

PERPETUAL ESG CREDIT INCOME FUND - CLASS A

January 2023



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: 2.99% as at 31 January 2023
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 January 2023

	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	1.14	2.75	3.46	1.59	1.82	1.97	-	-	2.34
Bloomberg AusBond Bank Bill Index	0.27	0.77	1.31	1.52	0.77	0.61	-	-	0.97

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

- Global economic outlook improves; Inflation moderates;
- Bond yields rally sharply; Credit spread tighten;
- Primary market issuance robust: led by domestic banks;
- The outlook for credit is 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

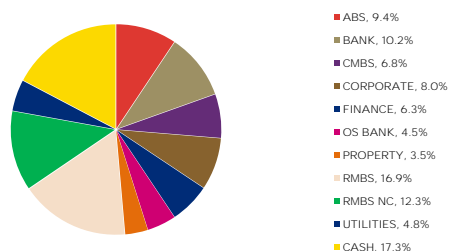
Issuers or counterparties remaining after the ethical exclusions are then subject to an SRI screening to evaluate how their business practices impact society and the environment, while other companies become allowable investments.

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	43.57%
Subordinated Debt	46.12%
Hybrid Debt	10.31%
Running Yield [^]	4.51%
Portfolio Weighted Average Life	2.45 yrs
No. Securities	110
Modified Duration	-0.46

* 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

Financial markets surged in January on an improved global growth outlook, moderating inflation and anticipation of a slowing rate of central bank policy tightening. Falling energy prices and resilient demand saw the economic outlook for Europe improve dramatically. At the same time, reopening, monetary stimulus and easing regulations in China were supportive for the economic growth outlook. Investors took comfort from confirmation that US inflation was moving in the right direction and that the US Federal Reserve and other central banks (including the RBA) would soon pause their monetary policy tightening cycles.

Bond yields fell precipitously during the month with the Australian 10-year government yield rallying 50bps. Moderating inflation was the key catalyst for the rally with increasing expectations that central bank tightening would slow as inflation rolled over. Global yields also performed well with 10-year US (-35bps), UK (-31bps) and German (-22bps) bonds all rallying.

Domestic credit spreads ground tighter throughout January as the economic outlook improved and discount rates were lowered. Market technicals were also supportive with investors deploying excess cash accumulated over the holiday period. After moving materially wider from their post COVID-19 low, credit spreads remain in sight of their highest levels in a decade (notwithstanding the March 2020 selloff).

Primary market issuance volumes were robust early in January before calming as the January 26 public holiday and lunar new year disrupted the issuance pipeline. A number of domestic financials moved to take advantage of beneficial conditions to raise capital in the new year. Commonwealth Bank launched the new record largest (by volume) domestic credit transaction with its \$5B 3 and 5 year senior unsecured deal. This was followed by a pair of regional bank deals with Bendigo and Adelaide bank (\$750M) and Bank of Queensland (\$800M) issuing 4-year senior unsecured bonds. Meanwhile a steady stream of offshore issuers across supranational, sovereign and agency sectors tapped the domestic market. The securitisation market was very quiet in line with seasonal expectations.

PORTFOLIO COMMENTARY

Credit spread tightening was the most significant contributor to outperformance over the month. In a strong month for credit, spreads narrowed as the outlook for global growth improved while investors also priced in a slower pace of monetary tightening from central banks. The key contributing sectors to credit spread outperformance were domestic and offshore banks, with a more modest contribution from non-financial corporates, utilities and securitised bonds. The Fund's exposure to USD and EUR denominated debt performed well across the aforementioned non-securitised sectors. While the Fund retains the capability to invest in offshore credit markets, all foreign denominated exposures are hedged back to AUD. Following the robust rally in credit spreads and cognisant of the impact successive interest rate increases will have on the debt servicing metrics for more highly leveraged issuers, the Manager elected to add a short position on the European crossover CDS index (which tracks European issuers on the cusp of investment grade and high yield).

Over recent months, in recognition of tightening financial conditions and liquidity risks, the Fund has held approximately 15-17% in cash and highly liquid government and semi-government bonds. During January, this high liquidity sleeve of the portfolio was converted to cash from semi-government securities following the sharp fall in bond yields, contributing to portfolio performance. The Fund ended the month with a small, short (negative) duration position which is expected to perform if bond yields rise following their strong January rally.

Sector allocation was actively managed during the month. The Manager elected to increase exposure to securitised sectors, buying RMBS in secondary markets. The Manager believes that the sector offers attractive value relative to the major bank curve which it is typically correlated with. The Fund's regional bank exposure was increased via new deals from Bendigo Adelaide Bank and Bank of Queensland which offered attractive value relative to the majors. Elsewhere, the manager elected to trim exposures to subordinated financials.

The Fund's defensive positioning continues to mitigate the impact of tightening financial conditions and the potential elevated market volatility that may result as central banks continue to withdraw liquidity from financial markets (quantitative tightening) at an unprecedented pace. This positioning provides a degree of risk mitigation, whilst preserving the capacity to take advantage of relative value opportunities should market volatility increase.

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

As of the end of January, 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. While recession risks have eased somewhat, there remain risks to economic growth. Tightened financial conditions as described in the Fed's Senior Loan Officer survey continue to be a significant headwind.

Supply and demand indicators are neutral. While an elevated volume of maturities in the first quarter is expected to be supportive, robust recent issuance volumes detract from the outlook.

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

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