Perennial Value Shares for Income Trust

Monthly Report September 2022

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception^ (% p.a.)
Income Distribution	0.5	1.6	1.6	11.1	7.5	8.0	6.6
Capital Growth	-5.5	-2.5	-2.5	-14.1	-5.9	-3.8	-1.0
Total Return	-5.0	-0.9	-0.9	-3.0	1.6	4.1	5.6
Franking Credits#	0.4	0.6	0.6	5.0	3.2	3.4	2.4
Income Distribution including Franking Credits	**0.9**	**2.2**	**2.2**	**16.1**	**10.7**	**11.4**	**9.0**
Benchmark Yield including Franking Credits*	1.6	2.5	2.5	5.4	5.0	5.5	5.9
Excess Income to Benchmark#	**-0.7**	**-0.3**	**-0.3**	**10.7**	**5.7**	**5.9**	**3.1**

^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.

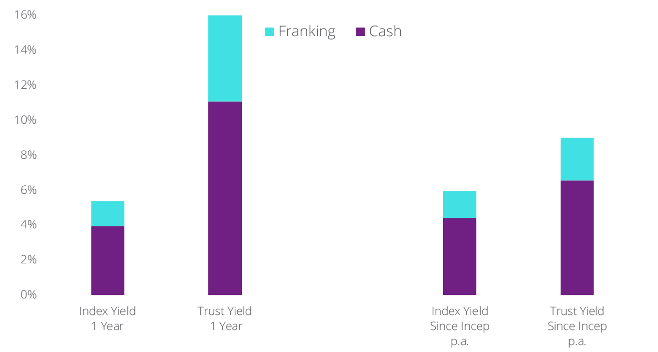
Overview

Persistently high inflation and ongoing hawkish commentary from the US Fed and other central banks, saw bond yields rise and growth expectations fall, sending global markets sharply lower in September.

The Australian market was also weaker in September, with the ASX300 Accumulation Index finishing the month down -6.3%. The Resources sector again outperformed, while interest rate sensitive sectors such as Utilities, REITs and IT were down sharply. Concerns over a darkening economic outlook saw the Industrials and Consumer Discretionary sectors weaker also.

The Trust is currently targeting a 5% increase in FY23 net monthly distributions to 0.49 CPU. Based on the unit price at the start of the financial year, this equates to an annualised cash distribution yield of around 6.7% or 9.6%, 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 $18 million

Distribution Frequency
Monthly

Minimum Initial Investment
$25,000

Trust Inception Date
December 2005

Fees
0.92%

APIR Code
IOF0078AU

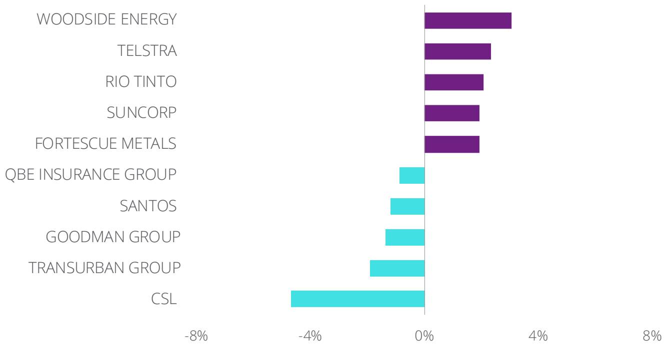
Portfolio Characteristics – FY23	Trust	Market
Price to Earnings (x)	12.9	14.4
Price to Free Cash Flow (x)	13.8	13.6
Gross Yield (%)	7.0	5.6
Price to NTA (x)	2.3	2.5

Source: Perennial Value Management. As at 30 September 2022

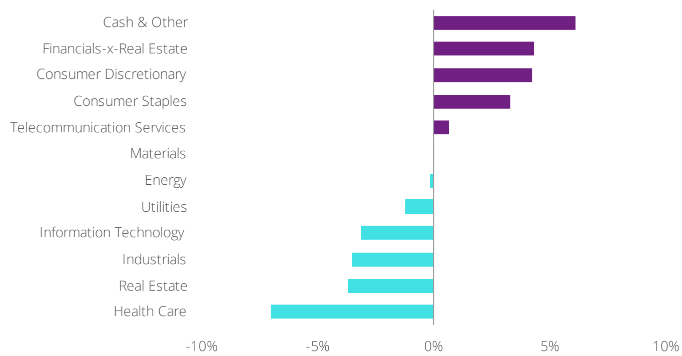
The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Franking Levels (%)			
FY22	100.2	FY19	95.1
FY21	90.3	FY18	99.2
FY20	94.4	FY17	65.6

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The Trust returned -4.7%, including franking credits and after-fees in September outperforming the benchmark by 1.1%

Key positive contributors to performance included resources holdings, with BHP (+1.2%), Rio Tinto (-1.2%) and Fortescue Metals (-2.1%) all outperforming. The Trust holds an overweight position in the miners, seeing positive sector dynamics as demand for minerals is boosted by the post-COVID reopening of China near-term and the energy transition medium-term.

One feature of the economy, both here and abroad, has been the resilience of consumer spending, with actual behaviour not reflecting the negative sentiment reported in surveys. While it is almost inevitable that consumer spending will fall from its current very elevated levels, there are certain categories which are likely to continue to deliver growth. Travel is a good example, where there is still likely to be considerable pent-up demand. This bodes well for the earnings of Qantas (-5.6%), which is experiencing a rapid recovery in demand. At the same time, industry capacity constraints are allowing strong ticket pricing, which more than offsets higher costs such as fuel.

In a similar vein, outdoor apparel retailer, KMD Brands (-5.7%), owner of brands such as Kathmandu, Oboz and Rip Curl, is another stock which stands to benefit from the recovery in travel. During the month Kathmandu reported its full-year result, which showed a very strong recovery, with sales and margins accelerating through the year. Further, management indicated continuing momentum into FY23, benefitting from the return to travel.

Rising bond yields saw IAG (-1.1%) outperform, with insurance companies being leveraged to higher Interest rates. Further, while a spate of extreme weather events means there is currently no shortage of natural perils, the premium pricing environment continues to remain strong for the sector.

The Energy sector outperformed, with Woodside energy (-2.8%) the key driver. Woodside is very well-placed to benefit from the current strong energy prices, with around a quarter of its production uncontracted and able to be sold into the spot market. While the Energy sector is, hopefully, in a long-term decline as fossil fuels are replaced with renewables, this will not be a rapid process and LNG will be a transition fuel along that journey. In the meantime, Woodside is generating enormous cash flows and sitting on an ungeared balance sheet. While the war in Ukraine has dramatically increased gas prices, it is important to remember that, prior to the invasion in February, Brent crude was trading at around US$100 per barrel. This strength reflected tight supply resulting from several years of significantly reduced investment across the sector. This underinvestment has continued and, as a result, energy prices can be expected to remain relatively high for some time.

Telstra (-3.0%) continues to outperform and remains one of our preferred defensive holdings. At the AGM in October, the company will seek shareholder approval to legally restructure the company into four separate entities. This essentially separates the operating business from the infrastructure assets and international operations. This aims to allow for greater focus on operations and strategy of each of these separate businesses. Further, it aims to provide greater transparency and create greater flexibility to realise the value of some of these assets, as they did with the sale of 49% of the mobile towers business.

Trust Activity

During the month we took profits and trimmed our holdings in Treasury Wine Estates and Tabcorp, both of which had outperformed in recent times. At month end, stock numbers were 33 and cash was 6.1%.

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.

Looking to the current financial year, while the economic outlook is more uncertain, most companies are in good financial shape and we expect healthy dividends. The Trust is currently forecasting a 5% increase in monthly net cash distributions to 0.49 CPU. Based on the month end unit price, this represents an annualised cash distribution yield of 6.7% or 9.6%, including franking credits.

We do not expect the same level of off-market buy-backs or special dividends in the coming year compared to the high level seen in FY22, as many companies have now restored their balance sheets to their desired gearing ranges.

Outlook

Global growth is clearly slowing as interest rates rise and economies grapple with the impacts of high inflation and energy supply problems. However, we believe that this will be offset to some extent by the benefits to economies as COVID disruptions continue to recede. While economic data is mixed, and varies greatly from region to region, unemployment rates are very low in most major markets. The Australian economy is performing particularly strongly and will continue to be a key beneficiary of the strength in commodity markets. However, there are a number of potentially significant changes in the global economic and political backdrop, from the return of inflation and the change in the interest rate cycle, to rising geopolitical tensions. As a result, the level of uncertainty is elevated, and a degree of caution is warranted.

This view is expressed in the portfolio through holding a combination of stocks with cyclical leverage, as well as stocks with solid defensive characteristics. Importantly, the portfolio is positively leveraged to improving growth, higher inflation, and rising interest rates. Within the cyclical part of the portfolio, this is achieved through overweight positions in the Resources, Energy and Consumer Discretionary sectors. In the defensive part of the portfolio, this is achieved through holdings in the sectors such as Telcos and Consumer Staples.

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.

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