

Perpetual Investment Funds

PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS W

31 May 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: \$841.0 million as at 31 March 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 MAY 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)	-0.3	1.4	1.6	2.7	5.3	5.1	6.5	Perpetual Diversified Real Return Fund	3.1	3.3
Perpetual Diversified Real Return Fund (Net)	-0.4	1.2	1.2	1.8	4.4	4.2	5.6	Mercer Balanced Growth Median	8.6	7.9

FUND OBJECTIVE OUTCOME AS AT 31 MAY 2023

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

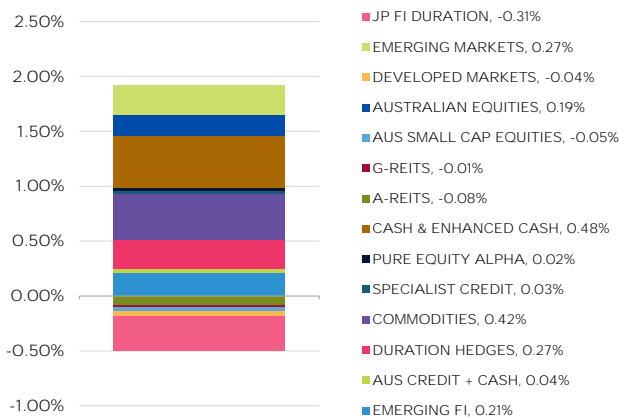
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	5.1	6.5
CPI plus 5%	8.6	7.8

Past performance is not indicative of future performance.

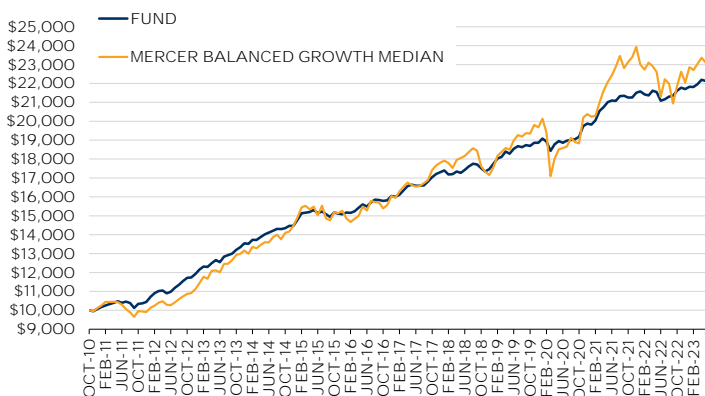
^{^^} Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS

[^] 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.

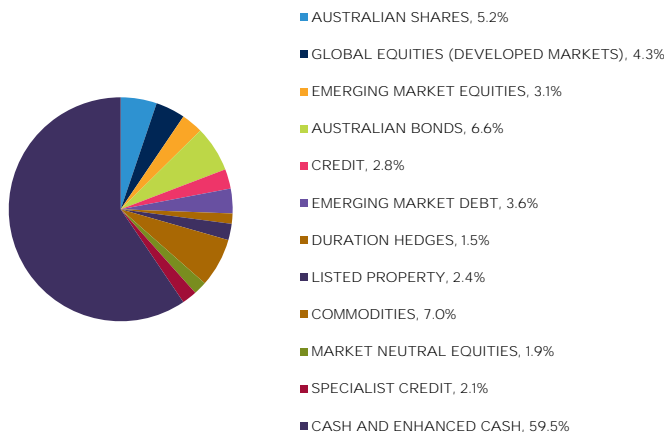
FUND RISKS

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	-1.3	-1.3	-2.4
Global Equities (Developed Markets)	-0.8	-2.0	-8.4
Emerging Market Equities	0.1	0.1	0.5
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	0.0	-1.6	3.5
Credit	0.0	0.0	-3.2
Global Bonds (Developed Markets)	0.0	0.0	0.0
Emerging Market Debt	0.1	0.1	-0.1
Duration Hedges	-8.0	-0.8	1.6
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	0.0	0.0	0.0
Listed Property	-0.1	-0.1	-0.8
Commodities	2.4	2.6	1.7
Market Neutral Equities	0.0	0.0	0.0
Infrastructure Debt	0.0	0.0	0.0
Other Investments	0.0	0.0	0.0
Specialist Credit	0.0	0.0	0.2
Cash and Enhanced Cash	7.6	3.0	7.4
Alternative Beta	0.0	0.0	0.0

FUND PERFORMANCE

The Diversified Real Return Fund returned -0.3% (gross) during May. Over the past year, the Fund has returned 2.7% (gross) and over the past 5 years the Fund has returned 5.1% (gross) per annum compared with the objective of 8.6% (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 most substantial detractor from return during the month was the Fund's fixed income exposure. The Fund maintains exposure to Australian and US government bonds which both saw yields move higher during May. The duration risk of these investments is partially offset by short Japanese government bond futures. During the month however, Japanese bonds held firm as the BOJ quashed the possibility of a near term change to their Yield Curve Control policy.

Global equity markets were mixed, with the strong performance of a small concentration of large cap US tech stocks offsetting falling valuations elsewhere. The value tilt of the Fund's equity exposures was not rewarded, and stock selection detracted across global and domestic equities (with the exception of the underweight exposure to China within the Fund's emerging markets exposure).

During a month of mixed returns for risk assets, the Fund benefitted from its substantial cash allocation. Notably the large US dollar exposure was the most significant contributor to performance as the Greenback powered ahead of peers on anticipation of further tightening from the US Federal Reserve (the Fed).

Elsewhere, the Fund's allocation to a diversified basket of commodities including Gold detracted as weakening Chinese demand and anticipation of further monetary tightening impacted prices.

*All groups CPI measured and published by the ABS as at 31 March 2023

MARKET COMMENTARY

Financial markets were mixed in May following a robust start to the year across almost all asset classes (with the notable exception of commodities). This strong first half has been despite headwinds including moderating earnings growth, tightening monetary policy, a potential US treasury default, turmoil in US regional and global banks and concern over a looming credit withdrawal. While US equity performance has been wholly reliant on the positive contribution of high growth tech stocks, more traditional value markets such as Europe, the UK and Japan have also performed well.

- During May, US equities (+0.4%) ticked marginally higher, however this masked a widening gap between the performance of value stocks and sectors (-3.9%) and growth (+4.6%) led by the strong performance of the tech giants.
- Japanese equities (7.0%) were buoyed by attractive valuations, the depreciating Yen and the return of inflation after years of deflationary conditions. Meanwhile, Chinese equities (-8.2%) continued to recede from their post reopening peak as economic growth indicators weakened.
- European equities trailed the broader developed market with French stocks (-3.9%) falling sharply. The value correlated UK market (-4.9%) underperformed, reflecting the broader relative outperformance of growth stocks.
- Australian equities (-2.5%) underperformed developed markets on the back of hawkish monetary policy expectations and weakened materials demand.
- Domestic bond yields sold off over the month with 10-year yields rising 26bps to 3.6%. US (+19bps) ten-year yields also rose during the month while the short end saw elevated volatility as the fight over increasing the debt ceiling continued until the end of the month.

We continue to observe a disconnect between the strength of the US equity index returns and weakening economic indicators and corporate profits. The US equity market continues to be led by the large cap tech giants which have benefitted from moderating long term bond yields over the first half of 2023 and robust earnings results. US equities outside of the largest market cap stocks have starkly underperformed, suggesting that the market is pricing in weakening corporate profits, but this is being masked by rising valuations of a select few firms.

Meanwhile, the shape of government yield curves imply recession followed by subsequent rate cuts. In the US, the yield curve has been inverted since the middle of last year and during the month, short end yields inverted further across multiple government bond curves. Yield curve inversion is the single best indicator of recession risk. Other reliable recession indicators like the manufacturing surveys, the senior loan officer survey and current activity indicators are suggesting growth is very weak. At the same time, while the temporary raising of the debt ceiling soothed concerns of a US default, the restrictions on government spending growth limit the capacity for fiscal policy to stimulate activity.

Resilient regional labour markets and sticky core inflation are keeping the pressure firmly on the Fed. US year-on-year inflation fell below 5% despite core components including rents remaining stubbornly high. April payrolls were strong which is good news for avoiding recession but add to the challenge facing the Fed. Sticky services sector inflation typically requires an output gap to materially decrease. In other words, the economy needs to be operating below full potential implying higher unemployment and lower wages growth.

As financial conditions continue to tighten, risks of an accident or a significant credit contraction are elevated. While the banking sector concerns which reached a peak in March have subsided somewhat, we expect further disruption as market excesses predicated on unsustainably easy monetary policy are washed out.

The US is not the only economy facing challenges with the growth outlook for China continuing to deteriorate as the tailwind from their post-COVID reopening dissipates. And locally, the Reserve Bank of Australia continues to grapple with inflation that is well above targets set against a very challenging backdrop for the consumer. In contrast, the recovery in Japan looks the most upbeat in decades, supported by a potent mix of reopening dynamics, a surge of inbound tourism, strong nominal income growth and foreign investment drawn by attractive relative valuations.

CURRENT POSITIONING

The aggressive tightening of financial conditions alongside well above target inflation and elevated recession risks presents a very challenging environment for investors to navigate.

We remain concerned about the outlook for global equity markets with equity valuations above levels which are attractive and market capitalisation increasingly concentrated in long duration sectors. At the same time, there are some assets capable of offering more attractive defensive returns, reducing the allure of equities as the only option for portfolios. In particular, the sharp increase in cash rates and bond yields since the start of 2022 – has brought an end to the TINA (There Is No Alternative) to equities paradigm in favour of TARA (There Are Real Alternatives). As such, the Fund's equity exposures remain very low and the emphasis on diversifying opportunities is correspondingly elevated. The Fund's equity exposures are focused on value and quality sectors and securities which we expect to be rewarded in an environment of restrictive monetary policy and slowing growth.

The Fund maintains a small overall exposure to duration, but that masks a position in US and Australian Government bonds, which is largely offset by a short (negative) position in Japanese bonds.

The portfolio has a low (direct and indirect) sensitivity to higher interest rates which should provide resilience if persistent inflation extends the current monetary policy tightening cycle. The Fund also maintains a small exposure to metals and soft commodities, which offer inflation protection.

While the Fund's allocation to traditional defensive assets (like government bonds) remains limited (reflecting valuation concerns), the Fund's defensive position is supported by a very substantial cash allocation. Cash-type investments are providing investors with higher returns than have been the case for many years, and there is also significant optionality in holding cash. For some time, we have been highlighting that this is an extreme environment for the economy and for markets. 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

Adviser Services 1800 062 725

Investor Services 1800 022 033

Email investments@perpetual.com.au

www.perpetual.com.au

