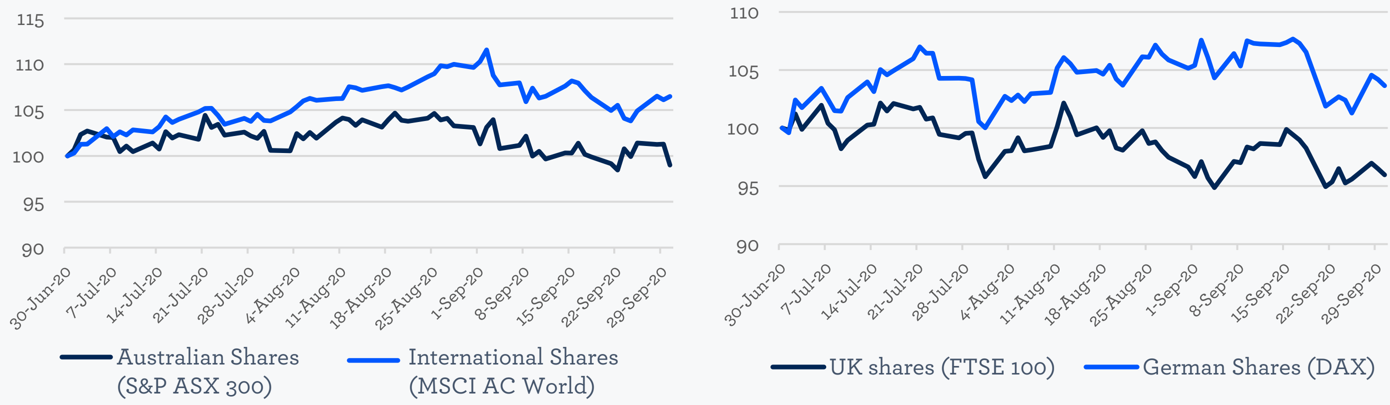
For most investors, the past three months will not have felt calm. This is a function of two factors. Firstly, work in behavioural finance tells us that investors emotionally experience losses at greater than twice the intensity to that which they experience from gains. Additionally, headlines throughout the past few months have been shrill and hyperbolic. It is worth recognising that we have welcomed into our lives, daily bulletins of infection and death rates, alongside almost constant speculation on the economic hardships driven by lockdown conditions. These issues contribute to a general sense of unease across society, including investors.

The second contributor to unease is uncertainty in the outlook. One of the biggest constraints on traditional economic indicators is their timeliness. Whilst providing a great deal of information about the strength and momentum of economies, they can take many months to finalise data points. Historically this hasn't proven to be

[1] As represented by the ASX 300 index
[2] As represented by the FTSE 100 index
[3] As represented by the Nikkei 225 index
[4] As represented by the Hang Seng index
[5] As represented by the MSCI All Countries World index

Figure 1. Chart ASX 300 vs MSCI AC World

Australian and International Shares | **UK and German Shares**

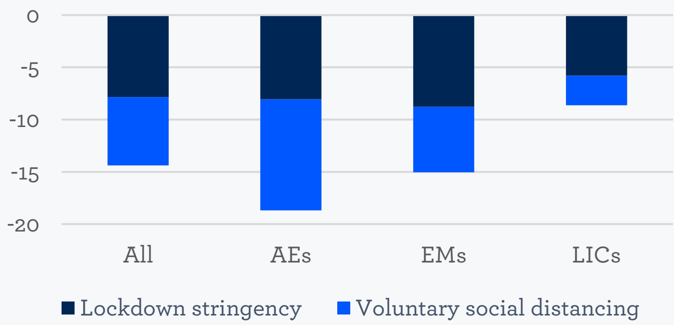


Source: Factset and Perpetual Private

too much of an impediment as economies have tended to change slowly. However, with more uncertainty on economies and the impact on growth, economists have been forced to embrace newer "higher-frequency" sources of data to better understand the developing situation. The International Monetary Fund, for instance, has begun interesting work using Google Mobility Reports to understand societal responses to the virus. Recently on their blog, they showed that people are voluntarily self-distancing, in excess of the lockdown requirements imposed by governments. This is interesting as it supports the notion that even once lockdowns are no longer imposed, a change to consumer behaviour is likely to remain. The RBA's deputy Governor, Guy Debelle, acknowledged as much at a speech in late September, stating "behavioural responses are having a significant impact on the shape of the recovery"[6], "Until households and businesses are confident about future demand and income, they will be reluctant to spend and invest."[7]

Encouragingly, even after allowing for weaknesses, traditional measures of economies have been painting a stronger picture of health, than had been expected, even just a few months ago. Locally the RBA has pointed to a "decline in output [that was] smaller than in most other countries and smaller than what was earlier expected"[8] and "labour market conditions [that] have improved somewhat over the past few months"[9]. The European Central Bank (ECB) credits national fiscal policy measures with having "successfully prevented a large-scale increase in unemployment", citing estimates of millions of people having been kept in jobs as a result. As we have previously argued, connections between businesses and employees are of crucial importance for an economy's ability to recover from this shock. Indications of resilience in these connections allow for a more optimistic outlook.

Figure 2. Lessons from the early phase of the pandemic



Note: The chart displays the contribution of lockdowns and voluntary social distancing in reducing mobility during the first three months of each country's epidemic.

Source: "Covid's Impact in Real Time: Finding Balance Amid the Crisis", Francesco Grigoli and Damiano Sandri, IMF Blog

What are the dark clouds on the horizon?

Despite cause for cautious optimism, there are several obvious threats to the recovery that "has not been a rapid bounce but more of a slow grind"[10].

The most immediate and obvious concern for markets is the US presidential election. During a time in which we have been drowned in the use of the word "unprecedented", President Trump has broken with convention more times than we care to count. Given that both he, and Vice President Mike Pence have refused to commit to a peaceful transfer of power should they lose in November, markets must contend with a third source of uncertainty for the world's largest economy.

[6] "The Australian Economy and Monetary Policy – Virtual Conference", 22nd September 2020, Guy Debelle, Deputy Governor, RBA
[7] "The Australian Economy and Monetary Policy – Virtual Conference", 22nd September 2020, Guy Debelle, Deputy Governor, RBA
[8] "Statement by Philip Lowe, Governor: Monetary Policy Decision" 6th October 2020, Phillip Lowe, Governor, RBA
[9] "Statement by Philip Lowe, Governor: Monetary Policy Decision" 6th October 2020, Phillip Lowe, Governor, RBA
[10] "The Australian Economy and Monetary Policy – Virtual Conference", 22nd September 2020, Guy Debelle, Deputy Governor, RBA

Whilst there is a low probability that this will happen, there is not a zero probability and assets will bear some of this concern until it is resolved. Looking through a financial market lens, the best outcome would be a clear and decisive win for either candidate.

In addition, we are in a time when geopolitical tensions are heightened. We note risks with the U.S./China relationship militarily and economically, Russia and ex-soviet states experiencing armed conflict, and a nuclear capable North Korea to name a few.

Brexit is another issue that will occupy the concerns of markets, as British Prime Minister Johnston has threatened to crash out of the EU without a trade agreement, should one not be reached by the 31st of December. Whether this is more than a bargaining tactic remains to be seen, but the likely disruption of exchange between the trading partners, when pressures from a second wave of infections whose transmission is likely to be benefiting from a European winter, would place further pressure on the economic recovery.

All the while, COVID-19 continues to be passed between thousands of new hosts every day, with the chance of mutation always a possibility. Should a significant mutation occur and become prevalent, efforts to develop a vaccine will likely be set back, further extending lockdowns and increasing economic headwinds.

These considerations are not insignificant on an individual basis. If they occur in combination, they provide more than enough pressure to threaten the tentative recovery.

While we reflect on this, the relative level of the VIX index (a measure of market stress) is significantly below the levels it saw in February and March but is still elevated against its long-term average. This is how we're viewing investment markets; a heightened level of caution, alongside tentative confidence in a nascent recovery.

Where to from here and how should I consider investing in this environment?

The old investors adage that "markets climb a wall of worry", infers that, despite many prevailing headwinds, asset prices tend to appreciate over time. Over the coming months, we are anticipating heightened volatility as these issues rise and fall away.

In such situations, opportunities can be found during periods of market dislocation. Having confidence and expertise to exploit these opportunities can lead to success for patient investors as near-term risks are resolved.

Central banks and governments have so-far successfully utilised extreme amounts of market power in the form of stimulus. They stand ready to do the same again, as and when it's necessary. In his speech to fellow central bankers at the annual symposium in Jackson Hole, Andrew Bailey the governor of the Bank of England commented in celebration of these stimulative measures, "there are times when we need to go big and go fast"[11]. As such, we believe that they are likely to do so, until they are successful or are unable. This is a good thing from an investment point of view, though we do hope for more finesse as time progresses. The blunt instruments employed to-date have been effective but as the recovery will likely continue to be uneven across geographies and sectors, we expect measures to become more refined. In the words of Christine Lagarde, "national support measures should be temporary and targeted to ensure that only structurally sound firms are supported"[12]. Implicit in this statement, is the acknowledgement that stimulus is not without cost or unintended consequences. For the ongoing strength of economies, it is important that "capital and labour flow to the most productive companies in the economy".

Enjoying the greater calm of the past few months, investors should be prepared for a few more chapters in the story, before expecting markets to find a stable equilibrium. In the meantime, there remain four guiding principles which we advocate:

1. **Stay calm –** Having already experienced a difficult period this year, it is worth reflecting on how much damage could have been done to investment returns had you panicked, selling assets at lows only to buy them back later at elevated prices. Studies show that this is an all too common investor behaviour.
2. **Stick to the plan –** Having a well-considered long-term plan, is a great touchstone in times of crisis. Effective planning includes consideration of good and bad times, and thus reducing the chance of needing to make drastic changes in fast moving markets.
3. **Rebalance –** If market movements have taken you away from your target asset weights, seek to resolve this. Asset allocation is one of the most effective ways you can control the risks in your portfolio, often explaining more than 90% of returns.
4. **Scan the market –** Correctly identifying winners and losers in the world that emerges from the health crisis of COVID-19, is likely to deliver enhanced risk/reward metrics. Our belief in active management speaks to this, as it will be those with robust analysis techniques who have the best chance of being correctly positioned for the new landscape.

As we prepare to farewell the most challenging calendar year in recent times, it will be helpful in retaining a healthy sense of perspective. The world has become a challenging place, but we for the most part, have come through it in good shape. Asset values are not significantly below where they were at the beginning of the year, despite a once-in-a-hundred-years shock. The end of the year is traditionally a time for family and friends, and we hope that you like us, will be spending time with these infinitely valuable assets, as often as you can.

[11] "Speech – The central bank balance sheet as a policy tool: past, present and future", 28th August 2020, Andrew Bailey, Governor of the Bank of England
[12] "Written interview with Harvard International Review", Interview with Christine Lagarde, President of the European Central Bank

Australian cash rate and dollar

With the target rate held at 0.25% and the Board being philosophically opposed to negative interest rates, we do not see a reduction in the cash rate by the RBA in the near future. Indeed, against the broader economic backdrop and based on comments by Governor Lowe, our base case is for this rate to remain unchanged for the next three years. Based on today's facts, it is more likely that additional easing measures will be deployed long before we see any increase in rates.

As tensions eased over the quarter, strength continued to drive the Australian dollar. It now trades near its long-term average against the USD, which is at the core of our future expectations for its value. The RBA echoed very similar sentiments when they considered the potential for intervening in currency markets, stating "with the Australian dollar broadly aligned with its fundamentals, it is not clear this would be effective in the current circumstances"[13].

Changes against most other major currencies were unremarkable with the Japanese Yen, Euro and Pound changing 1.4%, -0.6% and -0.5% respectively.

Australian Dollar Outlook

Australia has benefited from an increasingly constructive market environment. As it has in previous years, the trade relationship with China looks likely to continue to support its value, although there are threats to this relationship on the horizon. As China's draconian lockdown measures have benefited its recovery, a renewed thirst for commodities is likely to continue to drive these factors.

Figure 3. Australian long-term interest rates
Long-Term Cash Rate VS Inflation

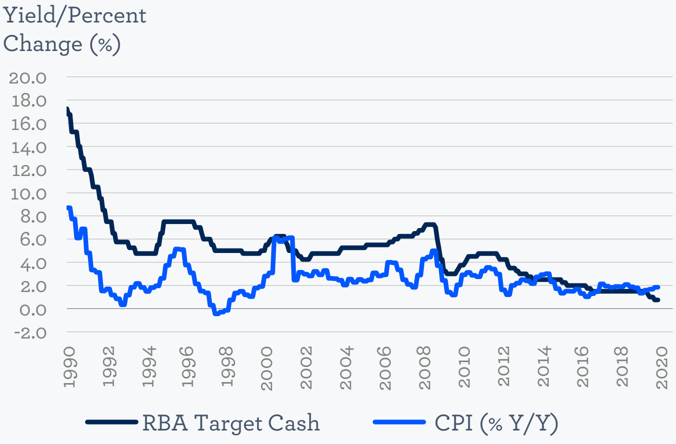
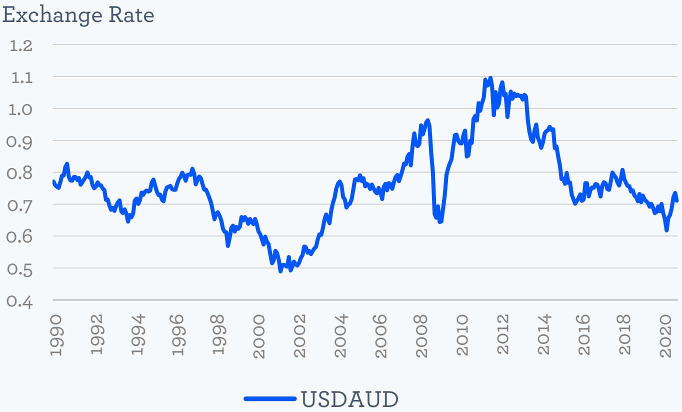


Figure 4. Australian Dollar U.S. Dollar (Daily) Long Term
USD Per AUD Long-Term Exchange Rate



Source: Factset

[13] "The Australian Economy and Monetary Policy – Virtual Conference", 22nd September 2020, Guy Debelle, Deputy Governor, RBA

Australian and international equities

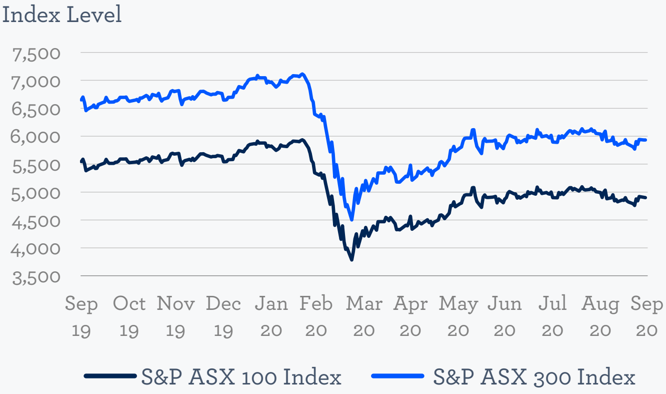
Australian equities

The Australian equity market, as measured by the S&P/ASX 300 Index, took a breath this quarter and finished down 0.1% after gaining 16.79% in the previous quarter. The local market underperformed the aggregate global index, reversing last quarter's trend as measured by the MSCI All Country World Index, which posted a gain of 3.7% in local currency terms. Domestically, sector returns were more varied this quarter with positive returns from the Information Technology, Consumer Discretionary and Materials sectors which generated gains of 13.0%, 10.1% and 4.1% respectively. While Energy, Utilities and Consumer Staples stocks were the weakest performers for the quarter generating losses of 13.5%, 8.2% and 3.9% respectively.

On the economic front, the economy has officially dipped into recession for the first time since 1991, as governments at both the federal and state level heavily restricted the flow of people and commerce in an effort to blunt the spread of the virus. To offset the massive economic hardship resultant of such a strategy, record stimulus and support packages have been provided to soften the economic and social impact. However unemployment has risen sharply and is expected to increase further when JobKeeper payments and other subsidies start to roll off.

Figure 5. Australian Shares

Australian Shares – Large Companies



Source: Factset

Since the start of the year, the markets attention continues to be gripped by the COVID-19 pandemic and the effects it is having both domestically and offshore, where it continues to cause havoc in both the developed and developing worlds. Although the situation in Australia when compared to many parts of the world is very good, the economic and social impacts are not fully yet known and will most certainly be significant and long lasting.

Australian equities outlook

The domestic share market finished the quarter on a largely flat note which given the highly uncertain earnings period could be considered a positive result. After the previous quarter's strong recovery, the local market is in a much stronger position, although still off its recent highs. Technology and Consumer driven stocks, boosted by government stimulus, continue to drive the market forward.

Although the outlook continues to remain uncertain, the first quarter market sell-off gave fundamental stock pickers the opportunity to establish well weighted positions in high quality companies that the market in its panic had mispriced. Although this period of low hanging fruit has almost passed, there remains opportunities for managers who take a long-term high conviction approach to investing in high quality companies with sustainable long-term earnings.

International equities

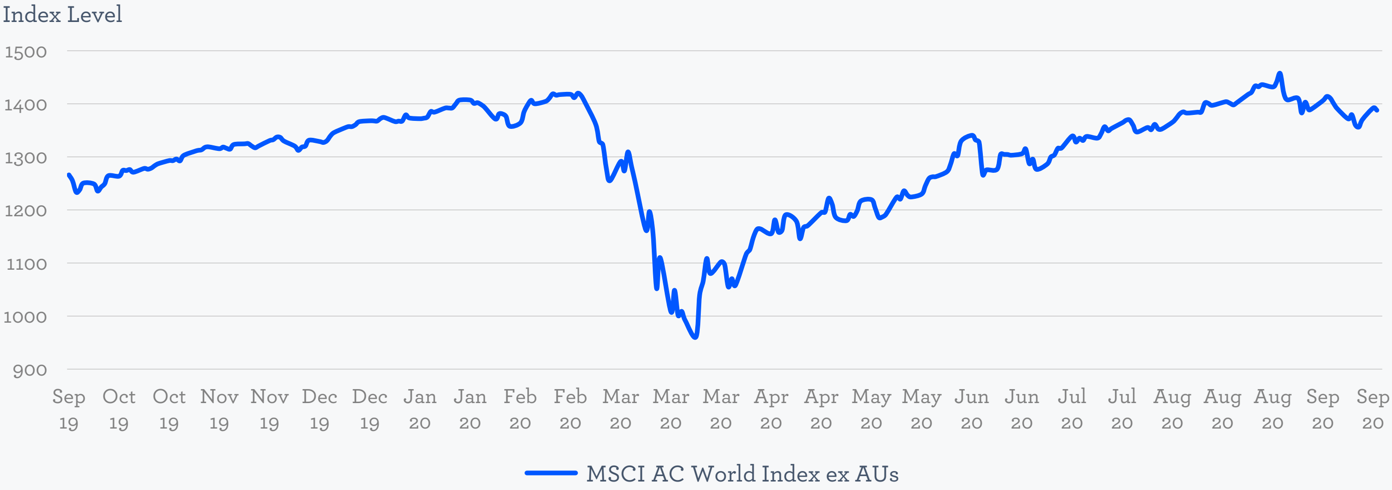
Global equity markets rallied higher in Q3 despite a pullback in mega cap tech stocks in September. Emerging market equities beat developed markets, global growth outperformed value for the seventh consecutive quarter, whilst large caps bested small caps. The MSCI All Country World Index gained 6.9% in local currency terms. US equities had another strong quarter, gaining 8.8%, outpacing both developed market peers and emerging markets: the MSCI EAFE (Europe, Australasia and Far East) index posted a 1.2% return and the MSCI Emerging Markets' index returned 8.6%.

Consumer discretionary stocks had a strong quarter, returning 16.8%. Despite a selloff in September, information technology stocks continued their rally in Q3, returning 12.0%. Materials delivered a healthy 9.6% return, industrials gained 9.4%, and communication services 6.6%. The worst performing sector was energy with a negative 13.6% return.

International equities outlook

We expect volatility in global equity markets to remain elevated as investors and economies attempt to navigate their way out of the health crisis. Geopolitical risks are heightened as unilateral and often divisive foreign policy has increased. This in turn has increased the fragility of the post WWII world order, reflected in China's increased assertion and U.S. power appearing to wane. These issues though tend to play out over years and decades rather than months, so we see them as long run trends rather than immediate concerns. It is likely that the future looks very much like the past quarter, with a grinding recovery atop of some meaningful divergences for individual countries and sectors.

Figure 6. International Shares (Local Currency Terms)



Source: Factset

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

In Australia, A-REITs rose 7.4% over the quarter, outperforming the broader Australian equity market. Despite this outperformance, A-REITs still trail Australian equities over the past 12 months. The main news during the quarter was Unibail announcing its ‘Reset plan’, which involves a EUR3.5b rights issue and EUR4.0b of asset sales. Additionally, Scentre issued a 60 year USD3.0b subordinated hybrid at a blended coupon of 4.93% which will be treated as equity for covenant purposes. On the transaction front, Charter Hall Long WALE and Charter Hall Retail acquired a 49% interest in BP NZ on a 6.25% yield.

In AUD terms, Global Real Estate Investment Trusts (G-REITs) fell 1.9% over the quarter to the end of September 2020 (as measured by the FTSE EPRA/NAREIT Developed Index). On a currency hedged basis, the FTSE EPRA/NAREIT Developed Index rose by 0.6%. Similar to last quarter, company fundamentals were not the market’s focus. Rather, market participants were focused on monetary and fiscal stimulus measures, and increasingly the upcoming US Presidential Election. The variance between sectors during the quarter was marked with Self Storage and Hotel / Lodging REITs rallying strongly, while Retail and Office REITs underperformed the broader market.

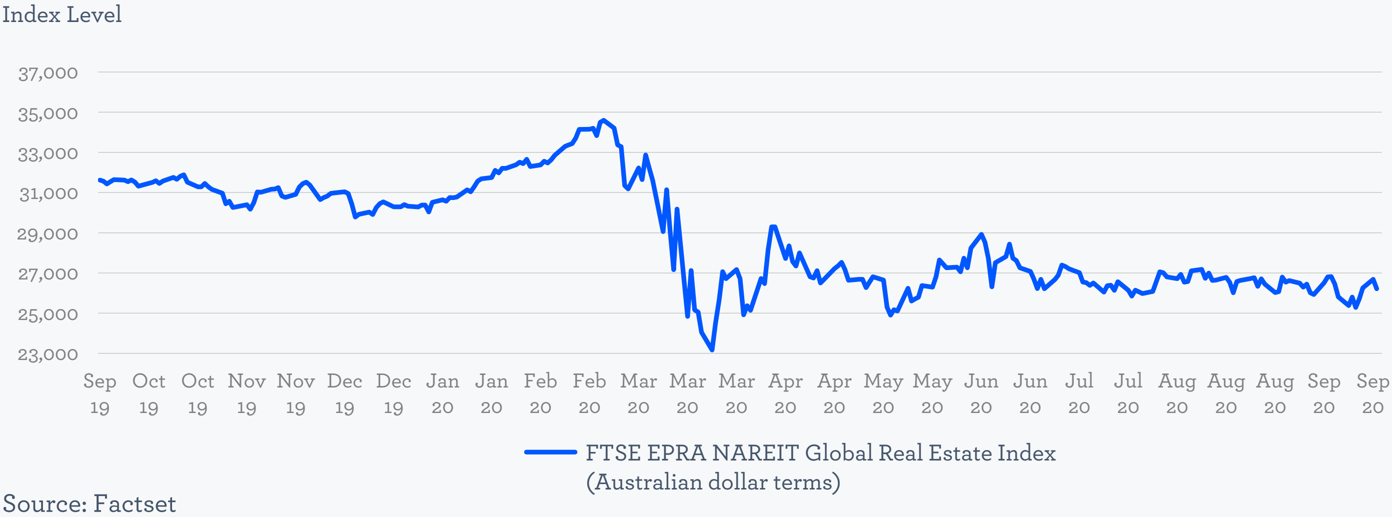
Figure 7. Australian Real Estate Investment Trusts (A-REITs)

Property

Index Level

Source: Factset

Figure 8. Global Real Estate Investment Trusts (G-REITs)
Property



Source: Factset

REITs outlook

The COVID-19 pandemic continues to result in significant disruption, volatility and uncertainty in the global economy and financial markets. Despite the market rally post March, COVID-19 and government policy responses have created uncertainty across real estate markets. Until markets have 'certainty' around government policy as it relates to when normal economic activity can recover, and become self-sustaining, we expect markets to be less focused on company and real estate fundamentals.

While many REITs were in good shape coming into the crisis, operating conditions have changed meaningfully for some sectors, including Hotels, Retail and Office. It is still unclear as to what the near, medium and long-term impacts will be on revenue and earnings. For corporates, it's likely that management teams will use this crisis to further 'right size' their retail footprints. With working from home becoming the norm for many companies during this period, it is possible there may be a shift in thinking about office space requirements by many corporates as leases expire over the coming months and years.

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. 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.

Given the recent drawdown in markets, valuations appear to be more attractive relative to the recent past. However, we remain cautious on the robustness of short-term earnings underpinning current valuations and the valuations ascribed to various assets. Longer term, we believe that REITs are well placed to benefit once the economic recovery begins to take hold. Furthermore, we expect the accommodative monetary policy and quantitative easing to remain a feature of markets for some time to come, supporting real estate values.

Fixed interest

The Bloomberg AusBond Composite Index returned 1.02% during the September 2020 quarter, whilst the Bloomberg AusBond Bank Bill Index returned 0.03%. The Bloomberg Barclays Global Aggregate Bond Index (AUD Hedged) returned 0.68% during the September 2020 quarter. Australian 10-year bonds were yielding 0.85% at the end of the quarter, whilst its US counterpart was yielding 0.68%.

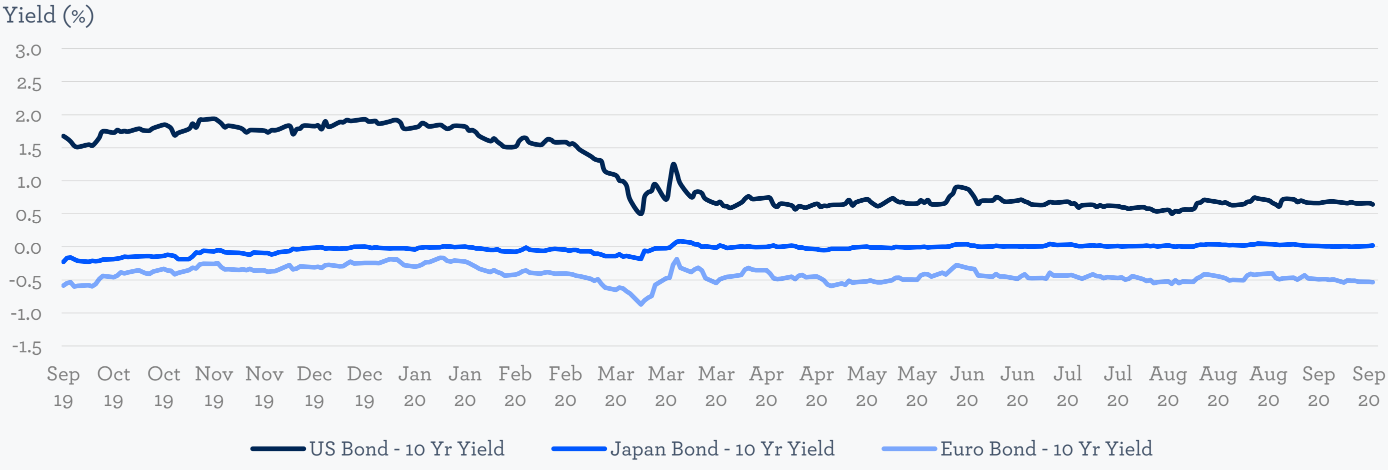
The RBA kept the official cash rate steady at 0.25%. In the 6th October 2020 statement by the RBA Governor, Philip Lowe, re-affirmed that the RBA board will "do what it can to support jobs, incomes and businesses in Australia". The Australian seasonally adjusted estimated unemployment rate fell to 6.8% in August, down from 7.5% in July. The All groups seasonally adjusted Consumer Price Index (CPI) fell 2.0% in the quarter to June 2020 with falling prices in transport, household equipment & services and education.

The Federal Reserve also maintained its target rate in a range of 0.00-0.25%. In their September meeting, the Federal reserve committee expected to maintain an accommodative stance of monetary policy until inflation is anchored at around 2%. In August 2020, annual US inflation was 1.3%, up from 0.6% in June 2020. The Federal Reserve have upgraded their projections for US real GDP to -3.7% versus its June projection of -6.5%, helped by policy measures and the continued flow of credit into the economy.

Figure 9. Australian Government Bonds

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

Figure 10. Global Government Bonds



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

Fixed interest outlook

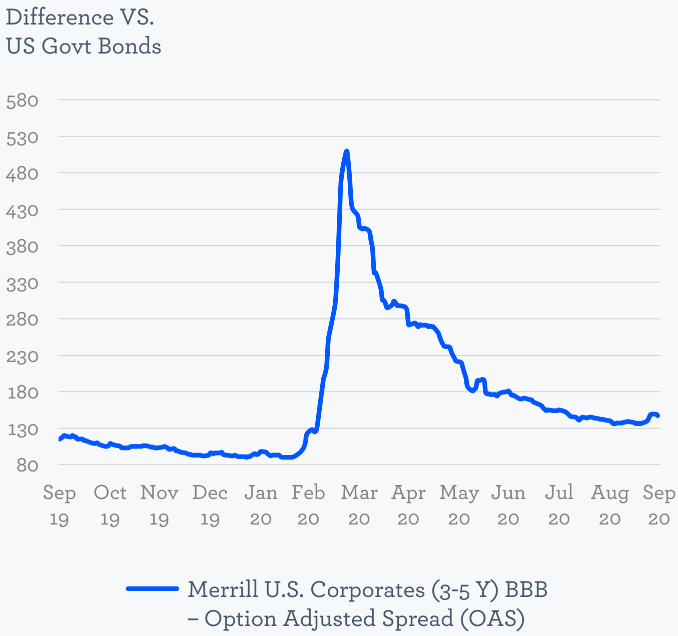
We expect monetary policy to remain accommodative globally until economic growth is re-established.

The ECB, Federal Reserve, Bank of England and the RBA all kept their target rates at historical lows. It is unlikely central banks will allow for government bonds yields to move materially higher from current levels to ensure debt affordability until growth and inflation expectations are normalised.

We have a positive view on investment grade credit. After the short spike in credit spreads in March, spreads have fallen to more normal levels, fuelled by asset buying programs from the ECB, Bank of England and the Federal Reserve. The eased flow of credit to the consumer and businesses have contributed to the improved US growth forecasts by the Federal Reserve and the improved inflation expectations of the ECB. All three central banks have indicated that these programs will remain open for the foreseeable future.

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

Figure 11. Global Credit Markets



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

Alternatives

Defensive alternatives

For the Perpetual Income Opportunities Fund (IOF), our focus across non-investment grade credit remains within senior secured leveraged loans, predominantly in the USA and Europe. This is a floating rate, liquid bank loan syndicated market. As at the end of the June quarter, the bounce from COVID-19 induced lows has pushed current investor yields (to maturity) down to approximately 6.8% from 9.9% p.a., with an equivalent average credit spread of 6.5% p.a., at an average price of 89.5 cents in the dollar. Whilst current default rates remain relatively low across both sides of the Atlantic, they are expected to rise as the impacts of the crisis are felt throughout various sectors of the economy. On a positive note, this market has little exposure to the energy and energy related sectors, which have faced particular difficulties on the back of a contraction in demand, and a breakdown in negotiations between OPEC producing nations and their allies.

We increased IOF's exposure to the leveraged loan market at the beginning of the June quarter and took advantage of lower prices as the market looked attractive, after adjusting for higher expected default rates and lower expected recovery rates. We intend to opportunistically allocate capital in the medium term as we continue to monitor the ongoing developments of the COIVD-19 pandemic.

To further diversify our traded credit exposure, our research pipeline includes managers and strategies across diversified credit strategies, which in addition to syndicated bank loans, incorporate high yield and structured credit opportunities. We believe now is a very good time to fast track this research, given the impact to liquidity that COVID-19 has had across broader credit markets, particularly those of a structured nature, such as Residential & Commercial Mortgage Backed Securities.

In private and unlisted credit, Australian and global banks continue to consolidate their loan books, providing opportunities for skilled managers to conduct direct lending to companies that require capital. Our focus is on lending strategies that are senior in the capital structure and secured against assets. Across the Perpetual Income Opportunities Fund we have identified and built material investments in four key credit sectors:

1. infrastructure debt,
2. private corporate debt,
3. senior bank loans, and
4. commercial real estate mortgages.

COVID-19 is likely to create significant private debt opportunities going forward. The funds are invested in private debt strategies which have ample dry powder to take advantage of such opportunities.

The specialist credit allocation within the portfolio is currently yielding approximately 3.5% per annum (net of fees). In comparison, the Australian cash rate is currently yielding 0.25%.

Growth alternatives

Despite a lower interest rate outlook, the Perpetual Growth Opportunities Fund's (GOF) exposure to listed infrastructure has seen adverse impacts from the COVID-19 pandemic. This impact has been pronounced in areas such as airports and toll roads, which are expected to incur significant revenue declines. We had opportunistically lightened the fund's exposure following a bounce in the sector during late March. We expect to be adding to current exposures during periods of weakness.

Absolute return funds, including GOF's investment into Invesco's Global Targeted Return Fund ('Invesco GTR'), delivered flat to positive returns during the September quarter. COVID-19 has seen short term activity across private equity and debt markets grind to a halt, which will delay the pace of realisations previously expected across the portfolios. Valuations across private markets, private infrastructure, private equity, private property and private debt, are likely to come under pressure over the short to medium term. At this stage, it is too early to ascertain the impact, with a lot still depending on the duration of the crisis. However, we are comfortable that the managers and strategies we have invested with are high quality, and that value will be realised over the longer term.

Throughout late 2018 and 2019, we maintained a cautious approach towards private equity and private infrastructure, given heightened levels of deal activity, rich valuations and heightened levels of leverage within some strategies. We allocated minimal capital to these sectors and our approach remains to selectively invest with managers and strategies that operate in niche markets, which are relatively less competitive and well sized to provide flexibility when exiting. Our biases away from sector specific strategies (e.g. energy, consumer) adds an additional layer of diversification, which will protect the downside in the current environment.

Exposure to distressed debt and restructuring strategies will incur some volatility in the current environment. We had opportunistically increased the exposure to distressed debt and restructuring strategies during late 2017 and early 2018. With a significant amount of dry powder left to invest, these strategies are well placed in today's environment. COVID-19 may prove to be an event, which will necessitate further restructuring and consolidation, providing ample opportunities for these strategies to deploy capital.

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