Perennial Value Shares for Income Trust

Monthly Report January 2022

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception^ (% p.a.)
Income Distribution	0.5	1.4	3.2	5.7	8.1	7.3	6.2
Capital Growth	-3.2	-1.1	-4.7	5.5	-0.6	-2.5	-0.2
Total Return	-2.8	0.4	-1.5	11.2	7.5	4.9	6.0
Franking Credits#	0.2	0.7	1.4	2.5	3.4	3.0	2.4
Income Distribution including Franking Credits	**0.7**	**2.1**	**4.6**	**8.2**	**11.5**	**10.3**	**8.6**
Benchmark Yield including Franking Credits*	0.0	0.6	2.6	5.3	5.1	5.5	5.9
Excess Income to Benchmark#	**0.7**	**1.5**	**2.0**	**2.9**	**6.4**	**4.8**	**2.7**

^Since inception: December 2005. Past performance is not a reliable indicator of future performance. #Franking credits are an estimate as tax components will only be known with certainty at the end of the financial year. *Benchmark yield including franking credits is calculated as the difference between the return on S&P/ASX300 Franking Credit Adjusted Daily Total Return Index (Tax Exempt) and the return of the S&P/ASX300 Index.

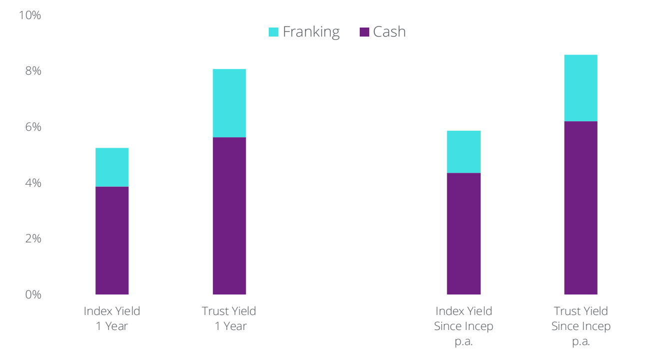
Overview

Global markets were weaker in January, as the comments by the US Federal Reserve were interpreted as suggesting that monetary tightening may be earlier and more aggressive than had previously been expected.

The Australian market was also down in January, with the ASX300 Accumulation finishing the month down -6.5%. The Index was cushioned to some extent by very strong performances from the Resources and Energy sectors, driven by rallies in the iron ore and oil prices.

Looking to the current financial year, the Trust is currently targeting a 30% increase in FY22 net distribution to 5.5 CPU. Based on the unit price at the start of the year, this equates to a cash distribution yield of around 5.5% and 7.5%, including franking credits.

Distribution Yield



Performance shown net of fees with distributions reinvested. Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Fund Characteristics

The objective of the Trust is to provide investors with an attractive level of tax effective income, paid via monthly distributions. The Trust aims to provide a gross distribution yield, adjusted for applicable franking credits, above that provided by the S&P/ASX300 Franking Credit Adjusted Daily Total Return Index (Tax-Exempt).

Portfolio Manager
Stephen Bruce

Trust FUM
AUD $19 million

Distribution Frequency
Monthly

Minimum Initial Investment
$25,000

Trust Inception Date
December 2005

Fees
0.92%

APIR Code
IOF0078AU

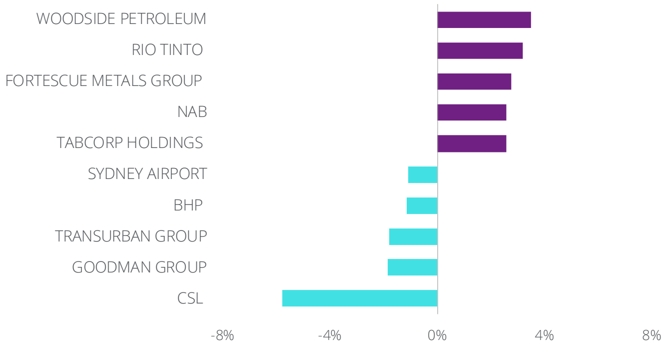
Portfolio Characteristics – FY22	Trust	Market
Price to Earnings (x)	12.6	15.9
Price to Free Cash Flow (x)	10.4	14.6
Gross Yield (%)	7.4	5.1
Price to NTA (x)	2.5	2.8

Source: Perennial Value Management. As at 31 January 2022

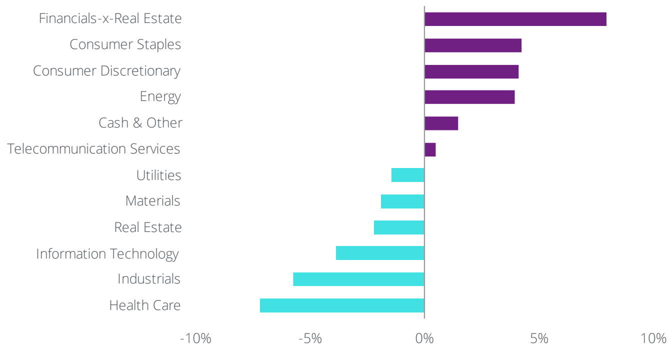
The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Franking Levels (%)			
FY21	90.3	FY18	99.2
FY20	94.4	FY17	65.6
FY19	95.1	FY16	55.9

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The strong run global markets had been experiencing came to an abrupt end in January, as investors began to factor in the prospect of interest rate hikes and the end of bond buying by the Fed. This had been expected for some time, given the strength of the post-COVID economy and the high level of inflation, however, the tone of commentary from the Fed was more hawkish than some had hoped. The result was a sharp sell-off in those parts of the market most lacking in valuation support. In particular, expensive growth and loss-making tech stocks were hit very hard. By contrast, the better value parts of the market tended to outperform. This saw the Trust outperform by +4.0% over the month.

Within the Australian market, commodities were again the standout in January, with the Energy (+7.5%) and Metals and Mining (+1.6%) sectors outperforming strongly. While over the long-term, the demand for oil and gas will decline as it is replaced by renewables, in the short-term, it is indispensable. The rebound in demand post-COVID, combined with a period of underinvestment has seen prices rising very strongly, with Brent crude finishing the month at over US$90 per barrel – the highest level since 2014. Gas prices have been similarly strong, exacerbated by the tensions in Ukraine. This saw a very strong performance from Woodside Petroleum (+14.3%).

Moves by the Chinese government to stimulate their economy and support their property market have seen a strong rally in the iron ore price, which finished the month at over US$140 per tonne. At these levels, the iron ore miners are generating huge amounts of cash. Given their already de-geared balance sheets, this can be returned to shareholders or used to fund growth projects. This saw strong outperformance by the bulks miners, with BHP (+11.7%), Rio Tinto (+11.4%) and Fortescue Metals (3.4%). During the month, BHP also completed the collapse of its dual listing structure, converting all of its shares into one class. This resulted in its index weighting in Australia increasing by around 60%, making it the largest stock on the ASX.

UK challenger bank, Virgin Money UK (+8.2%), performed very strongly. Bank earnings are highly leveraged to interest rates and the expectation is that rates will soon rise in the UK. This stock is trading on a very cheap valuation and has the potential to re-rate strongly as the UK economy normalises.

Insurance stocks IAG (-0.5%) and Suncorp (-0.3%) also both outperformed, with continuing strength in premium rates, combined with the benefits they will receive from higher interest rates on earnings from their investment portfolios. We believe that the insurance sector is trading on an attractive valuation and offers significant upside at present.

Fertiliser manufacturer, Incitec Pivot (+1.2%), also outperformed. Global fertiliser pricing is at record levels, with strong demand driven by positive agricultural conditions in most regions. Margins are at very high levels due to the dynamics of the gas market which have pushed up the cost curve of the marginal producer. Should this continue, we expect ongoing earnings upgrades over the coming year.

Holdings which underperformed during the month included Sonic Healthcare (-18.7%) and Healius (-15.9%), as the level of PCR testing began to fall from its recent very high levels. These stocks provide something of a hedge should there be a resurgence or new COVID variant.

Trust Activity

January was a quiet month, with no significant changes to the portfolio. We are comfortable with our key exposures to the resources and banking sector, which should both generate attractive levels of dividend income and provide leverage to the ongoing economic recovery. We also see significant upside in the Energy sector to which we are exposed through Woodside Petroleum. These more cyclical exposures are balanced with high quality defensive holdings such as Woolworths and Telstra. At month end, stock numbers were 31 and cash was 1.5%.

Distribution

In order to provide a regular income stream, the Trust pays monthly distributions. We aim to pay equal cash distributions each month, based on our estimate of the dividend income to be generated over the year. Franking credits, surplus income and any realised capital gains will then be distributed, as per usual, with the June distribution.

Despite the current COVID outbreak, many businesses are seeing strong operating conditions. Further, corporate balance sheets are generally strong. In particular, the banks are holding significant surplus capital and the resources sector is largely debt free and generating very strong cash flows. This should underpin an attractive level of dividends in the year ahead. In addition, many companies are likely to undertake capital returns such as off-market buy-backs to return excess capital and franking credits to investors.

As a result, the Trust is currently targeting a 30% increase in FY22 net distribution to 5.5 CPU. At the opening unit price of $1.02, this represents a net distribution yield of 5.5% or 7.5% including franking.

Outlook

Looking ahead to 2022, assuming that vaccines prove to be effective against the Omicron COVID variant, we see the outlook as positive, with ongoing economic recovery, underpinned by relatively low interest rates and continuing stimulus measures. Further, we look forward to the return to a more "normal" economic environment, as tapering and rate rises start to see the distortions caused by extremely low interest rates and unconventional monetary policy abate.

Domestically, the end of the COVID lockdowns and reopening of borders is set to see activity pick up and we would expect the economy to bounce back strongly, just as it did following previous lockdowns. Key economic indicators continue to be strong and while there are some concerns around supply chain issues and inflationary pressures, both corporates and consumers are in good shape. If this improvement continues, then corporate earnings and dividends are likely to continue to grow over the coming year.

The Trust is positioned to benefit from an ongoing economic improvement. In the meantime, the Trust continues to offer a higher forecast gross yield than the overall market and, as always, our focus will continue to be on investing in quality companies with strong balance sheets, which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors. Further, we believe the current very low interest rates highlight the relative attractiveness of financially-sound, high dividend-yielding equities.

Invest Online Now

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