

Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

June 2021



FUND FACTS

Investment objective: To provide investors with regular income and consistency of return by investing in a diversified range of income generating, ethical and socially responsible assets. To outperform the stated benchmark over rolling three year periods before fees and taxes.

Benchmark: Bloomberg AusBond Bank Bill Index
Inception date: June 2018
Size of fund: \$54.8 million as at 30 June 2021
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 0.03% as at 30 June 2021
Suggested minimum investment period: Three years or longer

FUND BENEFITS

Provides investors access to an actively managed fund that more closely matches their personal social and ethical beliefs or preferences, without compromising investment returns over the long term.

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.

TOTAL RETURNS % (AFTER FEES) AS AT 30 June 2021

	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS PA	3 YRS PA	5 YRS PA	7 YRS PA	INCEPT PA
Perpetual Ethical SRI Credit Fund	0.26	0.78	2.11	5.74	2.98	3.01	-	-	2.93
Bloomberg AusBond Bank Bill Index	0.00	0.01	0.01	0.06	0.45	0.96	-	-	0.98

Please note: Performance for Perpetual's complete list of investment funds is available on www.perpetual.com.au. Past performance is not indicative of future performance.

POINTS OF INTEREST

- Domestic spreads tighten slightly; Financial spreads outperform.
- Credit curve steepens; Primary market activity orderly.
- Economic indicators remain strong;
- Inflation concerns subsiding; Yield curve flattens
- Credit outlook remains strongly positive.

ETHICAL EXCLUSIONS AND SRI SCREENING

There are two main steps to the process, namely ethical exclusions and socially responsible investments (SRI) screening.

ETHICAL EXCLUSIONS

We don't invest in issuers or counterparties that derive a material proportion (5% or more) of their revenue from:

- the manufacture or sale of alcohol or tobacco[^]
- the operation of gambling facilities or the manufacture of gambling equipment
- fossil fuels (upstream)
- uranium and nuclear
- animal cruelty (cosmetic testing)
- genetic engineering
- pornography
- armaments (including weapons)[^]

[^]For involvement in the production of tobacco, tobacco based products and the development and production of controversial weapons, a 0% revenue threshold is applied.

SRI SCREENING

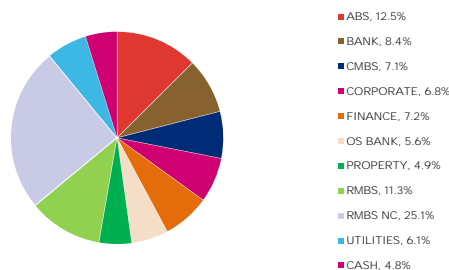
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment. While other companies become allowable investments.

SOVEREIGN ISSUERS

Governments will be analysed on ESG factors, based on a scoring system utilising research from external specialists. This may include, but is not limited to, considering any unethical practices such as corruption, rule of law and political instability of the sovereign.

For further details on the Ethical Exclusions or SRI screening please refer to the PDS.

PORTFOLIO SECTORS



PORTFOLIO COMPOSITION

	BREAKDOWN
Senior Debt	57.12%
Subordinated Debt	35.67%
Hybrid Debt	7.21%
Running Yield	1.58%
Portfolio Weighted Average Life	3.26 yrs
No. Securities	93
Modified Duration	-0.02

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

MARKET COMMENTARY

Financial markets continued to rise through June on the back of strong economic growth expectations, supportive monetary and fiscal policy and the continued COVID-19 vaccine rollout and reopening. The recovery in asset prices has been dramatic over the past 12 months with the ASX posting its highest financial year return since the 1980s. Valuations were supported during June by easing inflation concerns which saw long term bond yields dip. Markets were resilient to COVID-19 concerns including the spread of the delta variant and a late June lockdown in NSW.

Domestic spreads continued to grind tighter through June. Shorter dated credit performed well and the credit curve steepened over the month. Sector performance was mixed with financials outperforming corporates. The best performing sectors were energy – on the back of the surging oil price – consumer sectors and industries leveraged to reopening including universities. Corporate sector performance was sensitive to recent issuance volumes with sectors that have seen elevated issuance including utilities and listed property underperforming.

Yields were broadly stable over the month. The AUD yield curve flattened with longer tenors outperforming significantly. Inflation concerns subsided as the Australian CPI came in below expectations and the recent spike in CPI was considered transitory by investors. Rates markets in June were calm in anticipation of a number of monetary policy decisions from the RBA on the extension or tapering of quantitative easing and yield curve control policies. Semi-government spreads widened slightly over the month. Spread expansion was led by NSW as a result of reintroduced lockdowns and the announcement of a larger than expected borrowing program for the 2022 financial year.

Primary market activity was increased in June following a very quiet May. Corporate issuance was active, led by utilities and listed property sectors. AGI Finance – the financing arm of the Australian Gas infrastructure group – came to market for \$575M across two tranches. The deal met strong demand and priced tighter than guidance. Wesfarmers raised \$1B across 7 and 10-year tranches. The bond was Wesfarmers first sustainability linked issue and was significantly oversubscribed, priced tighter than guidance and tightening further in secondary.

Financial issuance was more subdued. Macquarie Bank, priced \$750M of tier -2 subordinated paper. Goldman Sachs raised \$325M in a senior unsecured deal. Notably, the RBA's Term Funding Facility closed at the end of June. The impact of the TFF on the issuance pipeline has been significant and domestic bank senior issuance is expected to resume in the second half of the year. The TFF will continue to impact credit supply in the coming years as the 3-year funding matures in FY2024. The primary securitisation market was quieter in June following a very busy period. Issuance was headlined by AMP's Progress 2021-1 Trust which raised \$1B during June.

PORTFOLIO COMMENTARY

The portfolio continued to collect running income in excess of the benchmark. This contribution from positive carry primarily came from non-financial corporates, RMBS and domestic banks. The portfolio running yield at month end was 1.58% with the spread measured at 1.44% above the benchmark.

Credit spread dynamics were the key contributing factor in outperformance over the month. Credit spreads continued their steady grind tighter during June. Financial spreads outperformed corporates on aggregate. Portfolio allocation to domestic banks, non-financial corporates, and offshore banks were the key contributing sectors to outperformance. Of note, the portfolio's allocation to Macquarie bank debt was a particularly strong contributor. The manager elected to increase the allocation to Macquarie via their June subordinated AUD deal which tightened on issue after meeting robust demand. The manager also elected to increase allocation to a Macquarie US dollar hybrid offering attractive relative value. Both issues performed well and were substantial contributors to outperformance.

The manager was active in primary and secondary markets during the month, deploying a portion of the portfolio's cash position. The portfolio took part in new deals from AGI Finance and Goldman Sachs group. Credit duration was increased with the manager choosing to increase allocation to longer dated corporate positions. Valuations are stretched in some sectors and the manager remains selective, investing where there are compelling relative value opportunities.

Portfolio risk was actively managed throughout June. Allocation to BBB rated issuers was increased while AAA exposures were trimmed. Meanwhile portfolio exposures were moved up the capital structure, reducing subordinated exposures and increasing the senior allocation. Domestic bank sub debt in particular has performed well recently, and valuations are looking full as the hunt for yield continues. Despite the positive credit outlook, the manager remains selective. With many credit spreads tighter than their pre-COVID levels, active management is crucial to identifying the remaining pockets of compelling relative value in the credit market.

The fund applies both ethical and socially responsible investment (SRI) screens relating to what the company is in the business of and the way business operations are conducted respectively. Upon application of the ethical and SRI screens, several bond issuers have been screened out - including for example, companies involved in the extraction of fossil fuels or companies whose revenues are significantly associated with socially questionable products or services.

OUTLOOK

The credit outlook remains strongly positive.

Valuation indicators have degraded slightly and are now marginally neutral. Spreads have contracted significantly over the past year reaching below their pre COVID levels. US high yield in particular now appears expensive relative to medium term averages and is detracting from the overall credit outlook.

The growth outlook remains strongly positive. Leading and trailing economic indicators suggest conditions for explosive economic growth and robust support for spreads. During the month the ratio of credit upgrades to downgrades improved further on the back of strong commodity price tailwinds and positive economic growth expectations.

Demand and supply indicators have continued to support the overall credit outlook. Reduced primary market activity over the recent months and reduced pipeline for issuance are supportive for credit spreads. Demand is orderly with spreads being sensitive to issuance volume.

Technical indicators remained positive for the overall credit outlook. Broker inventories remain somewhat reduced and intermediaries are adding selectively. Investor cash reserves have increased slightly over the month but remain neutral to the overall outlook. Tightening US credit spreads alongside robust equity valuations and volatility are all supportive for domestic credit.

The sustained rally in credit spreads continues to be supported by positive leading and trailing macroeconomic indicators, supply and demand conditions and technical factors. The portfolios remain well positioned to benefit from further spread contraction offered by the current conditions.

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Adviser Services 1800 062 725
Investor Services 1800 022 033
Email investments@perpetual.com.au
www.perpetual.com.au

