Perpetual Investments
PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS W
31 July 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: $749.8 million as at 30 June 2021
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

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

TOTAL RETURNS % AS AT 31 JULY 2021

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	-0.1	1.6	6.3	11.1	6.2	6.0	7.2
Perpetual Diversified Real Return Fund (Net)	-0.2	1.3	5.9	10.2	5.3	5.2	6.3

VOLATILITY^	3 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund	3.7	3.3
Mercer Balanced Growth Median	10.5	7.6

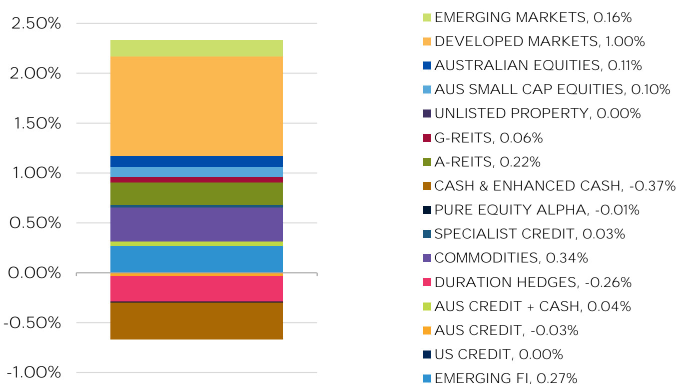
FUND OBJECTIVE OUTCOME AS AT 31 JULY 2021

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

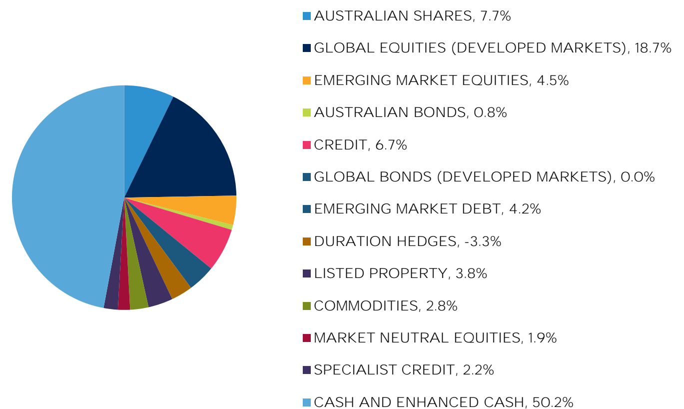
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	6.0	7.2
CPI plus 5%	7.0	7.1

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

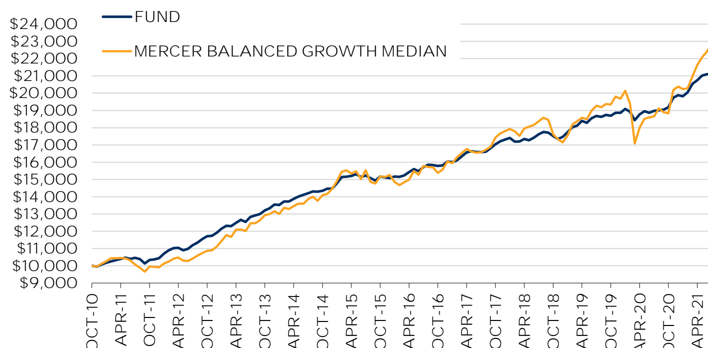
CONTRIBUTION TO 3MTH PERFORMANCE (GROSS)



PORTFOLIO SECTORS



GROWTH OF $10,000 SINCE INCEPTION



CHANGES IN ASSET ALLOCATION (%)

	3 MTHS	6 MTHS	1 YR
Australian Shares	-1.0	-2.6	1.5
Global Equities (Developed Markets)	-4.4	3.5	7.9
Emerging Market Equities	-2.5	-3.0	1.1
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	-0.8	-7.2	-7.4
Credit	-0.6	-1.2	-1.1
Global Bonds (Developed Markets)	-2.1	-2.4	-2.2
Emerging Market Debt	-0.1	-0.4	0.0
Duration Hedges	-2.1	-1.8	-2.1
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	0.0	-4.1	-4.8
Listed Property	0.0	1.9	1.8
Commodities	0.2	-2.9	-4.8
Market Neutral Equities	-0.2	0.0	0.0
Infrastructure Debt	0.0	0.0	0.0
Other Investments	0.0	0.0	0.0
Specialist Credit	0.1	0.1	-0.1
Cash and Enhanced Cash	13.6	20.2	10.1
Alternative Beta	0.0	0.0	0.0

FUND PERFORMANCE

The Diversified Real Return Fund returned -0.1% (gross) for the month of July. Over the past year, the Fund has returned 11.1% (gross) and over the past five years the Fund has returned 6.0% (gross) per annum compared with the objective of 7.0% (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 7.1% (CPI plus 5%*).

The key detractor from performance over the month was the fund's allocation to emerging market equities. Emerging markets significantly underperformed over the month as increasing regulations, COVID-19 concerns and slowing growth caused a selloff in Chinese stocks. The Fund's emerging market equity allocation remains significantly underweight China which mitigated a portion of the downside.

The Fund retains a bias towards value and quality in stock selection and country selection as these are the investments with the best prospects of generating CPI plus 5% over the medium term. This positioning has performed very strongly over the past year. But with long term interest rates falling in July, stock selection and style bias in equities detracted from performance in July.

During the month the Fund's allocation to global equities and the US dollar alongside other foreign currency exposures performed well. The Australian dollar declined as a result of increasing COVID-19 concerns and some downgrades to global growth expectations.

*All groups CPI measured and published by the ABS as at June 2021

MARKET COMMENTARY

The resurgence of COVID-19 was the dominant theme in markets during July. The extremely contagious delta variant is sweeping the globe with highly variable impacts. While developed market equities continued to rise, the signs of increasing investor caution were apparent in a rally in long term bonds and appreciation of the US Dollar.

While global growth is still expected to be very strong through the second half of 2021, it appears that US growth has peaked and will revert towards pre-pandemic growth of 2% or less by the second half of 2022. The tailwinds that have powered the US growth story will fade as fiscal support declines – notwithstanding the Biden administration's infrastructure plan.

It is crucial to note, however, that first half economic and earnings growth in the US was exceptional. Early indicators are that US second quarter earnings results will be very robust with a majority of the companies that have already reported exceeding broker expectations.

Inflation uncertainty continues to be a key theme in US markets with headline inflation above 5% and the US Federal Reserve's (the Fed's) preferred measure of core inflation at a 30 year high of 3.5%. High inflation prints over recent months have been attributed to 'transitory factors' caused by supply side bottlenecks. A lot hinges on this assessment as monetary policy settings are so extreme – our own view is that core inflation will subside from recent levels back towards 2% next year as some of these 'one-offs' reverse. However, with estimates expected to be well above potential growth, average core inflation will likely be somewhat higher than we previously estimated. As a result, the Fed is likely to be successful in getting inflation up to 2% or higher. Of course, there is also a significant risk that core inflation settles closer to 3% which would be very uncomfortable for the Fed and therefore financial markets with the prospect of higher interest rates.

US equities continued their rise as interest rates fell during July and profit expectations continued to rise. Long term treasury yields rallied over the month as the resurgence of COVID-19 and the spread of the delta variant contributed to uncertainty about the economic outlook. The impact of rising COVID-19 cases on economic activity in the major developed economies of North America and Europe, however, has been lessened by increased levels of vaccination and natural immunity. During July, the Fed noted the economy's increased resilience in the face of the delta strain, with Chairman Powell stating that "there has tended to be less in the way of economic implications from each wave".

There is a dichotomy between economies with higher levels of vaccinations and/or natural immunity (the US and Europe) and those with lower levels. The US, UK and Europe have high rates of vaccination and natural immunity and have demonstrably broken the nexus between infections and hospitalisations. Conversely, markets with low natural immunity and low vaccinations rates (Australia) or questionable vaccine efficacy (China and many other emerging economies) are more exposed to disruption. The reduced risk of serious infection has allowed the reopening of European economies to continue despite the increasing case numbers. With the benefits of reopening still to be realised, we believe Europe and the UK are the regions with the most promising growth outlook for the second half of 2021.

Conversely, emerging market economic growth has been impacted by reactions to the spread of the delta variant. Additionally, Chinese equities are pricing an increasing regulatory risk as the authorities clamped down on the private education industry. Over the month, the MSCI Emerging Markets index returned -6.1% significantly underperforming the developed World index. MSCI China returned -13.8%, the largest monthly decline in nearly a decade.

Domestically, the Greater Sydney lockdown as well as shorter term lockdowns in much of the rest of Australia has caused growth expectations to be revised down significantly. During the month Australian equities rose, but marginally underperformed the broader market. Meanwhile, the fall in domestic long-term yields outpaced global peers. The outlook for Australia is delicately poised given the combination of a highly contagious variant and low levels of vaccination and natural immunity. We expect the Australian economy to contract during the September quarter given tighter mobility restrictions. The lack of a massive direct fiscal stimulus program to date, suggests the recovery may be less robust as there will not be comparable accumulated savings.

Up to this point, equity and credit markets have been supported by the extraordinary monetary policy settings. With the recovery fully priced into markets, any upward shift to interest rates could negatively impact equity market valuations. Central banks went to extreme monetary policy settings when the coronavirus hit early last year with zero (or negative) policy rates in all major economies supported by massive quantitative easing (QE) programs. While the global economic recovery is now well established, there has been very little change so far in the guidance for monetary policy from the key central banks (the Fed, the European Central Bank and the Bank of Japan). The strongest year of economic growth in many decades and a series of upside inflation surprises sits very awkwardly with current policy settings.

It is difficult to be precise about the timing of such a major change. As usual one central bank, the Fed, will dominate the narrative. For now, we are in a holding pattern awaiting more inflation data, developments on the delta variant and central bank policy decisions.

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. In particular, the role of bonds in portfolios as a defensive anchor is under question. Long-term interest rates remain at extraordinarily low levels supported by zero cash rates and aggressive quantitative easing. Indeed, other than last year, they have never been lower. 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.

At the end of last year and early this year, the Fund's overall risk exposure was increased with a focus on value markets. These exposures have performed well and were trimmed somewhat in the month (including exposure to emerging markets). Relative value positions were also reduced by decreasing the underweight to the US market and selling some value markets leading to a commensurate small reduction in risk. At the same time, a put option position on the Nasdaq was initiated to protect against the specific risk posed by the valuation of the US technology sector.

Our focus remains on investments that can generate CPI plus 5% per annum over a five-year horizon. Against this backdrop, we remain cautious about the outlook for some major parts of the investment universe including:

- the US equity market (which on some measures is the most expensive it has ever been) and specifically the technology sector.
- credit markets -- very little compensation for the risk of default.
- government bonds – yields are negative after allowing for inflation.

The Fund also retains a significant cash allocation reflecting the winnowing out of investments with poor prospects of generating the target return of CPI plus 5% in the medium term. This cash position is balanced by a substantial risk allocation to diversifying opportunities (including equity alpha and currency positions).

There is also significant optionality in holding cash. This is an extreme environment for the economy and for markets. Valuations are extremely extended in some parts of the equity market and bond yields have never been lower than in the past year. Financial markets history is replete with dire warnings about the risks of investing when valuations are as extended as they are now. 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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