

# Perpetual Investments

## PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS W

30 April 2021



### 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:** \$691.4 million as at 31 March 2021  
**APIR:** PER0556AU  
**Management Fee:** 0.85% pa <sup>^^</sup>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 30 APRIL 2021

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA	VOLATILITY <sup>^^</sup>	3 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	1.0	4.7	8.2	10.6	6.2	6.1	7.2	Perpetual Diversified Real Return Fund	3.7	3.4
Perpetual Diversified Real Return Fund (Net)	1.0	4.5	7.8	9.6	5.3	5.2	6.3	Mercer Balanced Growth Median	10.5	7.6

### FUND OBJECTIVE OUTCOME AS AT 30 APRIL 2021

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

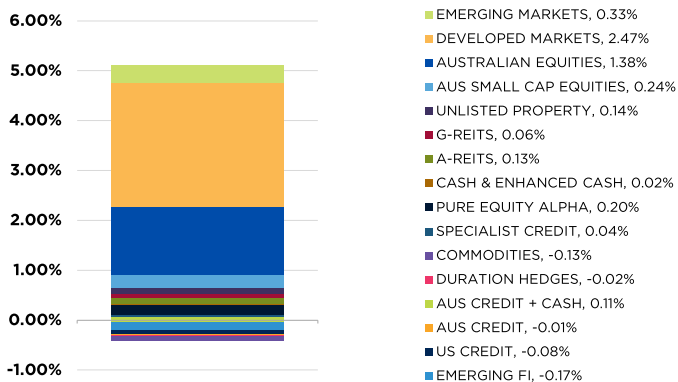
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	6.1	7.2
CPI plus 5%	7.1	7.2

Past performance is not indicative of future performance.

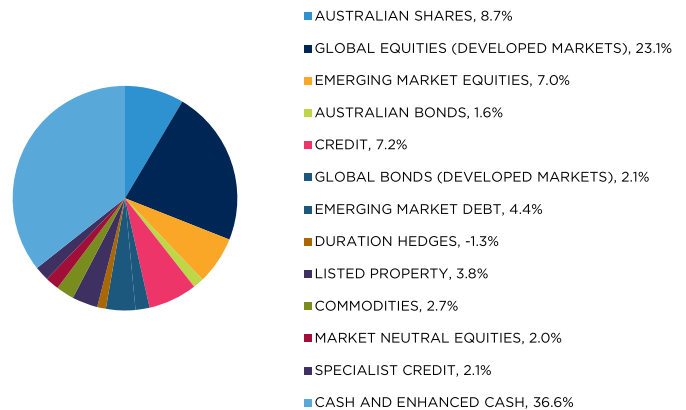
<sup>^^</sup> Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS

<sup>^</sup> Volatility and Mercer Balanced Growth Median data is lagged by 1 month

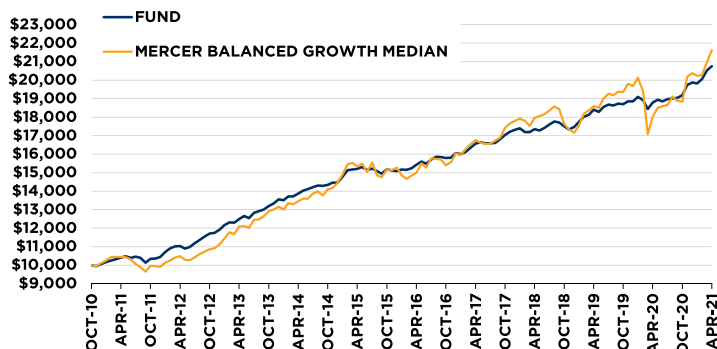
### CONTRIBUTION TO 3MTH PERFORMANCE (GROSS)



### PORTFOLIO SECTORS



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



### CHANGES IN ASSET ALLOCATION (%)

	3 MTHS	6 MTHS	1 YR
Australian Shares	-1.6	1.6	0.6
Global Equities (Developed Markets)	7.9	9.9	12.6
Emerging Market Equities	-0.4	3.6	4.0
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	-6.4	-6.2	-6.7
Credit	-0.7	-0.4	-0.6
Global Bonds (Developed Markets)	-0.3	-0.2	-0.5
Emerging Market Debt	-0.3	-0.3	0.0
Duration Hedges	0.2	0.4	-0.2
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	-4.1	-4.5	-5.0
Listed Property	1.9	1.8	0.5
Commodities	-3.1	-1.5	-4.7
Market Neutral Equities	0.2	0.3	0.1
Infrastructure Debt	0.0	0.0	0.0
Other Investments	0.0	0.0	0.0
Specialist Credit	0.0	-0.1	-0.1
Cash and Enhanced Cash	6.6	-4.2	0.0
Alternative Beta	0.0	0.0	0.0

## FUND PERFORMANCE

The Diversified Real Return Fund returned 1.0% (gross) for the month of April. Over the past year, the Fund has returned 10.6% (gross) and over the past five years the Fund has returned 6.1% (gross) per annum compared with the objective of 6.7% (CPI plus 5%\* over rolling five years). Since inception (in 2010) the Fund has returned 7.2% (gross) per annum compared with the objective of 6.8% (CPI plus 5%\*).

The key drivers of return for April were Australian and global equity exposures. Equity markets continue to perform well on expectations of very strong economic growth this year and robust earnings results.

The main detractor from performance was the Fund's foreign currency exposure. The Australian dollar continued to appreciate, supported by surging iron ore prices, while simultaneously, the Fed's aggressive monetary policy puts downward pressure on the US dollar.

\*All groups CPI measured and published by the ABS as at 31 March 2021

## MARKET COMMENTARY

Financial markets performed well through April, supported by strong economic growth.

- US equities (+5.4%) rose on robust first quarter earnings results and promising growth indicators.
- European markets were mixed with the UK (+4.1%) and France (+3.6%) performing strongly while Germany (+0.9%) lagged somewhat.
- Performance in Asian markets was led by Taiwan (+7.0%) while Korea (+2.8%) and Hong Kong (+1.3%) also posted gains. Japan (-1.3%) was an outlier in the major developed markets, with a small fall in April.
- Australian equities (+3.6%) continued to rally, supported by rising iron ore prices and expectations of an ongoing economic recovery.
- Credit spreads tightened and long-term government bond yields fell modestly after the substantial increase in the March quarter.

The positive macroeconomic outlook outweighed ongoing concerns about the COVID pandemic. Global COVID-19 cases spiked due to a significant surge of the virus in India. By contrast, in Europe and the US, the number of new cases continues to fall and restrictions were relaxed supporting economic growth. The tragic situation in India has, however, raised concerns about new mutations of the virus and created more supply chain pressure on the global vaccine rollout.

Global growth in 2021 is set to be the strongest since the 1970s as social mobility restrictions ease, monetary and fiscal stimulus remains potent and consumers start to run down elevated savings. And the economic outlook continued to improve over the month with explosive growth either underway (in the US) or in prospect (in Europe) later this year.

The outlook for growth in the major developed economies this year is underpinned by the massive fiscal expansion observed over the past year. The new US Administration has been very active in this area and in April President Biden announced the details of the infrastructure spending plan. Their US\$2 trillion package targeting job growth would be funded by corporate tax reforms. Market reaction to the proposal was mixed with initial exuberance dampened somewhat by concerns regarding the proposed corporate tax increases. The infrastructure proposal follows closely on the heels of the 'American Rescue Plan' in March. The impact of this latter plan is likely to peak in the current quarter with another big boost in consumer spending likely.

In Australia, fiscal policy has been progressively wound back with the end of the JobKeeper program. Judging by the most recent labour market data, the economy appears to be resilient in part helped by an effective response to the COVID crisis and by yet another stunning surge in commodity prices. Moreover, the Treasurer has said that the upcoming federal budget would continue to support economic recovery without any "sharp pivots toward austerity".

Meanwhile, monetary policy remains on 'tilt' settings globally led by the US Federal Reserve's (the Fed) policy of zero rates supported by a massive quantitative easing program. During their April meeting, chairman Powell noted the improving labour market outlook but quashed talk of tapering, reasserting the high bar required for policy changes.

The Reserve Bank of Australia also remains similarly steadfast in its pursuit of inflation and employment goals before changing monetary policy settings. Inflation in the March quarter in Australia was below expectations, further supporting our belief that policy rates will remain on hold for an extended period. These extraordinary monetary policy conditions continue to be extremely supportive for equity and credit markets as liquidity remains abundant and the discount rate used to value equity markets remains incredibly low.

Global equities were further supported in April by rapidly recovering corporate earnings. US first quarter earnings results were strong with many companies beating consensus expectations. The robust performance was headlined by a number of the US tech conglomerates including Apple, Facebook and Alphabet. The combination of resurgent earnings and a small fall in long term yields ensured that the recent rotation from growth to value stocks retraced somewhat in April.

At this stage of the economic cycle (ie growth recovery at the same time as central banks are committed to keeping interest rates low) the yield curve usually steepens significantly as long-term interest rates rise while short term interest rates are anchored. The beginning of this process was observed in February as long-term yields sold off, fuelling the rotation in equity markets from growth to value as discount rates increased. We expect the current conditions of continued massive fiscal support in the US and rising bond yields will continue to be supportive for value stocks.

## CURRENT POSITIONING

The extraordinary monetary and fiscal policy response to the COVID-19 crisis has been very successful in minimising the damage of a massive shock to the global economy. It has also had profound implications for portfolio construction:

- Zero (or near zero) cash rates in all major developed economies have increased the attractiveness of any yielding asset.
- Notwithstanding the recent rise in yields, long term interest rates remain at extraordinarily low levels supported by zero cash rates and

aggressive quantitative easing. A key feature of portfolio construction for the past four decades has been the diversification benefit of owning bonds (with bonds rallying when equities are in bear markets) – this time, bonds appear vulnerable and could continue to be the cause of a significant rotation within equity markets.

- Credit markets are also heavily distorted by the actions of the Fed with very low spreads on offer against a backdrop of elevated default risk.
- Equity markets in aggregate are extremely expensive – particularly growth sectors and the euphoria in some significant parts of the market is reminiscent of the bubble in technology stocks in the late 1990s. Just as importantly, there are some parts of the market that are very attractively priced -- particularly value stocks, including some cyclical sectors adversely impacted by the lockdowns.

These developments led to a significant restructure of the portfolio late last year:

- The equity portfolio has been restructured to be more defensive by reducing exposure to the US (and the technology sector in particular) and increasing exposure to a number of different ‘value’ opportunities including the UK, Europe, Australia and emerging markets. These investments should be well placed to out-perform if the strong economic recovery we expect plays out in 2021. We expect outsized profit recoveries in many cyclical stocks as well as some upward pressure on interest rates which favours ‘value’ over ‘growth’.
- The portfolio remains selective in applying downside protection. A key feature of this portfolio is that downside protection strategies are not mechanically implemented. The portfolio utilises cross asset hedges alongside direct downside protection where there is attractive relative value. During April, the Fund added some put option protection in Australian equities. Australian equity options pricing finally became attractive again after an extended period where options were generally expensive in the aftermath of the extreme volatility in the first half of 2020.
- During the month, the last of the Fund’s direct industrial property allocation was liquidated. Capitalisation rates in the industrial property space have fallen significantly and the opportunity was taken to dispose of assets at a healthy premium. At the same time, allocations to listed Australian and Global REITs were selectively increased.

The Fund retains a significant cash allocation. This is an extreme environment for the economy and for markets. Valuations are extremely extended in some parts of the equity market and interest rates have never been lower. Financial markets history is replete with dire warnings about the risks of investing when valuations are as extended as they are now. Even though there is a significant opportunity cost in holding cash, our focus remains on investments that can generate CPI plus 5% per annum over a five-year horizon. At the moment, that is a very narrow part of the investment universe – concentrated in the long neglected ‘value’ parts of the market. As a result, we want to hold cash to take advantage of attractive investment opportunities in the broader investment universe that we expect to arise in the period ahead.

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## **MORE INFORMATION**

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