

Perpetual Investment Funds

PERPETUAL ESG CREDIT INCOME FUND

September 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: \$61.8 million as at 30 September 2022
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 1.79% as at 30 September 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 30 September 2022

	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS PA	3 YRS PA	5 YRS PA	7 YRS PA	INCEPT PA
Perpetual ESG Credit Income Fund	-0.38	0.65	-1.00	-1.86	1.29	1.17	-	-	1.72
Bloomberg AusBond Bank Bill Index	0.15	0.42	0.49	0.52	0.28	0.38	-	-	0.82

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

- Financial markets sell off sharply on hawkish central banks;
- Domestic credit spreads widen: in range of post COVID selloff level;
- Corporate issuance orderly; securitisation issuance robust;
- Bond yields rise along the curve; AU yields outperform global peers;
- The outlook for credit remains challenging.

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

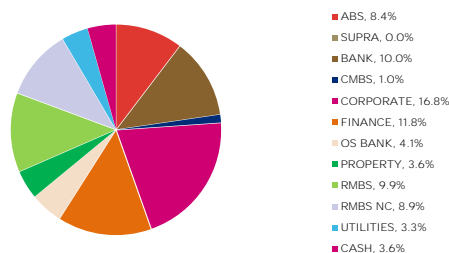
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

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	55.27%
Subordinated Debt	36.11%
Hybrid Debt	8.61%
Running Yield [^]	3.93%
Portfolio Weighted Average Life	3.45 yrs
No. Securities	89
Modified Duration	0.57

* 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 were again in turmoil during September as central banks continued to aggressively tighten monetary policy and recession risks persisted. Bond markets remain in a historic bear market with the 12-month return on fixed rate bonds as low as any on record.

Domestic spreads traded in a tight range over the first half of the month before widening sharply over the last week of September. Spreads ended the month close to their recent June high. Following the extended expansion over the first half of 2022, spreads are in range of levels seen in the period immediately following the 2020 COVID-19 selloff. Slowing economic growth, rising recession concerns and tightening financial conditions have contributed to rising credit risk premia.

Primary market issuance was orderly during September. In the corporate space, NBN came to market for \$800M across a pair of senior fixed rate deals. ANZ's \$900M tier-2 deal headlined issuance in financial sectors following large tier-2 deals from Westpac and NAB during August. The Securitisation market rebounded over the month with 11 deals printing between the last week of August and the end of September. Securitised issuance remains short of the pace observed during 2021. The RMBS space saw two deals north of \$1B from Columbus Capital and Australian Finance Group during the month.

Domestic bond yields widened along the curve during September. Yields ground higher over the month as the RBA maintained its aggressive monetary policy tightening. The RBA increased the target cash rate by another 50bps early in September following consecutive 50bps increases in June, July and August. The 2.35% target cash rate represents the highest level since February 2015. US yields also sold off significantly during the month on hawkish commentary from the Fed and better than expected leading economic indicators. The RBA has a somewhat more favourable predicament - relative to the US - with less severe inflation and wages growth as well as greater consumer sensitivity to policy rates as a result of highly leveraged households and the prevalence of variable rate mortgages. While the Australian economy looks robust thus far, the RBA does have a delicate balance to maintain. Inflation remains above the target rate and labour conditions are very tight, but forward indicators suggest slowing growth.

PORTFOLIO COMMENTARY

Income return was the most substantial contributing factor to performance during the month offsetting a portion of the negative credit spread return. The Fund's running yield continues to offer a robust buffer against ongoing volatility in credit and fixed income markets. As a result of rising interest rates and widening credit spreads, the Fund has continued to increase its running yield while at the same time reducing credit risk. The portfolio's running yield was 3.9% at month end, with the spread measured at 2.2%.

Credit spread widening detracted from performance during the month. Domestic spreads widened on aggregate as hawkish central bank rhetoric, slowing economic growth and tightening financial conditions weighed on credit markets. Domestic spreads were more resilient than offshore spreads during September. The most significant detractors from credit spread return were foreign denominated, long dated, subordinated debt and hybrids. Elsewhere, spread dynamics were mixed, with the Fund's utilities allocation performing well.

In recognition of tightening financial conditions and the challenging outlook for credit, the Fund continues to hold and actively trade Australian government bonds. At month end, just under 25% of the fund's assets were held across highly liquid government bonds and cash. During the month the Manager elected to increase the allocation to government bonds while rotating into shorter dated bonds in order to keep the fund's duration steady. The Fund's duration exposure detracted from performance during September, as bond yields rose throughout the month.

Sector and issuer allocations were actively managed throughout the month. The Manager elected to opportunistically trim subordinated bank debt exposures. The Fund took part in the new deal from NBN co which represented an attractive relative value opportunity from a high-quality government owned issuer with an established monopoly. Overall, the fund remains defensively positioned in recognition of the challenging outlook for credit spreads, 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. These include, for example, companies involved in the extraction of fossil fuels or companies whose revenues are significantly associated with socially questionable products or services.

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OUTLOOK

The credit outlook remains negative. Valuation indicators remain marginally negative. Credit spreads are at neutral levels relative to historical averages and offshore peers. The USD AUD basis swap remains elevated relative to long term averages, detracting from the credit outlook.

Growth indicators continue to detract from the overall credit outlook. Recession risks remain prominent and financial conditions are notably tighter. While the ratio of upgrades to downgrades remains robust, the team is cognisant of risks as financial conditions tighten and corporate earnings see increasing pressure.

Supply and demand indicators have improved while remaining marginally negative. Demand remains orderly in primary and secondary markets. Recent primary issuance volumes have been slightly elevated, detracting from the outlook for spreads.

Technical indicators have declined and are now neutral. Investor cash levels are healthy which contributes positively to the outlook. The negative trend in US equity and equity volatility indicators is detracting from the credit outlook.

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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