

Perpetual Investments

PERPETUAL ETHICAL SRI CREDIT FUND

August 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: \$55.9 million as at 30 June 2022
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 1.36% as at 31 August 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 31 August 2022

	1 MTH	3 MTHS	6 MTHS	1 YR	2 YRS PA	3 YRS PA	5 YRS PA	7 YRS PA	INCEPT PA
Perpetual Ethical SRI Credit Fund	0.40	-0.09	-0.88	-1.38	1.45	1.41	-	-	1.85
Bloomberg AusBond Bank Bill Index	0.15	0.33	0.35	0.37	0.21	0.36	-	-	0.80

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

- Hawkish tone from Jackson Hole sees markets falter.
- Bond yields rise: remain short of June highs.
- Domestic spreads rangebound: Earnings results robust.
- Primary market sees elevated domestic bank issuance.
- The outlook for credit remains challenged.

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

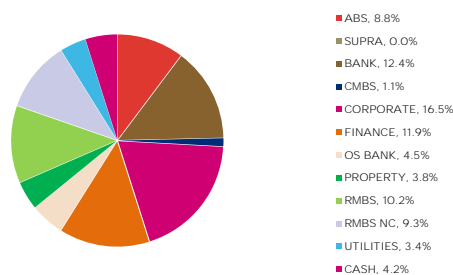
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

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	50.81%
Subordinated Debt	40.00%
Hybrid Debt	9.20%
Running Yield [^]	3.76%
Portfolio Weighted Average Life	3.71 yrs
No. Securities	90
Modified Duration	0.55

* 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

The reversal in fortunes of financial markets observed during July slowed during August. Bond yields rose throughout the month while equities fell over the second half as hawkish central bank commentary saw investor sentiment weaken. Whereas in July, markets priced in less aggressive monetary policy tightening, hawkish comments from Fed chair Jerome Powell saw investors move to reduce risk towards the end of the month.

Credit spreads were rangebound over the month. Spreads rallied through the first two weeks of August before widening over the second half, ending the month slightly tighter on aggregate. Robust earnings season results were supportive as well as improved liquidity conditions in the secondary market. A busy month in the domestic bank primary market was headlined by Commonwealth Bank's \$4.5B multi tranche senior unsecured transaction, which was met with a record order book. Westpac also issued senior debt, pricing a \$1.55B floating rate note in the first week of the month. Offshore banks were also active with a number of smaller deals pricing during August. Elsewhere, Suncorp-Metway raised \$750M across fixed and floating tranches. Non-financial corporate issuance was notably quieter.

Domestic bond yields rose throughout August gaining more than 50bps at most tenors along the curve. The RBA maintained its aggressive tightening cycle, raising the target cash rate by 50bps in the first week of August, marking 175bps of increases since the start of May. Alongside the domestic monetary policy tightening, rates markets also adjusted in anticipation of Powell's comments at the Jackson Hole Economic Symposium. 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 significant contributing factor to outperformance during the month. The Fund's allocation to RMBS, domestic and offshore banks as well as non-financial corporates were the key contributing sectors to income return. The Fund's running yield continues to offer a robust buffer against ongoing volatility in credit and fixed income markets. The portfolio's running yield was 3.8% at month end with the spread measured at 2.2%.

Credit spread tightening was a large contributing factor to outperformance during the month. Domestic spreads were rangebound on aggregate, however the fund's exposure to offshore credit was rewarded. USD denominated hybrid and subordinated domestic bank positions performed well. The Fund's exposure to Euro denominated non-financial corporates continued to recover following the indiscriminate spread widening observed in June.

The Fund's duration exposure detracted from performance during August, as bond yields rose throughout the month. The Fund continues to hold and actively trade Australian government bonds, contributing to portfolio liquidity and running income, whilst further strengthening the portfolios credit quality. In recognition of tightening financial conditions and the challenging outlook for credit the Manager has allocated approximately 25% of the fund to highly liquid exposures across cash and government bonds. At month end, this defensive allocation was predominantly held in Government bonds.

The Manager was active in secondary markets during the month, rotating issuer exposures across domestic and offshore banks and non-financials. One of the instruments the Manager continues to utilise in actively managing credit risk is exposure to the EURO crossover CDS index (which tracks European non-investment grade corporate issuers). Allocation to this position was increased towards month end. Overall, the fund remains defensively positioned in recognition of the challenging outlook for credit spreads and increasingly tight financial conditions, 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.

OUTLOOK

The credit outlook remains negative.

Valuation indicators have improved while remaining 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.

The growth outlook reduced during the month. Recession risks continue to escalate with a number of forward indicators deteriorating over the month. While the ratio of upgrades to downgrades remains robust, the trend is starting to turn as financial conditions tighten and corporate earnings see increasing pressure.

Supply and demand indicators remain mixed. There has been a noticeable improvement in demand across secondary and primary markets. At the same time, recent supply has been heavy and the upcoming maturity schedule is light both of which detract from the outlook for spreads.

Technical indicators have improved and are now positively contributing to the overall credit outlook. Intermediaries have been more active, contributing to improvements in secondary market liquidity. Strengthening US equity markets and increased equity volatility are also contributing to the positive technical score.

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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