

# Perpetual Investment Funds

## PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS W

### 31 August 2023



#### FUND FACTS

**Investment objective:** The Fund targets a pre-tax return of 5% per annum above inflation (before fees and taxes) over rolling five-year periods. The Fund aims to provide investors with exposure to a balanced portfolio that is constructed with reference to risk premiums (risk contribution to the overall portfolio) rather than capital allocations

**Inception date:** October 2010  
**Size of fund:** \$835.7 million as at 30 June 2023  
**APIR:** PER0556AU  
**Management Fee:** 0.85% pa ^^Refer to PDS for Management Costs  
**Investment style:** Diversified risk budgeting, active, value  
**Suggested minimum investment period:** Five years or longer

#### TOTAL RETURNS % AS AT 31 AUGUST 2023

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA	VOLATILITY^	3 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	0.7	1.1	2.6	5.0	5.6	4.7	6.5	Perpetual Diversified Real Return Fund	3.1	3.3
Perpetual Diversified Real Return Fund (Net)	0.7	0.9	2.1	4.2	4.7	3.9	5.6	Mercer Balanced Growth Median	8.6	7.8

#### FUND OBJECTIVE OUTCOME AS AT 31 AUGUST 2023

**Objective:** Gross returns of CPI plus 5% over rolling 5 year periods

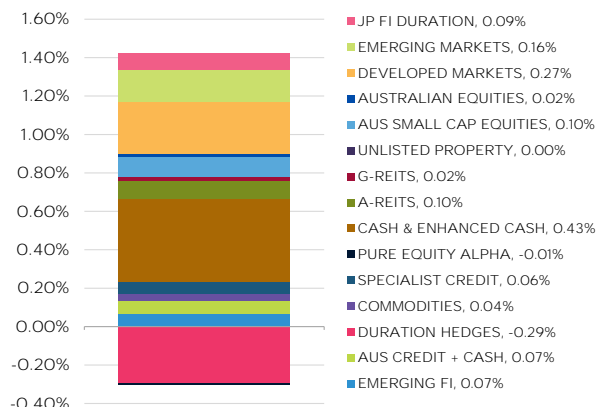
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	4.7	6.5
CPI plus 5%	8.7	7.8

Past performance is not indicative of future performance.

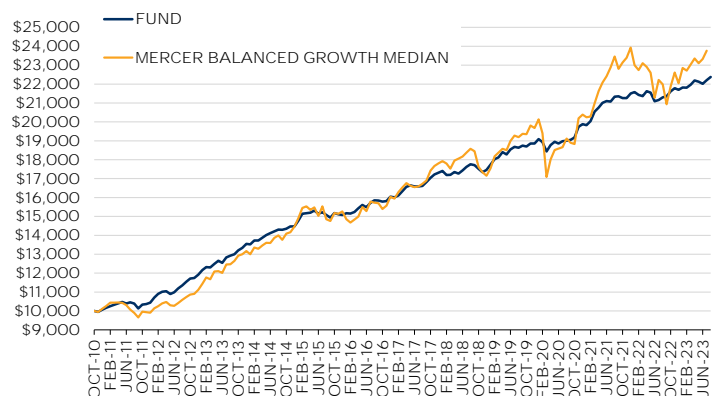
^^ Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS

^ Volatility and Mercer Balanced Growth Median data is lagged by 1 month

#### CONTRIBUTION TO 3MTH PERFORMANCE (GROSS)



#### GROWTH OF \$10,000 SINCE INCEPTION



#### FUND BENEFITS

Provides investors with access to a broadly diversified portfolio that weights asset classes according to their overall risk contribution to the total portfolio rather than capital allocations.

Provides a more efficient portfolio that seeks to reduce the uncertainty of investment outcomes and protect returns against inflation.

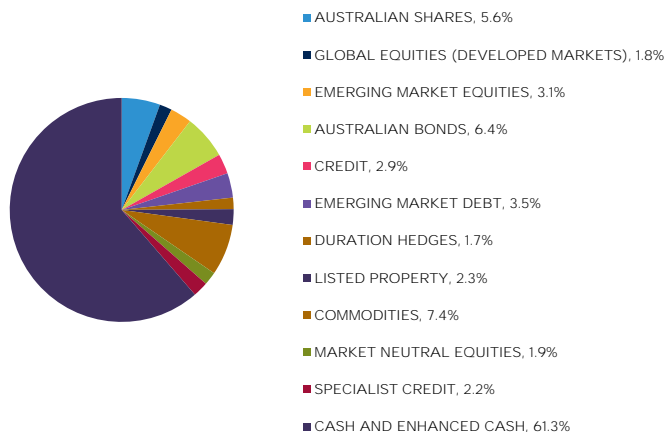
#### FUND RISKS

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.

#### FEE OPTION

Class W is the standard fixed fee class

#### PORTFOLIO SECTORS



#### CHANGES IN ASSET ALLOCATION (%)

	3 MTHS	6 MTHS	1 YR
Australian Shares	0.3	-1.0	-1.4
Global Equities (Developed Markets)	-2.5	-3.3	-0.8
Emerging Market Equities	0.0	0.1	0.2
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	-0.3	-0.2	-2.3
Credit	0.0	0.0	-0.1
Global Bonds (Developed Markets)	0.0	0.0	0.0
Emerging Market Debt	0.0	0.1	0.0
Duration Hedges	0.2	-7.8	7.1
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	0.0	0.0	0.0
Listed Property	-0.1	-0.2	-0.1
Commodities	0.4	2.7	3.0
Market Neutral Equities	0.0	0.0	-0.1
Infrastructure Debt	0.0	0.0	0.0
Other Investments	0.0	0.0	0.0
Specialist Credit	0.1	0.0	0.0
Cash and Enhanced Cash	1.9	9.5	-5.5
Alternative Beta	0.0	0.0	0.0

## FUND PERFORMANCE

The Diversified Real Return Fund returned 0.7% (gross) in August. Over the past year, the Fund has returned 5.0% (gross) and over the past 5 years the Fund has returned 4.7% (gross) per annum compared with the objective of 8.7% (CPI plus 5%\*) over rolling 5 years. Since inception (in 2010) the Fund has returned 6.5% (gross) per annum compared with the objective of 7.8% (CPI plus 5%\*).

The Fund's defensive positioning mitigated the impact of elevated volatility and sliding equity markets during August. In a month where global equities recorded a total return of -1.7%, the Fund's low equity weight and elevated cash allocation culminated in positive returns. The aggressive tightening of monetary policy since early 2022 has increased the attractiveness of yields offered on cash type investments, whereas rising valuations and stretched earnings expectations leave regional equity markets quite vulnerable to even modest changes in sentiment or expectations.

The Fund's modest allocation to developed and emerging markets were the largest detractor from performance last month as global equities sold off. Typically defensive assets such as government bonds and gold both experienced capital losses but cash bucked this trend, contributing to performance.

\*All groups CPI measured and published by the ABS as at 30 June 2023

## MARKET COMMENTARY

Global financial markets saw increased volatility in August as markets attempted to assess the impact of shifting economic growth prospects and the monetary policy path ahead.

- Global equities (-1.7%) receded in August. Markets sold off through the first three weeks of August with US equities (-1.6%) down by as much as -4% mid-month. Stronger-than-expected US data saw investors push US 10Y bond yields higher which weighed on equity market valuations. This trend partially reversed towards month end given a less hawkish tone from US Federal Reserve (The Fed) Chair Powell's Jackson Hole address which eased investor concerns about more rate hikes from the world's most important central bank.
- Australian equities (-0.7%) outperformed their developed market peers and experienced a relatively modest decline. The Australian reporting season was mixed with better-than-expected EPS growth offset by a large number of downward revisions to expectations. This signalled an impending contraction in total earnings underpinned by mounting cost pressures stemming from labour, rent, energy, transport, and technology expenditures weighed on operating margins. These costs, combined with a squeeze on disposable income and depleted household savings, conspire to constrain corporate pricing power and hence revenue growth.
- In contrast, Emerging markets (-4.7%) continued to underperform their developed market peers, reflecting the potent combination of slowing growth momentum in all key non-US economies, in addition to a stronger US Dollar and higher US bond yields.
- US 10-year yields (+15bps) rose sharply through the first half of the month before moderating. The US yield curve, however, remains deeply inverted which has historically signalled economic challenges are ahead. Australian 10-year bonds (-3bps) remained relatively unchanged after the RBA held rates at 4.1% at its August meeting while the yield curve steepened with 2-year yields (-23bps) rallying over the month.
- Meanwhile, energy commodities rose, led by thermal Coal (+13.6%) while Iron Ore (+6.9%) also performed well, on the back of robust Chinese steel production. Gold (-1.4%) gave back a portion of recent gains, reflecting rising bond yields and a stronger US dollar.

The heightened market volatility observed during August belies the sustained uncertainty surrounding the economic growth, inflation and monetary policy outlooks which are occurring at a time of high equity valuations and optimistic expectations for earnings growth. Our concern remains that the market is already pricing a scenario where earnings growth is double its historic average, inflation returns to target and central banks have the room to ease rates many times. This is against a backdrop of soft leading economic indicators and a swathe of recession signals including deeply inverted yield curves, which will weigh on earnings growth and could challenge valuations. In the US, the yield curve has been inverted since the July-22 with similar inversions in Canada, UK, Germany, France, Sweden, Netherlands, Switzerland, and New Zealand. Other reliable recession indicators including sub-45 scores on regional manufacturing PMI gauges, tightening credit standards in senior loan officer surveys and negative current activity indicators all suggest that global growth is set to slow as higher rates progressively weigh on activity and sentiment.

The pressure on the Fed to continue hiking interest rates has eased somewhat as while inflation is still double the typical +2%Y target, downward pressure on core goods price inflation is now broad based and looks set to continue. In addition, there are embryonic signs that global services inflation has eased marginally although this trend needs to persist for an extended period for core inflation gauges to return to the vicinity of the typical +2% target. The key central bank meeting during the month was the Jackson Hole Symposium which reiterated many of the themes highlighted at recent meetings such as caution, data dependence and the expectation of higher-for-longer rates, adding little new to the market narrative. While monetary policy operates with long and variable lag, the impact of 18 months of sustained monetary tightening is becoming clearer – Europe looks increasingly weak, the UK appears stagflationary, Australian corporate profit expectations have been heavily downgraded, and China could have sustained deflation unless material stimulus is provided.

In this environment, the risk of a significant credit contraction remains elevated. While the US economy continues to exhibit resilience, its financial system is vulnerable to contagion given the highly leveraged commercial and industrial sector which face refinancing at much higher rates and much more conservative lending standards. So far, the impact of the tightening cycle has been several US regional bank collapses, sharp price declines across speculative assets including cryptocurrencies and non-fungible tokens, and rising bond yields. For some time, we have been warning about the build-up of excesses in financial markets and we expect to see more of these excesses wash out over time, with China particularly exposed given its high debt and deflation.

China faces a daunting array of challenges, including slowing growth, sustained deflation, high debt levels, low living standards and the ongoing property malaise. The People's Bank of China (PBoC) is expected to cut rates, but the effectiveness of such measures remains uncertain as funds are not being lent out which suggests that the transmission mechanism of monetary policy is somewhat blocked. These challenges in China have implications not only for Asian neighbours but also for Europe and the US.

For some time, we have been highlighting that risk in this environment is underpriced by markets. Markets are priced for perfection with no downturn, strong earnings growth and central banks easing rates within 12 months. While the US economy has shown resilience thus far, other regions are clearly struggling in response to higher rates, and these are likely to be sustained for a while yet. During these times, our focus remains on identifying investments that can generate returns of CPI plus 5% per annum over a five-year horizon while maintaining an asset allocation that ensures that no individual position or cluster of positions will risk the medium-term investment objective.

## CURRENT POSITIONING

The key consideration in the prevailing investment environment is to not overpay for an investment. Global equity valuations are well above average levels - especially in the US - and the environment remains one of anaemic profit growth, high interest rates and elevated recession risks. **As such, the Fund's equity exposures in its return seeking quadrant remain modest and are concentrated in traditional value markets, which should outperform the broad index given their more conservative valuation and higher earnings resilience.**

Meanwhile, the Fund has maintained the inflation protection quadrant's exposure to metals (including gold) and soft commodities. Elsewhere, the downside protection quadrant has exposure to Australian and US government bonds but the overall portfolio weight in duration is lessened by a risk controlled short position in Japanese bonds which forms part of our diversifying opportunities quadrant. The Fund continues to manage its aforementioned modest equity exposures via put options on US and European equities.

Downside protection also has a large cash position (which provides a high running yield as well as optionality in the event of a market selloff) as well as a call option on the US Dollar and a put spread on the Dollar against the UK Pound.

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## MORE INFORMATION

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