

## Perpetual Investment Funds

# PERPETUAL CONSERVATIVE GROWTH FUND

December 2022

### FUND FACTS

**Investment objective:** Aims to provide moderate growth over the medium term and income through investment in a diversified portfolio with an emphasis on cash and fixed income securities; and outperform a composite benchmark (before fees and taxes) reflecting its allocation to the various asset types over rolling three-year periods.

### FUND BENEFITS

Provides investors with access to a diverse range of growth and income producing assets. Active management and asset allocation techniques are employed in order to further enhance the fund's return and manage risk.

### 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:** Conservative Growth Index (Internally generated composite)

**Inception Date:** September 2003

**APIR:** PER0077AU

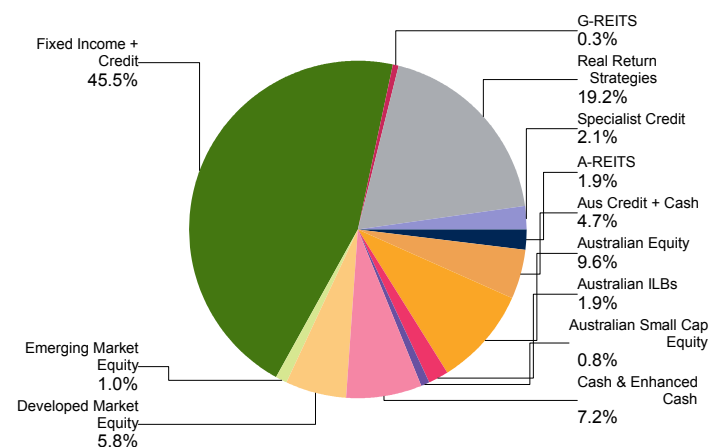
**Management Fee:** 0.90% p.a.

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

**Investment style:** Active, fundamental, disciplined, value

**Suggested minimum investment period:** Three years or longer

### PORTFOLIO SECTORS



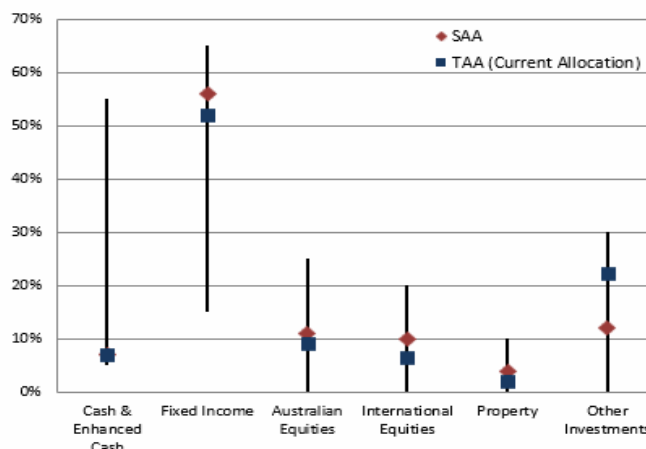
### NET PERFORMANCE- periods ending 31 December 2022

	Fund	Benchmark	Excess
1 month	-1.3	-2.3	1.0
3 months	1.9	2.6	-0.7
FYTD	2.1	1.8	0.2
1 year	-1.9	-7.7	5.8
2 year p.a.	2.2	-1.6	3.7
3 year p.a.	2.8	0.2	2.5
5 year p.a.	3.5	2.7	0.8
10 year p.a.	4.8	4.4	0.4
Since incep.	5.7	5.4	0.3

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

### ASSET ALLOCATIONS AND INVESTIBLE RANGES

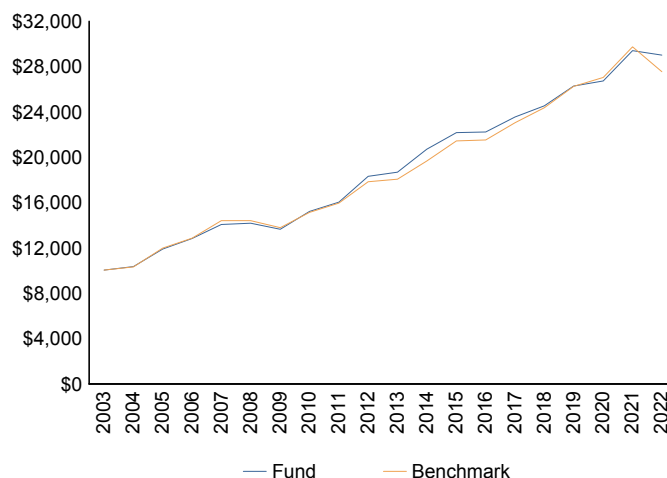
FUND TACTICAL AND STRATEGIC ALLOCATIONS INCLUDING ALLOWABLE MAXIMUM AND MINIMUM RANGES



### STRATEGIC AND TACTICAL ASSET ALLOCATIONS

The Strategic Asset Allocation (SAA) is the neutral allocation acting as an anchor for active positioning, while the Tactical Asset Allocation (TAA) process adjusts the asset allocation according to market opportunities and risks.

### GROWTH OF \$10,000 SINCE INCEPTION



## MARKET COMMENTARY

Global equity markets strengthened through October and November before giving back a portion of recent gains over the last month of the year.

- European equities (14.6%) led the pace of gains in regional sharemarkets with strong advances in Germany (14.9%) and France (12.6%) as well as targeted government stimulus and falling gas prices enable the region to perform much better-than-feared which suggested that the expected regional earnings decline may be considerably less than expected.
- US equities (7.6%) peaked in late November as markets anticipated a decline in the pace of policy tightening given softness in lead economic indicators. Among styles, 'value' (12.4%) had another very strong quarter relative to 'growth' (2.2%) which continues to be hindered by the poor performance of large-cap tech stocks.
- Australian equities (9.4%) outperformed as markets responded well to the slowing pace of rate increases from the Reserve Bank of Australia (RBA), and the continued strength of economic data outside housing.
- Chinese equities (12.5%) surged over the final weeks of the year following the abandonment of the government's zero-COVID policy, which was one of two key market unfriendly policies which had been holding growth down.
- Domestic long term bond yields in Australia and US yields were little changed over the quarter after rallying through October and November before rising back above 4% in December.

The path of US monetary policy and pricing of recession risks remained the key considerations for financial markets through the December quarter. Through the first 2 months of the quarter, there was renewed speculation that the US Fed would lessen the pace of rate hikes in order to increase the chances of engineering a soft landing. After the November CPI showed headline inflation declining to a 10-month low, the Fed slowed its pace of tightening with a 50 bps increase at the December meeting which further buoyed equity markets. However, sentiment weakened in the latter half of December after the Fed's updated Statement of Economic Projections suggested an expected increase in the Fed's terminal rate to 5.1% which raised questions about market's expectations about the future rates path. While one can never say a recession is certain the path to a soft landing still appears quite narrow with several leading US recession indicators already pointing to an upcoming contraction. These include the US 2-year - 10-year yield curve slope which is the most inverted since 1981, a negative score on the US Conference Board Leading Index and a sub-50 score on the ISM manufacturing PMI (49.0) which declined to an 18-month low.

Despite looming recession risks, the Fed still has an inflation problem to deal with, and while goods sector inflation has declined faster and further than expected, services inflation (+7.1%Y which is adding 4.0% to headline and core inflation) continued to accelerate. Inflation in this sector is far less sensitive to policy and supply chain issues, and traditionally has only ever materially declined after a negative output gap has led to higher unemployment and lower wages growth. The Fed's policy reaction function now has a sizable rise in US unemployment at its centre, and the US labour market remains very tight with U3 unemployment at a 50 year low of 3.5%, jobless claims anaemic in the low 200ks and job openings relative to idle workers remains very elevated at 1.9.

We also remain concerned about the outlook for corporate profits. While revenues have thus far proved resilient, the impact of the Fed's aggressive tightening on earnings has yet to be fully realised and the Bank has recently accelerated its monthly sales of US Treasuries and mortgage-backed securities, which will drain liquidity from the system that drives higher asset prices. The combination of tightening monetary conditions and slowing or negative earnings growth also highlights the risk of zombie companies (heavily leveraged unprofitable firms which have only survived due to incredibly low interest rates over the past decade)

being exposed to market forces.

Australia's path to a soft landing remains more viable than the US. The RBA slowed the pace of interest rate hikes during the December quarter and minutes from the final meeting of the year revealed that the possibility of no increase was discussed for the first time this cycle. The RBA has a more potent mechanism to address household spending given highly leveraged household balance sheets and a large amount of mortgages being at variable rates which are highly sensitive to changes in the RBA's overnight cash rate. At the same time, the economy looks quite solid at present and stands to benefit from Chinese reopening and improved relations between Canberra and Beijing.

The outlook for China has improved materially on the back of a combination of easing COVID restrictions, relaxed collateral and equity issuance standards in the property sector and stimulatory monetary policy. The abandonment of the zero-COVID policy is expected to be very supportive for economic activity following an initial surge in cases. The government also issued a series of measures intended to support the property sector which has languished since 2020, including credit support for highly leveraged housing developers, financing to ensure completion and transfer of projects, and loan assistance for home buyers.

The key contributing factor to relative performance over the quarter was the Fund's global equity stock selection. Value sectors and stocks substantially outperformed growth and the Fund's global equity exposure was rewarded. Partially offsetting this however was the negative contribution of the Fund's US and European put options. At quarter end, the Fund was underweight across global and Australian equities. All equity exposures retain their long-standing quality and value bias which are expected to continue to outperform against a backdrop of rising interest rates and slowing earnings growth.

During the quarter, the Fund's US duration was increased while remaining underweight and short of benchmark duration. The Fund's exposure to US and Australian government bonds remains partially offset by a small, short (negative) position in Japanese bonds. This position performed well over the quarter as the Bank of Japan elected to relax its yield curve control measures, precipitating a selloff in long term yields.

The Fund's elevated cash allocation detracted from performance over the quarter. The Fund maintains a significant foreign exchange exposure, diversified across a number of developed and emerging market currencies. The Fund's USD exposure detracted from relative performance over the quarter as the greenback gave back a portion of its gains over the year. The Fund has direct exposure to the USD as well as a USDCNH call option and emerging market currencies which are closely correlated.

The Fund maintains its position in the Diversified Real Return Fund which continues to deliver low volatility absolute returns while retaining a relatively low correlation to equity markets.

## OUTLOOK

Tightening financial conditions, very high inflation and slowing economic growth are a challenging environment for investors to navigate. High equity valuations were only supported while bond yields stayed low as inflation was contained. Equity valuations have adjusted (although there could be more to come), but now profit expectations need to be lowered to more closely aligned with the economic backdrop. In this climate the fund remains well positioned to navigate the tightening cycle and retains the capacity to add risk as valuations become more attractive.

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The Conservative Growth Fund gains its exposure to Australian Shares by investing in an underlying Australian Share Fund/s which primarily invests in Australian listed or soon to be listed shares but may have up to 20% exposure to stocks outside Australia. The investment guidelines showing the Fund's maximum investment in international shares do not include this potential additional exposure. Short positions may be part of the underlying Australian Share Fund's strategy. Currency hedges may be used from time to time.

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## **MORE INFORMATION**

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