

# Perpetual Investments

## PERPETUAL DIVERSIFIED REAL RETURN FUND - CLASS Z

31 January 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 Strategy:** \$632.7 million as at 31 December 2020  
**APIR:** PER6115AU  
**Management Fee:** 0.35% pa <sup>^^</sup>Refer to PDS for Management Costs  
**Investment style:** Diversified risk budgeting, active, value  
**Suggested minimum investment period:** Five years or longer

### TOTAL RETURNS % AS AT 31 JANUARY 2021

PERFORMANCE	1 MTH	3 MTHS	6 MTHS	1 YR	3 YRS PA	5 YRS PA	INCEPT PA	VOLATILITY <sup>^</sup>	3 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross)	-0.3	3.1	4.2	3.7	-	-	5.1	Perpetual Diversified Real Return Fund (Class Z)	3.6	3.4
Perpetual Diversified Real Return Fund (Net)	-0.3	3.0	4.0	3.3	-	-	4.7	Mercer Balanced Growth Median	10.5	7.6

### 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 Z is the performance fee option.  
 The maximum performance fee is 1%  
 The performance hurdle is 2.5%, the middle of the RBA target inflation rate

### FUND OBJECTIVE OUTCOME AS AT 31 JANUARY 2021

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

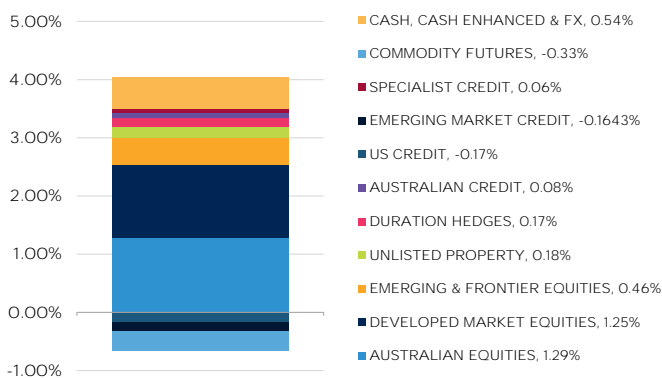
	5 YRS PA	INCEPT PA
Perpetual Diversified Real Return Fund (Gross - Class W)	5.5	6.9
CPI plus 5%	6.8	7.1

Past performance is not indicative of future performance.

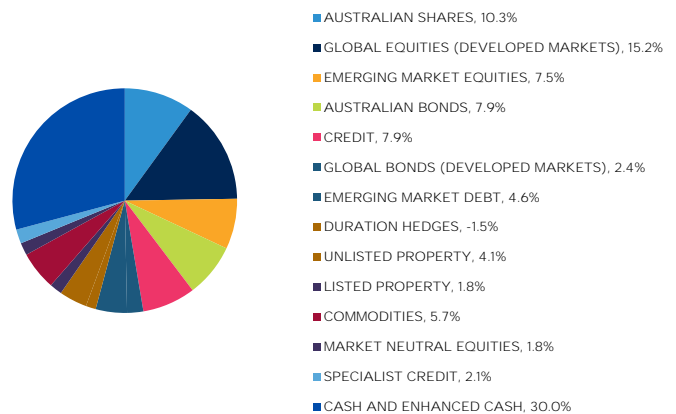
<sup>^^</sup> Information on Management Costs (including estimated indirect costs) is set out in the Fund's PDS

<sup>^</sup> Volatility and Mercer Balanced Growth Median data is lagged by 1 month

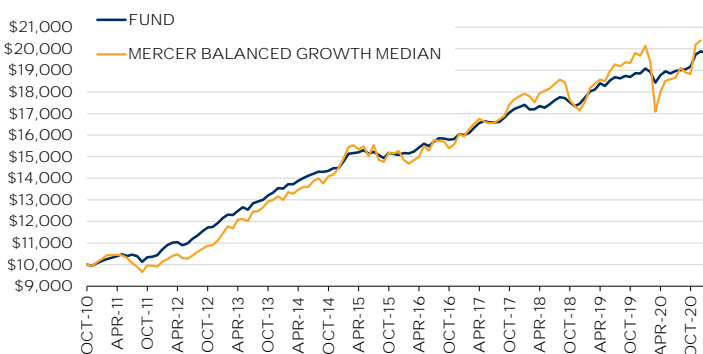
### CONTRIBUTION TO 3MTH PERFORMANCE (GROSS)



### PORTFOLIO SECTORS



### GROWTH OF \$10,000 SINCE INCEPTION



### CHANGES IN ASSET ALLOCATION (%)

	3 MTHS	6 MTHS	1 YR
Australian Shares	3.1	4.1	1.7
Global Equities (Developed Markets)	1.9	4.4	3.8
Emerging Market Equities	4.0	4.1	3.1
Frontier Market Equities	0.0	0.0	0.0
Australian Bonds	0.1	-0.2	0.1
Credit	0.2	0.2	0.2
Global Bonds (Developed Markets)	0.1	0.2	2.7
Emerging Market Debt	0.0	0.4	0.0
Duration Hedges	0.2	-0.3	-1.3
Secured Private Debt	0.0	0.0	0.0
Unlisted Property	-0.4	-0.6	-0.5
Listed Property	-0.1	-0.2	1.8
Commodities	1.6	-1.9	2.6
Market Neutral Equities	0.1	0.0	-5.6
Infrastructure Debt	0.0	0.0	0.0
Other Investments	0.0	0.0	0.0
Specialist Credit	-0.1	-0.2	-0.2
Cash and Enhanced Cash	-10.8	-10.0	-5.7
Alternative Beta	0.0	0.0	-2.9

## FUND PERFORMANCE

The Diversified Real Return Fund returned -0.3% (gross) for the month of January. Over the past year, the Fund has returned 3.8% (gross) and over the past five years the Fund has returned 5.5% (gross) per annum compared with the objective of 6.76% (CPI plus 5%\* over rolling five years). Since inception (in 2010) the Fund has returned 6.9% (gross) per annum compared with the objective of 7.1% (CPI plus 5%\*).

The portfolio was impacted by falls in developed global equities during the month. US and European equities fell due to a number of factors including the spread of COVID-19 issues with the vaccine rollout and the fall-out from a retail investor led short squeeze late in January. Stock selection in global and Australian equities also detracted as the recent out-performance of value compared with growth retraced somewhat, supported by stronger than expected US technology earnings.

The portfolio benefitted from allocations to Australian and emerging market equities, as these markets recorded small gains over the month.

\*All groups CPI measured and published by the ABS as at 31 December 2020

## MARKET COMMENTARY

Financial market returns were mixed in January.

- US equities (-1.0%) were up for most of the month until a correction in the last week of January.
- European markets also receded with the UK (-0.8%), Germany, (-2.1%) and France (-2.6%) all falling as the resurgence of the virus as well as a new strain continued to impact markets.
- Asian markets performed well with significant rises in Hong Kong (3.9%), Korea (3.6%) and Taiwan (2.8%).
- Australian equities rose marginally (+0.3%), supported by the successful handling of the pandemic, improved consumer optimism and strong commodity prices.
- Credit spreads continued to tighten showing increasing risk appetite as investors continue the hunt for yield.
- At the same time, global bond yields shifted higher as optimism about the economic outlook in 2021 continues to grow. US and Australian 10-year rates both moved from under 1% to over 1% over the month.

The spread of COVID-19, the vaccine rollout and a retail investor led short squeeze all impacted markets during January.

The US and Europe continue to struggle to contain COVID-19 and the emergence of new strains has compounded the issue. The second wave has been much worse than the first in terms of case numbers, although the preparedness and capacity of the health system to deal with a surge in cases is much improved. As a result, short term growth expectations in the US and particularly Europe (where social mobility has been limited much more significantly) have been marked down at the same time as confidence in a strong rebound in growth in 2021 has increased (due to the vaccine news).

While there remains optimism around the vaccine rollout, issues with supply chain and distribution strategy have emerged in the last month. While the logistical problem of distributing the vaccine globally is daunting, the vaccines remain very likely to be the game changer that we are all looking for. These vaccines dramatically change the outlook for the course of the virus in 2021.

At the same time, fiscal and monetary support are likely to continue at unprecedented levels in most global economies to reduce abundant spare capacity. Consequently, global growth in 2021 is set to be the strongest since the 1970s as social mobility restrictions ease and consumers start to run down elevated savings.

In late January, a retail investor led squeeze on a number of heavily shorted US mid-cap stocks prompted a selloff in US equities. The massive price spike in these stocks led to hedge funds selling long positions to cover and investors de-risking their portfolios in order to avoid a potentially significant market correction. The impact on the overall US equity market was a notable increase in volatility together with a modest market correction in the latter half of the month. The selloff also impacted other markets with global shares falling in the last week of the month as a result.

In the US, the political turmoil associated with the transition from the Trump administration to the incoming Biden administration was largely ignored by markets. In many ways the most significant political development in the month was the Democrat wins in the two Georgia Senate seat run-offs giving the Democrats a clean sweep with effective control of the House and Senate. As a result, further significant fiscal stimulus is much more likely, although the Democratic caucus is still struggling to reach consensus on some aspects of the stimulus package. Fourth quarter data suggest that the second round of stimulus had an immediate impact on consumer spending and another big boost is likely in the next few months once the next package comes into effect.

The US Federal Reserve (the Fed) reiterated that rates would remain at their effective lower bound and asset purchase programs would remain active “until the job is well and truly done”, intending to see progress towards employment and inflation targets before tapering the asset purchase program maybe early next year. By contrast, increases in the policy rate from zero are years away – maybe in 2024. These extraordinary monetary policy conditions continue to be extremely supportive for equity and credit valuations via record low discount rates and artificially supported demand for assets.

European markets continue to be impacted by the resurgence of COVID-19 and the emergence of a new UK strain. Thankfully, European healthcare systems and public services are far better prepared than in early 2020 when public health institutions were quickly overwhelmed. As of the end of January, the UK had the third highest portion of their population vaccinated of any country. In continental Europe, the vaccine rollout is slower but by mid-year the vaccine in addition to seasonal factors are likely to see a massive change in the course of the virus. In the meantime, despite widespread lockdowns remaining in place, some economic growth indicators are showing resilience including purchasing manager indices.

Australian equities outperformed global peers, rising marginally over the month. The success of Australia’s response to the pandemic and improving macroeconomic growth expectations continue to support investor confidence. This saw cyclical sectors led by consumer discretionary outperform across equities and credit. Improved sentiment was also seen in 10-year high consumer confidence and robust housing data.

There remain huge challenges for the Australian economy in 2021 in dealing with the COVID-19 crisis. Two issues that stand out are first winding back the Job Keeper program without undermining the recovery and second managing the broken relationship with our most important trading partner, China. Notwithstanding these challenges - with the virus now under control again and a vaccine in prospect for 2021 - the outlook has improved significantly.

## 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:

- Zero (or near zero) cash rates in all major developed economies have increased the attractiveness of any yielding asset.
- The combination of zero cash rates and aggressive quantitative easing policies has squashed long term interest rates to new record lows of less than 1% in Australia and the US, zero in Japan and negative in Germany and France. This limits the ability of bonds to rally (ie further falls in yields increasing bond prices) in the event of another bear market in equities. This diversification benefit has been a key feature of portfolio construction for the past four decades.
- Credit markets are also heavily distorted by the actions of the Fed with very low spreads on offer against a backdrop of elevated default risk.
- At the same time, the US dollar is less attractive as a defensive asset as the most aggressive central bank in the world is the Fed and their actions are, at least in part, aimed at keeping the US dollar weak.
- Equity markets in aggregate are extremely expensive – particularly growth sectors and the euphoria in some significant parts of the market is reminiscent of the bubble in technology stocks in the late 1990s. Meanwhile, just like late 1999 and early 2000, volatility is quite high (making put options expensive to implement). Just as importantly, there are some parts of the market that are very attractively priced -- particularly value stocks, including some cyclical sectors adversely impacted by the lockdowns.

These developments have led to a significant restructure of the portfolio:

- Explicit downside protection strategies have been reduced as they are generally quite expensive to hold or have less intrinsic investment merit – **a key feature of this portfolio is that downside protection strategies are not mechanically implemented. We adopt the same 'value' philosophy we apply to all investments in the portfolio.**
- At the same time, the equity portfolio has been restructured to be more defensive by reducing exposure to the US (and the technology sector in particular) and **increasing exposure to a number of different 'value' opportunities including the UK, Australia and emerging markets.** These investments should be well placed to out-perform if the strong economic recovery we expect plays out in 2021. We expect outsized profit recoveries in many cyclical stocks as well as some upward pressure on interest rates which favours 'value' over 'growth'.

The Fund retains a significant cash allocation. This is an extreme environment for the economy and for markets. Valuations are extremely extended in some parts of the equity market and interest rates have never been lower. Financial markets history is replete with dire warnings about the risks of investing when valuations are as extended as they are now. Even though there is a significant opportunity cost in holding cash, our focus remains on investments that can generate CPI plus 5% per annum over a five-year horizon. At the moment, that is a very narrow part of the investment universe – **concentrated in the long neglected 'value' parts of the market. 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.**

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 PDS for the relevant fund, issued by PIML, should be considered before deciding whether to acquire or hold units in that fund. The PDS 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 any 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 entry or exit fees or taxation (except in the case of superannuation funds). Past performance is not indicative of future performance. The Perpetual Diversified Real Return Fund gains its exposure to Australian shares by investing in underlying Australian Share Funds which primarily invest in Australian listed or soon to be listed shares but may have up to 20% exposure to stocks outside Australia. The investment guidelines showing the Fund's maximum investment in international shares do not include this potential additional exposure. Short positions may be part of the underlying Australian Share Fund's strategy. Currency hedges may be used from time to time.

## 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)

