Perpetual Investment Funds

PERPETUAL SMALLER COMPANIES FUND

January 2023

FUND FACTS

Investment objective: Aims to provide long-term capital growth and income through investment in quality Australian industrial and resource shares which, when first acquired, do not rank in the S&P/ASX 50 Index.

FUND BENEFITS

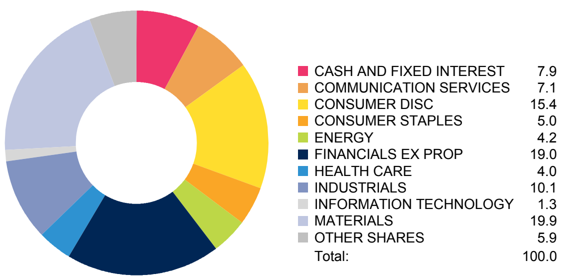
Provides investors with the potential to benefit from the growth of quality smaller or emerging companies, through active management by one of Australia's most experienced investment management teams.

FUND RISKS

All investments carry risk and different strategies may carry different levels of risk. The relevant product disclosure statement or offer document for a fund should be considered before deciding whether to acquire or hold units in that fund. Your financial adviser can assist you in determining whether a fund is suited to your financial needs.

Benchmark: S&P/ASX Small Ordinaries Accum. Index
Inception Date: October 1996
Size of Portfolio: $698.17 million as at 31 Dec 2022
APIR: PER0048AU
Management Fee: 1.25%*
Investment style: Active, fundamental, bottom-up, value
Suggested minimum investment period: Five years or longer

PORTFOLIO SECTORS



TOP 5 STOCK HOLDINGS

	% of Portfolio
Pacific Current Group Ltd	4.5%
Healius Limited	3.5%
Enero Group Limited	3.1%
Whitehaven Coal Limited	2.9%
NIB Holdings Ltd	2.8%

NET PERFORMANCE - periods ending 31 January 2023

	Fund	Benchmark #	Excess
1 month	3.57	6.56	-2.99
3 months	6.68	7.64	-0.95
FYTD	21.05	14.05	+7.00
1 year	10.46	-4.44	+14.90
2 year p.a.	14.80	0.95	+13.84
3 year p.a.	14.94	2.41	+12.53
4 year p.a.	15.16	6.29	+8.87
5 year p.a.	10.66	4.35	+6.31
7 year p.a.	12.12	8.42	+3.70
10 year p.a.	11.35	5.37	+5.98
Since incep.	12.47	5.45	+7.02

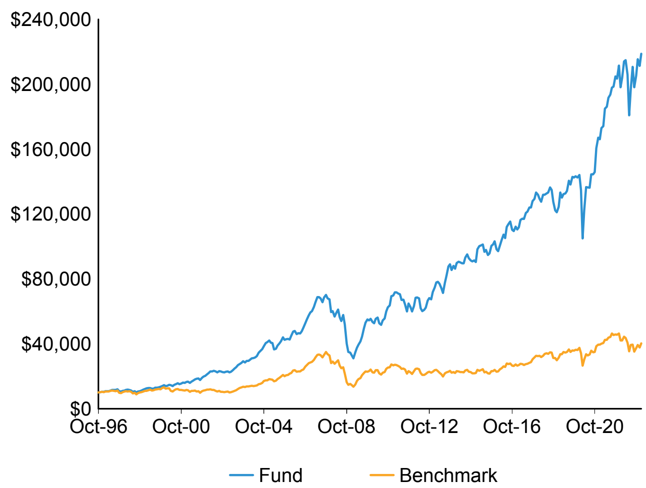
Past performance is not indicative of future performance. Returns may differ due to different tax treatments.

PORTFOLIO FUNDAMENTALS^

	Portfolio	Benchmark
Price / Earnings*	11.1	17.5
Dividend Yield*	5.2%	4.1%
Price / Book	1.5	1.6
Debt / Equity	18.2%	27.0%
Return on Equity*	13.5%	10.8%

^ Portfolio Fundamentals are compiled using our methodology and provided only for the purpose of illustrating the Fund's investment style in action. These figures are forecast estimates, calculated based on consensus broker estimates where available, and should not be relied upon. Dividend Yield is a dividend forecast of underlying securities for the portfolio and does not reflect the distributions to be determined for the fund.
* Forward looking 12-month estimate.

GROWTH OF $10,000 SINCE INCEPTION



*Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS.

MARKET COMMENTARY

The Australian equities market had a stellar start to the 2023 calendar year, with strong January performance underpinned mainly by traction behind the disinflation narrative, a rise in soft landing expectations, and hopes for a near-term Federal Reserve pause (and pivot later in 2023). Reopening momentum across China following signs that its latest Covid wave had peaked also helped boost investor sentiment throughout the month. All but one sector (Utilities) ended higher, with Consumer Discretionary, Materials, and REITS being the standout performers. Commodity producers also outperformed amid gains in iron ore following the latest policy support headlines out of China.

December quarter inflation came in hotter-than-expected, with data rising to its highest level since 1990 and trimmed mean inflation climbing to its highest point since the ABS first published this data in 2003. The main contributors to the rise were holiday travel, accommodation, and electricity, leading to expectations that the RBA will hike the cash rate by 25 bp to 3.35% in February. China's reopening momentum also threatened to increase global pricing pressures. While goods inflation showed signs of moderating, services inflation proved stickier with the economy still experiencing a tight labour market. This came as Australian home prices fell 1.0% m/m in January, a slight improvement on December's 1.1% drop.

Australian consumer confidence continued to recover from its lowest reading since April 2020. Retail sales, however, registered its largest fall in a year during December, breaking a run of 11 consecutive gains, and widely attributed to heightened cost of living pressures. The data led markets to peel back the projected peak cash rate to 3.7% from 3.8%, and while a February rate increase is fully priced in, markets pushed out expectations of a follow-up rate hike from March to May.

PORTFOLIO COMMENTARY

The Fund's largest overweight positions include Pacific Current Group, Enero Group Limited, and Whitehaven Coal Limited. Conversely, the Fund's largest underweight positions include Technology One Limited, Pro Medicus Limited, and Chorus Limited, all of which are not held in the Fund.

The underweight position in coal miner New Hope Corporation Limited (-7.9%) contributed to relative performance. The stock fell on the back of a 28.5% decline in the price of coal over the month, hampered by declining sales volumes as winter demand in the northern hemisphere passes and Europe's energy crisis eases. This followed reports that NSW Treasurer Matt Kean is looking to order thermal coal miners to reserve up to 10% of their output for NSW power station by the end of January to avoid a shortage of supply.
The overweight position in Australia and New Zealand media and online publishing company HT&E Ltd (+16.1%) contributed to relative performance. The stock price received a significant boost after the company announced it had signed a binding share sale agreement to sell its ~25% interest in Soprano Design Limited to Potentia Capital, a leading Australian technology-focused private equity firm. Under the agreement, HT&E will receive ~$66.3M in cash as consideration for the sale. The transaction is conditional upon receiving FIRB approval.
Not holding oil and gas miner Beach Energy Ltd (-5.3%) contributed to relative performance. Beach Energy reported a Q2 production of 4.8MMboe, which missed its 5.00MMboe consensus. Analysts attributed the weaker-than-expected production volumes to plant outages resulting from maintenance and lower demand rather than poor performance. Management also introduced a depreciation, depletion, and amortization guidance of $410-440M, a step up from $376M reported in FY2022.

The overweight position in coal miner Whitehaven Coal Limited (-10.9%) detracted from relative performance. The stock was adversely impacted following the 28.5% decline in the price of coal over the month. This came as the miner reported its December-quarter Managed ROM coal production of 4.84Mt (vs consensus of 4.95Mt) and reiterated its FY2023 guidance with Managed ROM coal production of between 19.0-20.4Mt.
The overweight position in gold exploration company Gold Road Resources Ltd (-2.7%) detracted from relative performance. The stock ended the month lower, with the market discouraged by the full-year report from its Gruyere gold mine joint venture, which posted gold production of 314,647 (vs guidance of 300-340koz). Later in the month, the management guided company-wide FY2023 production of 340-370Koz at an attributable all-in sustaining cost of $1540-1660/oz. Management noted that production had been reduced quarter-on-quarter due to lower process plant availability resulting in lower plant throughput and delays in accessing and processing higher-grade portions of its Stage 3 pit.
The overweight position in gold miner Capricorn Metals Ltd (-1.5%) detracted from relative performance. The stock sold off following an underwhelming December-quarter trading update, reporting gold production of 29,310oz (vs quarter-ago 31,005oz) at an all-in sustaining cost of $1,105/oz (vs quarter-ago $1,166/oz). Management also maintained its full-year gold production guidance of 115-125Koz with an AISC of $1,160-1,260/oz.

OUTLOOK

Economic conditions will continue to evolve, and uncertainty will continue to manifest in markets. The central banks' aggressive attempt to rein in inflation expectations will cause unintended consequences in both economies and the markets. Because central banks have no influence on the supply of goods and materials, they also cannot influence the willingness of companies to invest in expanding supply in response to higher prices. This hesitancy is mostly due to companies seeing this as a significant pull forward of demand from fiscal and monetary largesse. We see the only influence central banks can have is on demand, and to achieve a reduction in demand, we will see a tightening in liquidity and financial conditions. This will force many companies to face up to this new reality with many early phase/profitless companies not surviving.

We have long believed that markets are poised for further rotation to a more value-oriented investment environment as COVID-19 disruptions, waning stimulus, and war combine to keep consumer price inflation at high levels. However, we must also be willing to pivot the portfolio when the markets are pricing in overly aggressive rate expectations. With fear of a deep and long recession, this will be factored into markets, providing opportunities to redeploy capital. In these conditions, our focus on value-style investing and buying quality companies with strong balance sheets trading at reasonable valuations should continue to do well and offer attractive opportunities for investors.

Benchmark prior to 1/4/2000 was the ASX Small Ordinaries Accumulation Index. From 1/4/2000 to current the benchmark is S&P/ASX Small Ordinaries Accumulation Index.

MORE INFORMATION

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