

Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

November 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: 0.03% as at 30 November 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 November 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	-0.09	-0.10	0.43	2.85	2.29	2.77	-	-	2.62
Bloomberg AusBond Bank Bill Index	0.01	0.01	0.01	0.02	0.23	0.68	-	-	0.87

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

- Risk assets sell off; Domestic spreads widen;
- Spread volatility increases; Corporates outperform financials;
- Omicron variant concerns & Fed tapering weighs on markets;
- Domestic yield curve flattens;
- 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

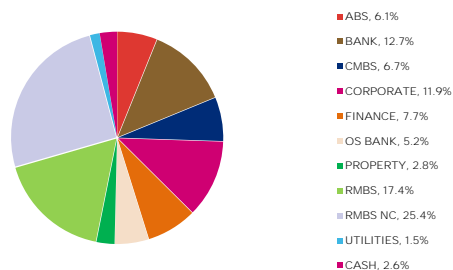
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

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	47.63%
Subordinated Debt	43.98%
Hybrid Debt	8.38%
Running Yield [^]	1.56%
Portfolio Weighted Average Life	3.48 yrs
No. Securities	130
Modified Duration	-0.10

* 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 increased volatility over the last two weeks of November with risk assets selling off. Concerns surrounding the Omicron variant and the swift response of governments saw credit and equities tumble while long term bonds rallied globally as investors sought to reduce risk. Contributing to the decreased risk appetite was the late month shift of the US Federal Reserve in the face of persistent high inflation data.

Domestic credit spreads saw increased volatility towards the end of November. Spreads expanded on aggregate with the BAML Australia Corporate spread widening 9 bps. Non-financial corporates outperformed financials. Financial spread expansion was led by major banks which underperformed non-bank financials and corporates over the month. AUD spreads were resilient relative to offshore peers, USD and EUR spreads saw greater volatility and more significant widening. Swap spreads widened significantly during the month most notably at the longer end. Swap rates were steady throughout the month while the curve flattened.

Yield volatility increased as the prospect of central bank tightening and concerns about the omicron variant impact rates markets. Early in November the RBA abandoned its yield curve control policy while remaining firm on the timeline for interest rate increases. Futures markets continue to price in rate hikes ahead of RBA guidance. Long-term yields fell over the month, and the yield curve continued to flatten.

Primary market credit issuance was subdued. Aggregate issuance volume remains well below trend for the year and is unlikely to change in December which is usually a quiet month for corporate issuance. Securitised issuance was reduced following a very busy October.

PORTFOLIO COMMENTARY

Income return was the key contributor to relative performance over the month. 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 1.6% with the spread measured at 1.4%.

Credit spread dynamics detracted from relative performance. Spread performance was mixed by sector with financial sectors including domestic and offshore banks as well as RMBS detracting from performance. Australian Dollar spreads – led by major banks – widened on aggregate on Omicron concerns and increasing expectations of central bank tightening. Portfolio allocation to non-financial corporates and utilities positively contributed to relative performance, offsetting a portion of the widening in financials. A tail risk hedge covering almost four percent of the portfolio was implemented during July and provided the portfolio with significant downside protection during November. The hedge was implemented using the European crossover credit default swap (CDS) index. As volatility increased and spreads – crucially European BBB and high yield – widened, the CDS hedge contributed strongly to performance. Following the late month selloff as result of the spread of the Omicron variant, the manager elected to take profit on the position and closed out the hedge.

Aside from the CDS tail risk hedge being closed, sector and risk allocations were broadly maintained over the month. The manager took the opportunity during market weakness to add exposure to subordinated bank debt. The manager was active in primary markets, adding CMBS exposure via a position in **Think Tank's new Commercial series. The portfolio established a position in a AAA tranche of the \$750M deal which was the largest ever CMBS deal in the Australian securitisation market.**

The outlook for credit has reduced while remaining constructive. The fund remains fully invested, albeit retaining a defensive posture given historically low credit premiums.

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 continues to moderate and is no longer strongly positive.

Valuation indicators have improved while remaining marginally negative. Concerns surrounding the Omicron variant and the more hawkish stance from the Fed contributed to widening spreads across US investment grade, high yield and AU investment grade. The basis swap continues to make 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. PMIs remain resilient to supply chain disruption. Growth expectations have cooled slightly as a result of increasing COVID concerns. The accessibility of equity capital and increasing credit quality remain supportive for spreads.

Demand and supply indicators have cooled slightly while remaining marginally positive for the overall outlook. Market demand has been more selective than recent months with a number of new deals trading wider than issue by month end. Spreads continue to be supported by reduced issuance volumes relative to recent years.

Technical indicators are marginally negative for the overall credit outlook. Investor and intermediary cash balances are very low relative to historical levels, weighing on the outlook for credit spreads. The team will continue to monitor technical and supply demand indicators to identify inflection points in investor risk sentiment.

The credit outlook has tempered recently as credit markets face risks in the form of central bank tapering and the Omicron variant. At the end of long rally in spreads, the credit outlook remains supported by positive macroeconomic indicators while valuation, technical, and supply and demand indicators have moderated. The portfolios are well positioned to continue to deliver income and defend capital in these conditions.

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