Perennial Value Shares for Income Trust

Quarterly Report
30 September 2015

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Shares for Income Trust*	-8.3	-8.3	0.2	11.8	8.8	6.7
S&P/ASX 300 Accumulation Index	-6.5	-6.5	-0.7	9.1	6.3	5.0
Value Added (Detracted)	**-1.8**	**-1.8**	**0.9**	**2.7**	**2.5**	**1.7**
Capital Growth	-10.4	-10.4	-6.1	5.9	2.8	0.5
Income Distribution	1.9	1.9	5.4	4.9	5.1	5.4
Net Performance^^	-8.5	-8.5	-0.7	10.8	7.9	5.9

*Gross Performance. ^Since inception: December 2005. ^^This refers to the Trust's gross performance net of investment management fees. Past performance is not a reliable indicator of future performance.

Perennial Value Shares for Income Trust

The Trust aims to provide investors with an attractive level of tax effective income, which the Trust aims to pay via quarterly distributions. The Trust aims to provide a dividend yield, adjusted for applicable franking credits and before fees, above that provided by the S&P/ASX 300 Accumulation Index*.

Portfolio manager:
Stephen Bruce

Risk profile:
High

Trust FUM (as at 30 September 2015):
AUD 66 million

Income distribution frequency:
Quarterly

Team FUM (as at 30 September 2015):
AUD 7.3 billion

Minimum initial investment:
$25,000

Trust inception date:
December 2005

APIR code:
IOF0078AU

*Gross dividend yield.

- **The S&P ASX300 Accumulation index (the Index) ended the quarter down 6.5%**
- **Investors should note that while the market has fallen 13.9% from its peak in April, it has delivered a largely flat return of -0.7% for the last 12 months, with the Trust delivering a positive return of 0.2%**
- **The best performing stock in the Trust for the quarter was Asciano (up 26.3%) following a takeover offer from Brookfield.**

Trust Characteristics

In line with the objective, the Perennial Value Shares for Income Trust (the Trust) continues to invest in a portfolio of financially sound companies which demonstrate superior dividend yield characteristics to the overall stock market.

Quarterly Distribution

The Trust paid a distribution of 2.3 cents per unit for the September quarter. Adding franking credits, the gross (pre-tax) distribution for the quarter was 3.2 cents per unit. Based on the unit price at the start of the financial year ($1.19), this represents a pre-tax distribution yield for the quarter of 2.7% and brings the pre-tax distribution yield for the last 12 months to 7.8%. This compares favourably to the 12 month term deposit rates available for that period of around 3.3%.

Portfolio Activity

During the quarter, we took profits in stocks which had performed strongly, including exiting our holdings in Asciano, which had outperformed the market by around 40% since we purchased the stock in April 2015, as well as JB Hi-Fi. We also sold out of our holding in Origin Energy due to concerns over the sustainability of the dividend given the current low oil prices. This was a good decision as, on the last day of the quarter, the company announced a highly-dilutive $2.5 billion capital raising and a 60% cut to the dividend.

Proceeds were used to increase our holdings in a number of stocks such as CBA (FY16 gross yield 8.1%), AGL Energy (6.3%), Amalgamated Holdings (6.2%) and Telstra (7.9%). The Trust remains well diversified, with exposures to a range of industries, with holdings across 9 sectors. At quarter end, stock numbers were 26 and cash was 4.1%.

Stock and Portfolio Performance

The market sold off in the September quarter, with the S&P ASX300 Accumulation index (the Index) ending the quarter down 6.5% and the Trust underperforming the index by 1.8%. The sell-off, in our view, has been very much led by global macro funds taking a very bearish view on the outlook for China and therefore Australia.

The Trust's underperformance was primarily due to the sell-off in housing and resource stocks. This is discussed in more detail below. The resultant downward move in share prices has also been magnified by unusually low stock turnover levels during the quarter, particularly in September, where the market fell 2.9%. Investors should note that while the market has fallen 13.9% from its peak in April, it has delivered a largely flat return of -0.7% for the last 12 months, with the Trust delivering a positive return of 0.2%.

Globally, the quarter was dominated by extreme gloominess about the prospects for growth in China. Key data disappointed, including the latest monthly production and investment prints, alongside the manufacturing Purchasing Managers Index (PMI) and many investors seem to be losing faith that China can maintain growth of close to the 7.0% target. This is despite even more stimulus being announced and further exchange rate depreciation. The weakness in China is reverberating through the region, with Taiwan, Singapore and now Japan in technical recession. Outside Asia, however, the news was better, with European growth seemingly tracking close to 2.0%, although inflation across the region has dropped back close to zero. Similarly, the US economy is doing well, although employment growth was unexpectedly weak early in the month. The Federal Reserve (the Fed), however, baulked at raising interest rates, citing offshore "wobbles" as a key reason for caution. Equity markets had a very tough quarter, with most indexes losing further ground, as many investors reassessed the prospects of a world without the same momentum in China's growth engine.

In Australia, the biggest development was not in economics, but in politics, with Malcolm Turnbull successfully challenging incumbent Tony Abbott to become Australia's fifth Prime Minister in as many years. There has been no significant policy change yet, but consumer and business confidence likely will lift on hopes of a fresh start, particularly around economic reform. The domestic data was a mixed bag. Retail sales growth was weak and consumer and business confidence fell, but the August employment report was much better than expected and the jobless rate fell slightly to 6.2%. The Q2 Gross Domestic Product (GDP) report was also underwhelming, showing that growth was barely positive, albeit after a decent Q1. The Australian Dollar (AUD) weakened further over the quarter, in line with Reserve Bank of Australia (RBA) expectations, dropping below 70 US cents, and the RBA left the cash rate steady.

In this risk-off environment with concerns over Chinese growth, industrial and defensive sectors tended to outperform, with industrials (up 3.6%), utilities (up 1.8%), consumer staples (up 1.5%), Real Estate Investment Trust (REITs) (up 1.1%) and consumer discretionary (up 1.1%) while resources (down 16.4%) fell sharply, with energy (down 24.1%) and metals and mining (down 12.8%) and financials (down 9.6%) with the major banks falling an average of 11.3%.

The other main focus of the quarter was reporting season. Results were generally in line with expectations, with industrials delivering modest Earning per Share (EPS) growth while resource company earnings fell sharply due to lower commodity prices. Low top-line growth was again a feature of results, with a significant proportion of earnings improvement being driven by cost-out and internal improvement programs. Currency was also a major driver, with many companies beginning to see benefits from the lower AUD. This particularly favoured companies with significant offshore earnings. Outlook statements were again cautious given the uncertain economic environment and weak demand conditions both domestically and globally.

Of the Trust's holdings, 22 companies representing 74% of the Trust reported. Of these, 12 companies increased their EPS and 15 companies increased their Dividend per Share (DPS). This ongoing increase in dividends is particularly pleasing as it reflects the generally strong financial position of corporate Australia and allows shareholders to be rewarded while they wait for stronger earnings growth. Holdings which showed particularly pleasing earnings and dividend growth were Boral (EPS up 45%, DPS up 20%), Amalgamated Holding (up 44%, up 26%) and Harvey Norman (up 25%, up 143% including a special dividend).

The best performing stock in the Trust for the quarter was Asciano (up 26.3%) following a takeover offer from Brookfield. Other strong performers included, Aristocrat Leisure (up 12.5%), Flight Centre (up 8.7%), Scentre Group (up 6.8%) and Amalgamated Holdings (up 5.2%).

In terms of stocks which detracted from performance, the sell-off in housing-related companies held in the Trust has been significant and, we believe, often indiscriminate, including Boral (down 23% off August highs), Harvey Norman and Lend Lease (both down 20%) and Stockland (down11%). Perennial Value does not subscribe to this sudden and negative change in sentiment, which appears to be driven by an overheated apartment building sector. Each of the building-related companies has diversified earnings streams. Boral's domestic housing exposure represents 21% of total profits, Lend Lease around 10% and Stockland 30% to 35%. Stocks held also generally have a far greater reliance on detached housing and renovations, where the cyclical upturn to date has been more muted. These companies have their largest presence in the eastern seaboard, especially New South Wales (NSW) where the detached housing cycle most likely has at least two years to run. Queensland is only starting to improve while Victoria is likely to slow from a high level. During the quarter, Brickworks (up 12.5%) delivered a record FY15 profit result and highlighted strong momentum in building approvals on the east coast, with an "extremely strong order book in most east coast divisions". Further, this group of companies offers significant value at current levels. Harvey Norman, for example, is currently trading on a prospective FY16 gross yield of 8.0%, Lend Lease on a FY16 P/E of 11.2x and Stockland on a FY16 price to NTA of 1.0x. Thus, we continue to retain these stocks in the Trust.

With regards to our materials and resources exposure, the Trust has held a range of companies providing select, diversified industry exposure. From a portfolio construction perspective, given global macro uncertainties, we have ensured in recent times that the Trust was not overly exposed to any one stock. Notwithstanding, this sector took the brunt of the global macro sell-off. Stock holdings which were hardest hit included Orica (down 29.3%), Downer (down 27.6%), South32 (down 23.7%), Iluka (down 18.4%) and BHP (down 14.6%).

ESG Factors during the quarter

Perennial Value Management (PVM) remains alert to Environmental, Social and Corporate Governance (ES&G) issues in the Trust. During the quarter, Harvey Norman announced an investment in a dairy farming operation. In our view these types of non-core investments are not in the interests of shareholders and we expressed this to management and the board and will take the issue up again ahead of the AGM.

Market Outlook

While there has been a heightened level of volatility in markets recently, the economic fundamentals of major economies overall seem to be improving slowly and this drive economic and earnings growth. Further the current very low interest rates highlight the relative attractiveness of equities.

Top 10 Holdings		
Stock name	Trust weight %	Index weight %
Commonwealth Bank	8.9%	9.3%
Telstra Corporation	8.1%	5.2%
Westpac Banking Corp	8.0%	7.1%
National Aust. Bank	8.0%	5.9%
BHP Billiton Limited	7.4%	5.4%
ANZ Banking Grp Ltd	6.9%	5.9%
AGL Energy Limited	4.9%	0.8%
AMP Limited	4.9%	1.2%
Woodside Petroleum	4.7%	1.6%
Macquarie Group Ltd	4.2%	1.9%

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	4.7%	4.0%
Materials	14.7%	13.9%
Industrials	0.8%	8.0%
Consumer Discretionary	8.9%	4.7%
Consumer Staples	2.0%	7.1%
Health Care	0.0%	6.4%
Financials-x-Real Estate	46.7%	38.4%
Real Estate	5.2%	8.4%
Information Technology	0.0%	1.1%
Telecommunication Services	8.1%	5.7%
Utilities	5.0%	2.3%
Other	4.1%	-

Rounding accounts for small +/- from 100%.

or all other enquiries please contact us on 1300 730 032
or visit www.perennial.net.au.

Signatory of:

PRI Principles for Responsible Investment