Perennial Value Shares Wholesale Trust

Monthly Report July 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	2 Years (% p.a.)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since Inception (% p.a.)
Perennial Value Shares Wholesale Trust (Net)	2.3	0.9	2.3	12.0	6.0	14.0	6.8	7.3	7.5	8.3
S&P/ASX 300 Accumulation Index	2.9	2.0	2.9	11.1	4.2	11.9	7.5	8.4	8.3	7.9
Value Added	**-0.6**	**-1.1**	**-0.6**	**0.9**	**1.8**	**2.1**	**-0.7**	**-1.1**	**-0.8**	**0.4**

Since inception: June 2001. Past performance is not a reliable indicator of future performance.

Overview

After selling off in the earlier part of the month, markets staged a strong recovery to finish up strongly. While most central banks raised rates in July, improving inflation data supported the view that we are close to the end of the tightening cycle. At the same time, ongoing healthy economic data gave rise to optimism that a soft landing may be achievable. This saw the S&P500 gain +3.1%, the NASDAQ rally +4.0% and the FTSE100 rise +2.2%. Despite Chinese economic data continuing to be weak, the Shanghai composite added +2.8% on hopes of further stimulus measures. By contrast, the Nikkei 225 eased -0.1%, following its very strong recent performance.

The Australian market was also strong, with the ASX300 Accumulation Index finishing the month up +2.9%. The market reacted positively as the RBA paused its rate increases, leaving the cash rate unchanged at 4.1% in July. As in other markets, there are clear signs that inflation has peaked, while economic data remains robust, with key measures such as employment, spending and house prices remaining resilient. However, we would caution that this data is backward looking and given the long lags in the transmission of monetary policy, the impact of previous rate increases is still yet to fully felt on the real economy.

Energy (+8.4%) was the best performing sector, with the oil price rallying on OPEC+ production cuts and the improving global outlook. Easing inflation and interest rate expectations also saw Financials (+4.9%), IT (+4.8%), Utilities (+4.0%) and REITs (+3.9%) outperform.

Fund Characteristics

The Trust aims to grow the value of your investment over the long term via a combination of capital growth and income, by investing in a diversified portfolio of Australian shares, and to provide a total return (after fees) that exceeds the S&P/ASX 300 Accumulation Index measured on a rolling three-year basis.

Portfolio Managers
Stephen Bruce,
Andrew King

Trust FUM
AUD $467 million

Distribution Frequency
Half yearly

Minimum Initial Investment
$25,000

Trust Inception Date
June 2001

Fees
0.92% p.a.

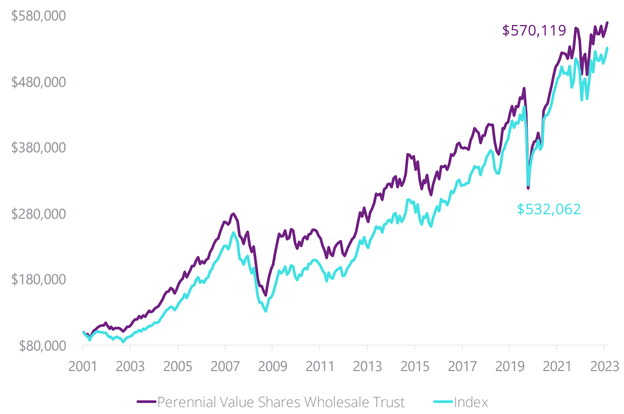
APIR Code
IOF0206AU

Portfolio Characteristics – FY24	Trust	Market
Price to Earnings (x)	13.8	15.7
Price to Free Cash Flow (x)	12.5	14.4
Gross Yield (%)	5.3	5.3
Price to NTA (x)	2.1	2.6

Source: Perennial Value Management. As at 31 July 2023

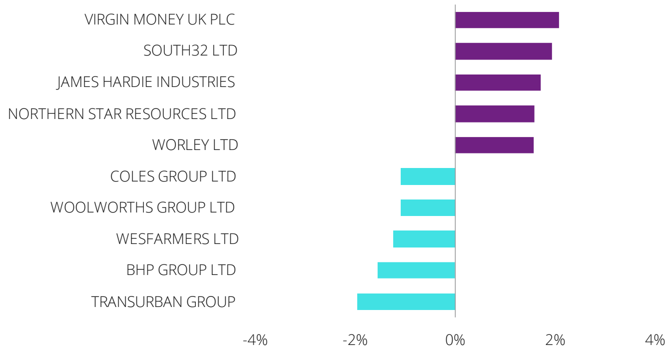
The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Growth of $100,000 Since Inception

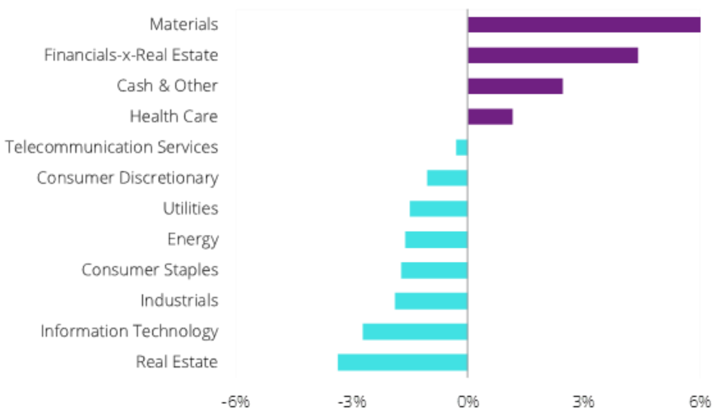


Performance shown net of fees with distributions reinvested. Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The Trust returned +2.3%, after-fees in July, underperforming the benchmark by -0.6%. The best performing holding over the month was Virgin Money UK (+20.7%). The UK commercial banks are all carrying significant amounts of surplus capital which can be returned to investors. Based on our calculations, Virgin Money UK could theoretically return up to 15% of its market capitalisation. A key pre-requisite for this to occur was the bank passing its annual "Cyclical Scenario Stress Test", which the Bank of England applies to the largest eight banks and building societies in the UK. This test looks at the impact on capital levels of deep, simultaneous recessions in the UK and global economies and higher global interest rates. Pleasingly, Virgin Money passed the test with flying colours, allowing it to resume its buyback program in the current financial year. Further, the sector is trading on very depressed valuations, with Virgin Money UK trading on an FY24 P/E of 5.2x and a P/Book ratio of 0.4x. This combination of surplus capital and very cheap valuation, suggests significant share price upside once the current economic uncertainty subsides.

The Energy sector (+8.4%) performed strongly, as the oil price rallied on the combination of improved sentiment around the economic outlook as well as production cuts by OPEC+. This saw strong performances from holdings in Karoon Energy (+13.2%), Woodside Energy (+10.3%) and Worley (+9.9%). Worley is particularly well-placed, being exposed to both the backlog of capex in the oil and gas sector as well as the rapid growth of the renewables sector, where it is a leader in the provision of engineering services. This is already a significant portion of their total business and an increasingly large part of their pipeline of new business.

James Hardie (+9.4%) continued its rally, with indications that the US housing market has stabilised after being impacted by the rapid rise in mortgage rates. While the company is subject to the cycle, over time it has consistently outgrown the overall market as its premium, differentiated products take share from other building materials. Management continues to focus on investing in the brand and distribution channels and we expect this to drive double-digit earnings growth over the medium term. The company recently announced that it has become the exclusive supplier of siding and trim to D.R. Horton until the end of 2026. D.R. Horton is the largest home builder in the US, delivering over 80k homes per annum, and this deal is a strong validation of James Hardie's standing in the US market.

United Malt (+9.5%) rose as French suitor, Malteries Souffle, completed due diligence and confirmed its initial offer of $5.00 per share to acquire the business. The takeover price represented a +45% premium to the pre-bid share price in March, highlighting the very great discrepancies that can exist between where the stock market prices a business and the value that strategic buyer with a long-term view ascribes to it. Of course, in addition to strategic buyers, there is a mountain of private capital globally from pension funds and private equity etc, looking for investment opportunities. Looking across the portfolio, we believe that many of our other holdings could well become takeover targets at some point.

Ag chem company, Nufarm (+5.5%), rose after its proprietary genetically modified, omega-3 canola oil received approval from the Norwegian Food Safety Authority for use in fish feed. This allows Nufarm to access the Norwegian salmon farming industry, which is the largest in the world. These novel seed technologies represent a source of significant unrecognised value within Nufarm.

The main detractors from performance over the month included resources holdings Northern Star (-4.7%), Iluka Resources (-8.0%) and Independence Group (-9.2%), all of which delivered quarterly production results and outlooks which were, for various reasons, slightly below expectations. This has been a theme across resource company updates and highlights the difficulty that the mining industry will have meeting the expected growth in demand for commodities, particularly those required for the energy transition. While production shortfalls and cost increases can be disappointing at the individual company level, they are supportive for pricing as supply struggles to meet demand and the cost curve rises. Integral Diagnostics (-7.6%) also underperformed, with the healthcare sector generally being weaker over the month. This is one company, in particular, which we see as a potential corporate target.

Trust Activity

During the month we reduced our holdings in CSL and Wesfarmers, freeing up funds to increase holdings in the major banks as well as adding new positions in Charter Hall and Dexus, to reduce our underweight to the REIT sector. At month end, stock numbers were 57 and cash was 2.4%.

Outlook

The global economy has proven surprisingly resilient in the face of the sharp rise in interest rates and other economic disruptions. Further, recent data suggests that, while inflation is proving sticky, it appears to have peaked. Importantly, unemployment rates remain very low in most major markets. The Australian economy continues to perform strongly, with strong employment growth, robust spending and healthy property prices. The resources and agricultural sectors continue to experience positive conditions and the surge in immigration is providing a further boost to activity.

While the backdrop is currently sound, the level of uncertainty is elevated, given the long lags in the transmission of monetary policy. As a result, a degree of caution is warranted and we prefer holding stocks with positive company specific drivers, as opposed to pure cyclical leverage, in addition to stocks with solid defensive characteristics. Importantly, the portfolio is positively leveraged to post-COVID normalisation, higher inflation, and higher interest rates. This is achieved through overweight positions in the Diversified Financials, Resources, and very select parts of the Consumer Discretionary sectors. In the defensive part of the portfolio, this is achieved through holdings in the Healthcare, Insurance, Telco and Gold sectors.

While there is a high level of economic uncertainty, our focus remains on investing in quality companies with proven business models and strong balance sheets, which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors.

Invest Online Now

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