Perpetual Investment Funds

PERPETUAL
ESG CREDIT INCOME FUND - CLASS A

December 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: $64.7 million as at 31 December 2022
APIR: PER1744AU
Mgmt cost: 0.59%pa*
Benchmark Yield: 2.91% as at 31 December 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 December 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	0.95	2.28	2.95	0.39	1.43	1.67	-	-	2.13
Bloomberg AusBond Bank Bill Index	0.25	0.74	1.17	1.25	0.64	0.55	-	-	0.93

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

-Domestic spreads rangebound.
-Swap spreads marginally tighter.
-Bond yields rise; curve steepens slightly.
-Primary issuance subdued in line with seasonal expectations.
-The outlook for credit remains neutral.

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

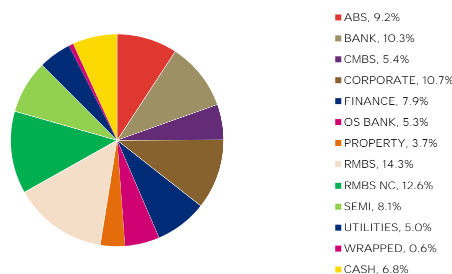
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment. while other companies become allowable investments.

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	42.92%
Subordinated Debt	46.44%
Hybrid Debt	10.64%
Running Yield^	5.04%
Portfolio Weighted Average Life	3.50 yrs
No. Securities	108
Modified Duration	0.22

* 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

Credit markets were steady in December while global equities (with the notable exception of China) gave back some their fourth quarter gains, and bond yields rose on aggregate. December brought to a close an extremely challenging year for financial markets with almost all asset classes retreating and fixed rate bonds experiencing their worst performance in 40 years. The key contributing factor to this turmoil has been the aggressive tightening of monetary policy, headlined by the greatest calendar year increase of the Fed Funds rate in history. Global recession concerns and the timing of potential pivots from the Fed and other central banks are expected to dominate financial markets into 2023.

Yield rose sharply in December, outpacing offshore peers. The curve steepened slightly with long term yields pushing back above 4% by month end. The RBA elected to increase the target cash rate by 25bps during for the third consecutive month. The current rate of 3.1% represents the highest level in over a decade while still well behind the US. Minutes released during the month revealed that the possibility of no increase was discussed for the first time since the commencement of the tightening cycle. Swap rates rose less than bond yields and swap spreads tightened slightly over the month.

Domestic spreads traded in a tight range, narrowing slightly over the month. Steep expansion throughout 2022 leaves domestic spreads at their highest consistent level since 2013 (2020 COVID spike notwithstanding). Offshore peers also tightened with the exception of Japan which pushed wider as the BOJ considered loosening their rates targets. Issuance was subdued in line with seasonal expectations. Notable issuance included a $1B benchmark deal from Suncorp Metway while Westpac saw strong demand for their 1-year senior unsecured issuance which raised $1.7B. Securitisation volumes were steady including new RMBS deals from Resimac and Mystate Bank.

PORTFOLIO COMMENTARY

Income return was the most significant contributor to relative return during the month. Financials and securitised sectors were the most substantial drivers of income return with non-financial corporate exposures also contributing. Ongoing increases in interest rates and expanding credit premia have contributed to the increase in portfolio income over the past year. The portfolio's running yield was 5.0% at month end, with the spread measured at 2.3%.

Credit spread dynamics contributed to outperformance during December. Credit spreads traded in a tight range, narrowing over the course of the month. Credit spread performance was led by domestic and offshore banks with corporates and utilities also contributing. The Portfolio's exposure to USD denominated domestic bank debt performed well, led by Macquarie and Westpac USD hybrids. The Fund's small, short position in the EUR Xover CDS index performed well during December as Euro corporate spreads surged in the middle of the month. The Manager exited the position at the peak in the wake of the surprise announcement on monetary policy by the Bank of Japan (BoJ), which loosened the yield on its ten year government bonds from 0.25% to 0.5%, wreaking havoc on equity, bond and currency markets.

The contribution of duration exposure was constructive. The portfolio began the month with near 0 duration. The Manager elected to add duration exposure as long term yields rose following the surprise BoJ policy change. As yields retraced lower by month end, portfolio performance benefited from the modest positive duration exposure (less than six months).

In recognition of tightening financial conditions, reduced liquidity (as a result of quantitative tightening by central banks) and the challenging outlook for credit, the Fund maintains approximately 10-15% weighting across cash and highly liquid government and government adjacent sectors. After selectively adding during December, the Fund's semi-government exposure was 8.1% at month end. Semi-government securities offer a slight premium to government bonds while remaining highly liquid and relatively low risk. Semi spreads widened slightly over the month, marginally detracting from outperformance.

Sector allocation was actively managed during the month. Allocation to domestic bank and semi government sectors was increased. RMBS exposures were rotated with the manager electing to take part in the December Resimac deal and trimming a number of existing RMBS positions. Elsewhere, the Fund took part in the new benchmark deal from Suncorp Metway. The Fund's defensive positioning continues to mitigate the impact of tightening financial conditions and disruptions to credit market liquidity. As the outlook for credit spreads improves, the Fund retains capacity to take advantage of relative value opportunities.

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 neutral.

Valuation indicators are marginally negative. Following a moderation in swap spreads, the majority of valuation indicators are in range of neutral levels. 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. The ratio of upgrades to downgrades has reached an inflection point and is no longer providing support for the growth outlook. Tightened financial conditions as described in the Fed's Senior Loan Officer survey continue to be a significant headwind.

Supply and demand have improved and are now neutral. Supply is expected to be subdued in line with seasonal patterns while an elevated volume of maturities in the new year is expected to be supportive.

Technical indicators remain supported by a noticeable recent uplift in cash across real money accounts and improving trends in US credit and equity markets.

While the outlook for credit spreads has improved considerably, the team remains cognisant of the risks associated with tightening financial conditions and slowing economic growth.

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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. 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.

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