

# PERPETUAL ESG CREDIT INCOME FUND - CLASS A

October 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:** \$61.8 million as at 30 September 2022  
**APIR:** PER1744AU  
**Mgmt cost:** 0.59%pa\*  
**Benchmark Yield:** 2.17% as at 31 October 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 October 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 | 0.68  | 0.70   | -0.02  | -1.07 | 1.38     | 1.27     | -        | -        | 1.84      |
| Bloomberg AusBond Bank Bill Index | 0.24  | 0.54   | 0.75   | 0.76  | 0.39     | 0.43     | -        | -        | 0.86      |

Please note: Performance for Perpetual's complete list of investment funds is available on [www.perpetual.com.au](http://www.perpetual.com.au). Past performance is not indicative of future performance.

## POINTS OF INTEREST

- Domestic spreads rangebound; Swap spreads surge.
- Bond yields rally as RBA slows rate hikes.
- Domestic banks headline primary issuance market.
- The outlook for credit remains negative.

## 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

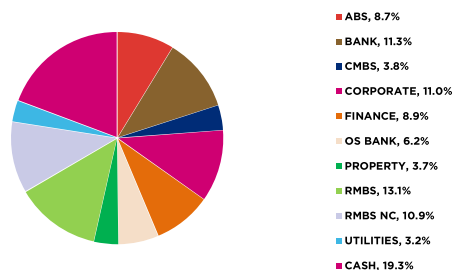
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

### 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                     | 46.50%    |
| Subordinated Debt               | 44.70%    |
| Hybrid Debt                     | 8.79%     |
| Running Yield <sup>^</sup>      | 4.05%     |
| Portfolio Weighted Average Life | 2.66 yrs  |
| No. Securities                  | 100       |
| Modified Duration               | -0.08     |

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

<sup>^</sup>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

Financial markets were supported during October by speculation that the pace of central bank policy tightening might slow and that the Fed was nearing a potential pivot. Risk sentiment remains closely tied to the path of central banks, as tightening financial conditions, rampant inflation and slowing growth weigh on markets.

Domestic credit spreads widened slightly over the month, remaining in range of recent levels. Slowing economic growth, rising recession concerns and tightening financial conditions continue contribute to rising credit risk premia. The domestic credit market has recently seen a marked reduction in liquidity as financial conditions have tightened. Meanwhile, swap spreads moved sharply wider during October. Swap rates surged as investors reduced risk while at the same time bond yields rallied. As a result, 3 year and 10 year swap spreads saw elevated volatility, reaching their widest levels in a decade.

Primary market activity was headlined by major bank issuance during October. ANZ came to market for a record breaking \$4.75B senior deal while CBA priced \$2B of subordinated debt. The deals represent the largest senior unsecured and tier two deals respectively in the Australian credit market. The deals were notable for the volume but also the spreads; both printing wide of recent transactions. Elsewhere, non-financial corporate issuance remained very subdued while securitisation activity also slowed.

Domestic bond yields rallied through October. Bond yields fell as the pace of monetary policy tightening slowed. The RBA increased the target cash rate by 25bps in October and November following a series of 50bps increases since June. Bond yields at the 3-10 year tenors rallied while the short and very long end was more subdued. This came against a backdrop of sharply rising inflation with 3rd quarter CPI beating expectations. With the impact of monetary tightening operating on long and variable lags, it remains to be seen how much further the central bank has to go in order to rein in inflation.

## PORTFOLIO COMMENTARY

Income return was the most substantial contributing factor to performance during the month. The fund's running yield continues to increase as interest rates rise and credit premiums widen remaining a crucial buffer mitigating ongoing volatility in credit and fixed income markets. The portfolio's running yield was 4.1% at month end, with the spread measured at 2.1%.

Credit spread dynamics were slightly negative for performance during October. Credit spreads moved slightly wider over the month while swap spreads expanded sharply. Credit spreads remain impacted by reduced secondary market liquidity. The Fund's exposure to USD corporates and financials were the most significant detractors as USD credit widened. The Fund's long position in the EURO crossover CDS index (which tracks European non-investment grade corporate issuers) performed well during the month. Euro denominated spreads have recovered over recent months following a sharp widening in June 2022. The Manager elected to take profits on the position, reducing credit risk within the portfolio.

In recognition of tightening financial conditions, reduced liquidity and the challenging outlook for credit, the Fund continues to actively trade Australian government bonds. Over recent months, the Fund has held approximately 20%-25% in cash and highly liquid government bonds. During October, the Fund's government bond exposure performed well as yields rallied and by month end, the Manager had reduced the position.

The Manager was active in primary and secondary markets during the month. The Fund took part in new deals from ANZ and Commonwealth Bank which offered attractive spreads and are indicative of the potential opportunities presented by recent spread widening. Elsewhere, the Manager was opportunistic in purchasing a number of competitively priced RMBS lines in secondary that were liquidated as part of the response of UK pension funds to the GILT's crisis. Securitised assets performed well during the month, with credit spreads contracting and contributing positively to portfolio returns.

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 challenged.

Valuation indicators have improved slightly and are now neutral. Over the month, the expansion of swap spreads contributed to the improvement in the valuation outlook. The USD AUD basis swap remains elevated relative to long term averages, detracting from the credit outlook.

Growth indicators continue to detract from the overall credit outlook. Recession risks remain prominent and financial conditions are notably tighter. While the ratio of upgrades to downgrades remains robust, the team is cognisant of risks as financial conditions tighten and corporate earnings see increasing pressure.

Supply and demand indicators have degraded over the month. Secondary markets have seen sharply reduced liquidity, with lowered demand weighing on spreads. Meanwhile, recent primary issuance volumes have been slightly elevated, detracting from the outlook. Technical indicators are mixed with elevated investor cash balances but reduced demand from intermediaries.

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.

This publication has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL No 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. The product disclosure statement (PDS) for the relevant fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS and Target Market Determination can be obtained by calling 1800 022 033 or visiting our website [www.perpetual.com.au](http://www.perpetual.com.au). No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Total return shown for the fund(s) have been calculated using exit prices after taking into account all of Perpetual's ongoing fees and assuming reinvestment of distributions. No allowance has been made for contribution or withdrawal fees or taxation (except in the case of superannuation funds, as applicable). Past performance is not indicative of future performance.

## MORE INFORMATION

Adviser Services 1800 062 725  
Investor Services 1800 022 033  
Email [investments@perpetual.com.au](mailto:investments@perpetual.com.au)  
[www.perpetual.com.au](http://www.perpetual.com.au)

