

Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

October 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: \$41.4 million as at 30 September 2021
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 0.02% as at 31 October 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 31 October 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	-0.12	0.16	0.74	3.89	2.45	2.80	-	-	2.71
Bloomberg AusBond Bank Bill Index	0.00	0.00	0.01	0.03	0.27	0.73	-	-	0.88

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 rangebound; Financial spread underperform;
- Bonds sell off sharply on inflation concerns.
- Monetary policy tightening expected by rates markets.
- Primary market issuance volumes mixed.
- Credit outlook moderates but remains 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

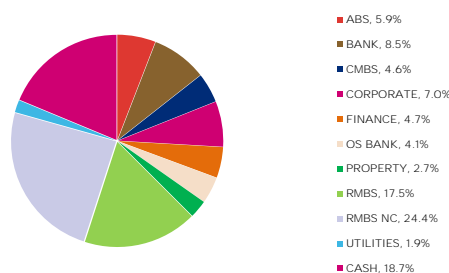
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

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	55.59%
Subordinated Debt	39.73%
Hybrid Debt	4.67%
Running Yield [^]	1.26%
Portfolio Weighted Average Life	2.86 yrs
No. Securities	128
Modified Duration	-0.04

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

[^]The methodology used to calculate Running Yield is derived from FactSet, and calculated as follows: The coupon rate of the security / the capital price of the security. Note that the exception is discounted securities, where a Yield to Maturity calculation is used.

MARKET COMMENTARY

Financial markets saw mixed performance through October. Equities continued to grind higher led by a strong month from US stocks. Domestic markets were turbulent as inflation spiked and bonds sold off.

Volatility in interest rates markets was the dominant theme throughout October. Domestic yields sold off sharply towards the end of the month. The catalyst was the high CPI print published in October. Core inflation reached the RBA's preferred band for the first time since 2015 which saw market expectations of rate rises brought forward. At month end, the forward curve had fully priced in an interest rate rise by July of 2022, significantly earlier than RBA guidance to this point. The selloff in yields – especially at the short end – also predicted the abandonment of the RBA's yield curve control program. The 3-year yield became untethered as the market expected the RBA to cease purchases of the April 2024 government bond it had previously utilized in its yield curve control policy. The result of the selloff was significant losses for Australian bonds with the Bloomberg Ausbond composite bond index losing 3.6% over the month.

Domestic credit spreads traded within range of recent levels throughout October. Sector performance was mixed with financial spreads underperforming, led by domestic bank senior spreads which widened significantly. Tier two domestic bank paper also saw widening but was more resilient and the subordinated premium relative to the senior curve decreased.

Issuance was slightly elevated in October, led by domestic banks. Non-financial primary market activity was subdued however. The securitisation market remains very active with \$5.2B priced across 10 transactions. Despite the elevated issuance, RMBS spreads remained resilient.

PORTFOLIO COMMENTARY

Income return was the key contributor to relative performance over the month. The portfolio collected running income in excess of the benchmark across all corporate and collateralised sectors. Contributions to income return were broad based, led by RMBS, non-financial corporate, domestic and offshore banks. The portfolio running yield at month end was 1.3% with the spread measured at 1.0%.

Credit spread dynamics marginally detracted from relative performance. Domestic spreads were rangebound on aggregate over the month. Spread movements were mixed by sector with non-financials and securitised sectors outperforming financials. The Fund's exposure to utilities and domestic banks were the key sectors that detracted from spread performance. Domestic bank senior spreads in particular widened during the month. We have continued to avoid exposure to senior domestic banks following the expiry of the RBA's Term Funding Facility at the end of June, with the resultant increase in supply of senior bank debt likely to continue pressuring these credit spreads wider in the near term. Sector allocations were broadly maintained over the month with exposure to securitised sectors being selectively added. The fund credit quality increased as a result of the fund investing in AAA RMBS securities in both primary and secondary markets.

The outlook for credit has cooled slightly while remaining constructive. The fund remains fully invested, albeit retaining a defensive posture given historically low credit premiums. The Fund retains its protection (short) position in an index credit default swap in order to hedge tail risks. With many credit spreads tighter than their pre-COVID levels, active management is crucial in managing downside risk and 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 has moderated slightly but remains positive.

Valuation indicators have turned slightly negative. Spreads extremely tight relative to historical averages. The 5y Basis swap moved materially wider during the month which dragged on the valuation outlook. The widening basis swap makes the AUD credit market more attractive for issuers and less attractive for offshore investors, and is expected to weigh on spreads.

The growth outlook remains strongly positive. Supply chain disruption continues to impact economic growth expectations as seen in a number of falling global PMIs (albeit from high bases). While growth expectations remain robust, they have cooled over the month. The accessibility of equity capital – as seen in the strong IPO pipeline – remains supportive for spreads. The ratio of credit upgrades to downgrades remains positive for spreads but is expected to moderate slightly while increased M&A activity may provide a headwind for credit quality.

Demand and supply indicators have settled but remain slightly supportive for the overall credit outlook. Market demand has cooled somewhat with interest rates volatility impacting bid volumes in secondary markets.

Technical indicators are neutral for the overall credit outlook. Intermediaries The team will continue to monitor technical and supply demand indicators to identify inflection points in investor risk sentiment.

The sustained rally in credit spreads continues to be supported by positive macroeconomic indicators. While valuation, technical and supply and demand indicators have moderated, the overall credit outlook remains positive. Despite the slight reduction in the credit outlook, the conditions are constructive and the portfolios remain well positioned to benefit from further spread contraction.

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