Perpetual Investment Funds

PERPETUAL BALANCED GROWTH FUND

November 2022

FUND FACTS

Investment objective: The fund aims to provide long-term capital growth and income through investment in a diversified portfolio with an emphasis on Australian and international share investments.

FUND BENEFITS

Provides investors with access to a diverse range of growth and income producing assets. Active management and asset allocation techniques are employed in order to further enhance the fund's return and manage risk.

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 consideredbefore 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.

Benchmark: Balanced Growth Index (Internally generated composite)

Inception Date: October 1997

APIR: PER0063AU

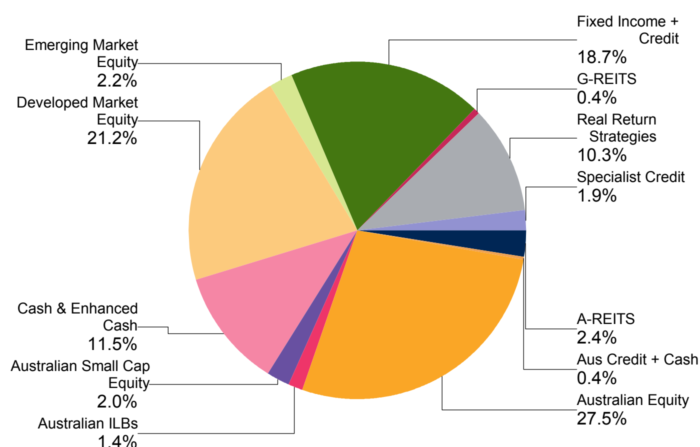
Management Fee: 1.04% p.a.

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

Investment style: Active, fundamental, disciplined, value

Suggested minimum investment period: Five years or longer

PORTFOLIO SECTORS

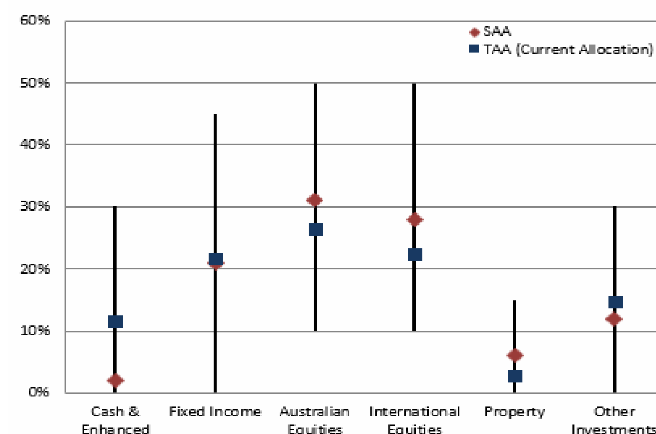


NET PERFORMANCE- periods ending 30 November 2022

	Fund	Benchmark	Excess
1 month	2.0	4.1	-2.1
3 months	4.0	3.7	0.3
FYTD	7.0	7.9	-0.8
1 year	5.9	-3.6	9.5
2 year p.a.	9.8	4.4	5.4
3 year p.a.	7.2	3.8	3.4
5 year p.a.	6.9	6.1	0.8
10 year p.a.	8.3	8.2	0.2
Since incep.	7.4	7.0	0.4

Past performance is not indicative of future performance. Returns may differ due to different tax treatments.

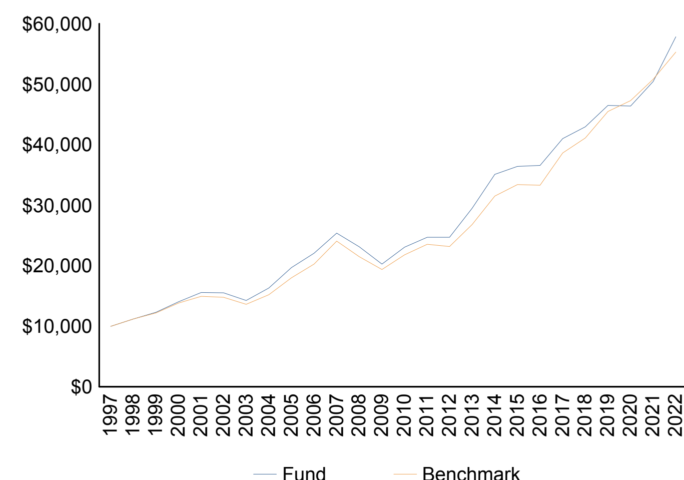
ASSET ALLOCATIONS AND INVESTIBLE RANGES



STRATEGIC AND TACTICAL ASSET ALLOCATIONS

The Strategic Asset Allocation (SAA) is the neutral allocation acting as an anchor for active positioning, while the Tactical Asset Allocation (TAA) process adjusts the asset allocation according to market opportunities and risks.

GROWTH OF $10,000 SINCE INCEPTION



MARKET COMMENTARY

Global equity markets rose in November as investors anticipated a slower pace of monetary tightening and lower terminal rates.

- US equities (5.6%) extended their October rally, pushing higher throughout the month before surging on the last trading day following dovish comments in a speech from US Federal Reserve (The Fed) chairman Jerome Powell.
- Emerging markets (11.7%) outperformed developed markets (5.7%) led by surging Chinese equities (28.4%). Hong Kong equities (26.8%) had their strongest month since 1998.
- Australian equities (6.6%) responded well to the slowing pace of rate increases from the Reserve Bank of Australia (RBA).
- European equities (9.7%) continued to rally strongly with gains from Germany (8.6%) and France (7.6%) as well as the UK (7.1%).
- The US 10-year bond yield (-38bps) rallied back below 4% on the back of below expectation October CPI print.

We maintain our view of the key pressures currently weighing on the market outlook.

- Even though equity valuations have improved this year, they still remain above levels which are attractive, given the weakening earnings backdrop across most regions.
- Inflation and the tightening of monetary policy has caused a nasty bear market in government bonds and much tighter liquidity conditions.
- A slowdown in economic growth with elevated recession risks in the US and Asia and acute recession risk in Europe have contributed to a moderation in profit growth with a significant fall in profits in prospect next year.
- Growing geo-political risks in Europe due to the Russia/Ukraine war and in Asia reflecting a much more assertive China and heightened tensions over Taiwan's future.

While markets continued to strengthen in anticipation of a slowing pace of rate increases, the path back to the Fed's target level of inflation remains challenging. Jerome Powell's comments that "the time for moderating the pace of rate increases may come as soon as the December meeting" was extremely well received by the market, propelling a strong rally in US and global equities. The path to a soft landing however, remains very narrow with a US recession in 2023 the base case and the number of leading indicators of recession continuing to mount. In particular, the US 2 year 10 year yield has now been inverted for over 4 months (ie the 2 year rate is higher than the 10 year rate), reaching a multi decade high in November and the 3 month 10 year curve is also inverted which has been an extremely reliable indicator of recession within 12-months. PMIs weakened over the month with the ISM manufacturing PMI (49.0) going into contraction for the first time since May 2020.

Recession may yet be the most direct path to taming inflation. There has been a shift in the key drivers of inflation over recent months, with goods prices moderating while services sector inflation remains entrenched. Services sector inflation is more intractable as a result of greater pricing power and lower sensitivity to supply chain issues and commodity prices. With extremely tight labour markets (unemployment in many key economies running at 50-yr lows) we believe that the pressure on services sector inflation will persist with a recession required to ease conditions. This is reflected in the Fed's policy reaction function which now has a sizable rise in US unemployment at its heart. At the same time, the size and speed of recent rate increases have made it more challenging to control recession risks as central banks have less room to evaluate policy impacts and the risk of financial accidents is elevated as a result.

We remain concerned about the outlook for corporate profits and the risks presented by high levels of leverage. While revenues have thus far proved resilient, the impact of the Fed's aggressive tightening on earnings has yet to be fully realised. More importantly, financial conditions are set to tighten further in the months ahead as the Fed accelerates the reduction of its balance sheet by selling US Treasuries and some mortgage-backed securities, which will place upward pressure on corporate financing costs and the US Dollar. The combination of tightening financial conditions and slowing or negative growth also highlights the risk of zombie companies (heavily leveraged unprofitable firms that have only survived due to the incredibly low interest rates over the past decade) being exposed given their weak operating models. Already we have observed some recent market excesses being purged from the system including the crash in cryptocurrency valuations and the collapse of FTX during November.

While the actions of the Fed remain the most crucial determinant of the market outlook, other major central banks are grappling with similar circumstances. The European Central Bank (ECB) faces a very challenging backdrop of double-digit inflation, an energy crisis and a sharply slowing economy. Meanwhile, Australia's path to a soft landing remains more viable than the US or Europe. The RBA has a more potent mechanism to address household spending given highly leveraged household balance sheets and the majority of local mortgages being at variable rates which are highly sensitive to changes in the RBA's overnight cash rate. At the same time, the economy looks quite solid at present and stands to benefit from the negative rate differential with the US resulting in a lower Australian Dollar.

Chinese equities surged during the month on a combination of easing COVID restrictions, relaxed collateral and equity issuance standards in the property sector and stimulatory monetary policy. The path to reopening remains the most crucial consideration for the Chinese growth outlook. While the Chinese government may be beginning to shift away from their zero-COVID policy, challenges remain as successful reopening requires a huge and effective vaccination program and cases have already risen sharply. During November, the government issued a series of measures intended to support the property sector which has languished since 2020. Measures included credit support for heavily leveraged housing developers, financing to ensure completion and transfer of projects and loan assistance for home buyers. These measures further fuelled the sharp rally seen in November.

The continued rally in global equities drove performance during November with the Fund's domestic and global equity exposure the key contributors to absolute return. This contribution was partially offset by the negative performance of the Fund's equity put options. The Fund's underweight exposure to emerging markets – especially China – detracted from relative performance as Chinese equities surged as markets anticipated the further easing of COVID restrictions. Lastly, stock selection within Australian equities detracted from relative performance during the month, following a period of robust outperformance. The Fund is underweight equities in recognition of expensive valuations, tightening financial conditions and slowing economic growth. All equity exposures retain their long-standing quality and value bias which are expected to continue to outperform against a backdrop of rising interest rates.

The sharp selloff in bonds and the rising recession risks throughout 2022 have increased the attractiveness of government bonds in some markets. The Fund maintains exposure to fixed income predominantly via 3 and 10-year Australian government bonds and 2 and 10-Year US treasuries. The Fund also retains a short position in Japanese 10-year bonds. At month end, the fund's fixed income allocation was in line with the benchmark.

The Fund maintains a significant foreign exchange exposure, diversified across a number of developed and emerging market currencies. The elevated cash position detracted from relative performance during November as equities and bonds rallied. The Fund also maintains a USDCNH call option position offering an asymmetric pay off should the authorities in China respond to their economic challenges by further depreciating their currency. The position has added significant value overall (in part as it was

adjusted to lock in profits) but detracted from return during November as the US Dollar retraced.

The Fund maintains its position in the Diversified Real Return Fund which is expected to deliver low volatility absolute returns while retaining a relatively low correlation to equity markets.

OUTLOOK

Rising interest rates, tightening financial conditions, 40-yr highs in inflation and slowing economic growth are a challenging environment for investors to navigate. High equity valuations were only supported by bond yields staying low as long as inflation was contained. Equity valuations have adjusted (although there could be more to come), but now profit expectations need to be lowered to more closely align with the economic backdrop. In this climate the fund remains well positioned to navigate the tightening cycle and retains the capacity to add risk as valuations become more attractive.

The Balanced Growth Fund gains its exposure to Australian Shares by investing in an underlying Australian Share Fund/s which primarily invests 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.

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 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 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 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
www.perpetual.com.au