

Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

May 2022



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: \$51.7 million as at 31 March 2022
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 0.11% as at 31 May 2022
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 May 2022

	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	-0.23	-0.79	-1.19	-0.77	2.72	1.77	-	-	1.99
Bloomberg AusBond Bank Bill Index	0.03	0.02	0.04	0.05	0.06	0.36	-	-	0.77

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

- AUD bonds and credit underperform offshore peers
- AUD spreads widen; Corporates outperform financials
- Yields rise early before moderating; RBA commences rate hikes
- Corporate primary issuance orderly; Major bank and securitised issuance robust
- The outlook for credit has continued to deteriorate and remains negative.

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

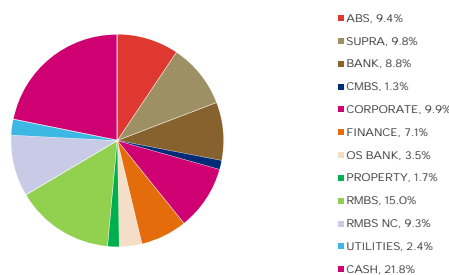
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

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	52.14%
Subordinated Debt	40.97%
Hybrid Debt	6.89%
Running Yield [^]	1.84%
Portfolio Weighted Average Life	3.01 yrs
No. Securities	108
Modified Duration	0.71

* 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

Global financial markets moderated somewhat during May following a tumultuous start to the year. Domestic markets underperformed offshore peers across fixed income, credit and equities as the RBA accelerated monetary tightening.

Domestic bond yields continued to selloff, ending the month higher along the curve. Yields rose early in May before rallying through the remainder of the month. The early month selloff was attributable to the greater than expected interest rate increase at the RBA's May meeting. The RBA elected to raise the target cash rate to 35bps and the subsequently released minutes revealed that 15, 25 and 40 bps increases were actively considered. The decision and subsequent increase in rate volatility demonstrate how central banks still retain the capability to surprise markets despite aggressive tightening already being priced in. US treasury yields rebounded slightly, and the US AU 10 Year spread tightened. US bond yields fell slightly on expectations of a more moderate tightening cycle which was supported by marginally below consensus April inflation print.

Domestic credit spreads continued to drift wider over the month. Accelerated monetary tightening and growth concerns continue to contribute to spread expansion. AUD credit underperformed relative to offshore peers. Corporates outperformed financials during May. Major bank spreads were impacted by a heavy issuance schedule. Among corporate sectors, Materials continued to lag with the weaker outlook for China weighing on spreads. Swap spreads widened as swap rates climbed higher during the month. The short end remains very steep in anticipation of a sharp tightening cycle.

Corporate and financial issuance was robust during May. Major banks headlined the domestic primary market following reporting season. ANZ came to market for \$4B across multiple tranches. A week later Westpac issued \$3B in covered and senior unsecured bonds. NAB later raised \$2.75B in the last week of May. Issuance in securitised sectors continued at a rapid pace with aggregate volumes trending above recent averages.

PORTFOLIO COMMENTARY

Income return contributed to relative performance over the month. Contributions to income return were broad based, led by RMBS, non-financial corporate, domestic and offshore banks. The fund's running yield remains a key buffer, mitigating the impact of widening credit spreads. The portfolio's running yield was 1.84% at month end with the spread measured at 1.34%.

Credit spread expansion was the most significant detractor from return over the month. Spreads continued to widen, impacted by growth and inflation concerns and uncertainty surrounding the pace and magnitude of monetary policy tightening. The Fund's allocations to domestic and offshore banks were the most significant detracting sectors. Alongside the broader move wider in spreads and tightening financial conditions, domestic bank spreads were impacted by elevated issuance volumes during the month.

The Funds allocation to government bonds continued to build, adding to portfolio liquidity in the form of highly liquid, AAA rated government issued securities with low transaction costs (bid/offer spreads) relative to credit securities which remain impacted by subdued secondary market liquidity. During May, the Fund's modest duration position detracted from performance as the RBA surprised the market with a larger than expected 25 bps increase to the cash rate.

Sector allocation was actively managed during the month. The Fund's exposure to RMBS was trimmed while selectively adding corporates in order to take advantage of the steepness of the BBSW curve. Interest rates for securitised assets are predominantly benchmarked against the 1-month BBSW, while corporates are benchmarked to the 3 month BBSW which is currently notably higher, reflecting market pricing of increases to the RBA official cash rate over this time horizon. The Manager also took the opportunity to add a number of Euro denominated bonds which were offering attractive relative value in the utility and telecommunications sectors.

With a challenging outlook for credit spreads and reduced liquidity in secondary markets, risk management remains paramount. The Fund maintains its defensive positioning while retaining the flexibility to take advantage of relative value opportunities presented by recent volatility.

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 continued to deteriorate and is now negative.

Valuation indicators turned slightly negative over the month. Swap spreads, which were previously at constructive levels, have expanded. Offshore spreads are offering more attractive value relative to the domestic market and the basis swap remains wide of recent averages both of which continue to weigh on the valuation outlook.

The growth outlook has reduced and is now neutral. The ease of access to equity capital has reduced somewhat over recent periods which can contribute to increased issuance of corporate debt. The strong ratio of upgrades to downgrades remains supportive while elevated oil prices continue to detract from the overall credit outlook.

Demand and supply indicators remained negative over the month. Aggregate issuance volumes remain above trend while primary market demand is slightly subdued. Technical indicators have deteriorated further over the month. Secondary market liquidity remains disrupted with intermediaries looking to reduce risk.

With a challenging outlook for spreads, risk management remains paramount. The team continues to position to defend capital while evaluating opportunities presented by the current market conditions.

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