PERENNIAL FIXED INTEREST

Perennial Tactical Income Trust

Monthly Report as at 31 May 2012

	Month %	Quarter %	FYTD %	1 Year %	2 Years % p.a.	3 Years % p.a.	Since Inception % p.a.#
Perennial Tactical Income Trust*	0.24	1.59	5.18	5.52	7.00	-	8.70
UBS Bank Bill Index and UBS Composite Bond Index (0+years) equally weighted	1.74	3.39	8.44	8.96	7.32	-	6.70
Value Added (Detracted)	-1.50	-1.80	-3.26	-3.44	-0.32	-	2.00
Net Performance	0.20	1.47	4.74	5.05	6.52	-	8.22

*Gross Performance. #Since inception 15 June 2009. **Past performance is not a reliable indicator of future performance.**

- During the month, bond yields continued their sharp decline and credit spreads edged wider.
- While the market's attention was firmly focused offshore, local data releases were mixed.
- Corporate debt remains our preferred sector and we maintain an overweight position, with an emphasis on large financials.

Performance

The month of May proved to be an extremely difficult period for the Perennial Tactical Income Trust (the Trust), with bond yields continuing their sharp decline and credit spreads edging wider. These developments were at odds with the investment strategy of the Trust and resulted in performance well below the benchmark, finishing 0.24%. The UBS Bank Bill Index and UBS Composite Bond Index (0+years) equally weighted (the Index) return for the month was 1.74%.

While the underperformance of credit securities was a contributing factor, by the far the most significant influence was the Trust's material underweight allocation to fixed interest. As enunciated in our previous report, we had moved to an aggressive underweight position over the latter part of April based on the view that bond yields had reached extremely overvalued levels. While in the short term, at least, this strategy has not delivered the results we are seeking, our investment focus remains clearly directed towards the medium to longer term.

The heightened degree of risk aversion also took its toll on the listed debt /hybrid market, with the prices on a range of these securities drifting lower over the month. This adversely impacted the performance of that part of the Trust that is invested in this sector. Despite this, we remain confident these securities will deliver solid income returns over the medium term.

Perennial Tactical Income Trust

The Trust aims to provide investment returns in excess of the Trust's benchmark the UBS Bank Bill Index and UBS Composite Bond Index (0+years) equally weighted by investing in a diversified portfolio of Australian income producing assets. The Trust aims to provide a total return (after fees), that exceeds the benchmark.

Portfolio Manager: Glenn Feben	**Risk Profile:** Moderate
Trust FUM **(as at 31/05/12):** AUD244.4 million	**Income Distribution** **Frequency:** Quarterly
Team FUM **(as at 31/05/12):** AUD5.8 billion	**Minimum Initial** **Investment:** $25,000
Trust Inception date: June 2009	**APIR code:** IOF0145AU

Ratings: Zenith Highly Recommended, Lonsec Recommended, Van Eyk 'BB' and Standard and Poor's 4 star.

Research House Ratings must be read in conjunction with the appropriate disclaimers available at www.perennial.net.au/Ratings_Disclaimers1.pdf

Since inception, the key features of the Trust's performance are:

- Strong absolute return, with a since inception net return of 8.70% p.a.
- Strong relative performance, with an excess net return of 2.0% p.a.
- Consistent positive monthly returns.
- A more stable return profile than traditional fixed interest.

Market Review

The Australian bond market recorded another month of strong returns, as yields continued to fall to historically low levels. Shorter term yields benefitted from the larger than expected easing from the Reserve Bank of Australia (RBA) earlier in the month and markets moving to price in further aggressive monetary easing on increasing risks of disruptive shocks emanating from Europe. The one month bank bill rate fell by 50 basis points (bps) to 3.57%, the three month by 70bps to 3.37% and the six month by 76bps to 3.23%. Further out along the yield curve, the yield on a three year government bond fell 88 basis points to end the month at 2.13%.

While the market's attention was firmly focused offshore, local data releases were mixed and reflected the disparate growth trends across the economy. On the stronger side were March retail sales and building approval data. The labour force proved to be more resilient than expected in April, with larger than expected gains in employment. Wages growth remained solid, with the wage cost index rising by 0.9% over the March quarter. Capital expenditure data was stronger than expected for the March quarter and capital expenditure plans for 2012/13 remain elevated. On the weaker side were a marked deterioration in Australia's trade position and a softening in business conditions in the NAB Survey. Following the release of the Federal Government's Budget during the month, fiscal policy looks set to have a material dampening effect on the economy over the next 12 months.

At the longer end of the curve, there were strong global flows into high quality government bonds as markets became increasingly risk adverse. These flows helped push the yield on a ten year Australian government bond down by 75 bps to 2.92%. As a result of these moves, there was some steepening in the yield curve with the spread between three and ten year government bonds widening by a further 12 bps to end the month at +79 bps.

Credit markets were materially weaker over the month with the iTraxx index finishing 50bps wider at 205bps. Physical corporate bonds outperformed as investors held onto their positions limiting the amount of spread widening. Despite the risk off sentiment, the National Australia Bank Limited and Tatts Group Limited both launched ASX listed bond deals, with the latter being an inaugural issue in the Australian market place. Towards the end of the month, Suncorp Bank became the first non-major Australian bank to issue covered bonds raising over $1.6 billion.

Market Outlook

There are significant tensions to the outlook, with a combination of global flight to quality flows and shifting cash rate expectations pushing government bond yields to extremely low levels and distorting normal term premia. While we understand the dynamics that have led to the current low levels of government bond yields, we see poor value at these levels. Investors are vulnerable to any improvement in the economic outlook or recovery in risk appetite and, on a longer timeframe, any lift in inflation.

On the outlook for the path of the cash rate, we are factoring in a 3.00% cash rate by late 2012. Softness in the non mining sectors of the economy and tight fiscal policy suggests that the RBA has room to provide another burst of stimulus. In terms of timing, further easing should be more front end loaded to get the best impact and a June easing is not out of the question. The economy should respond to this and once the worst of the fiscal tightening is behind us, we expect the RBA to gradually return monetary conditions from stimulatory to more normal levels. Market pricing has the cash rate heading towards 2.25% by the end of the year and needs a disorderly Greek exit and associated contagion to be validated. While this is a risk, it is not the most likely outcome for Europe given the costs involved. We see no value in a three year government bond at close to 2.00%.

Corporate debt remains our preferred sector, offering attractive spreads given the healthy state of company balance sheets and strong demand from investors searching for yield. We maintain an overweight position in corporate bonds, with an emphasis on large financials and, in particular, the senior debt of the 'big four' Australian banks, listed property trusts and selected infrastructure/utility debt. We also continue to favour holding government exposure via semi governments, where spreads remain attractive.

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Investment Strategy

The following is a summary of the key strategies in the Trust.

Interest rates – at the end of the month, the duration position of the Trust was as follows:

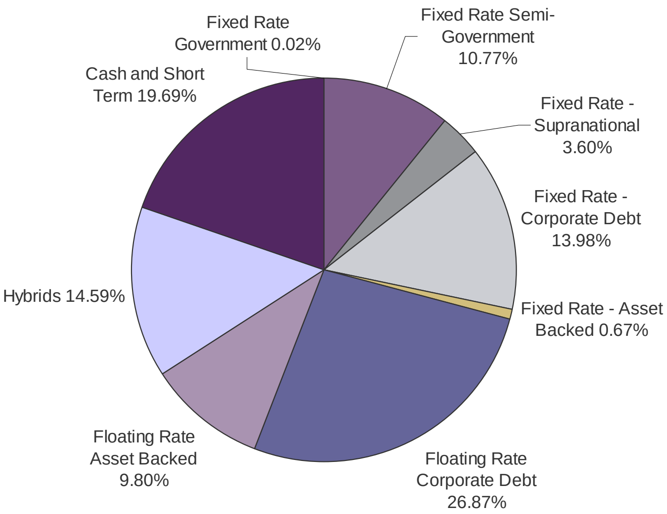
Modified Duration	Years
Trust	0.01
Index	2.05
Active Position	-2.04

Underweight fixed interest/overweight cash.
In our view, bond yields fully reflect the heightened level of negative sentiment that currently prevails, in effect discounting tail risk scenarios related to the dire situation in the Eurozone. At these low levels, we feel fixed rates offer little value as an investment and the downside risks of sharp reversal upwards in yields (capital loss) is material. Further, the market's pricing of the future path of cash rates imply a minimum 150bps of easing by year end. While we acknowledge a weakening domestic economy and hence the need for the RBA to ease monetary policy, we assess the market's pricing of the terminal cash rate as being too low. As such, we feel it is prudent to remain aggressively underweight fixed interest in order to preserve capital should bond yields rise.

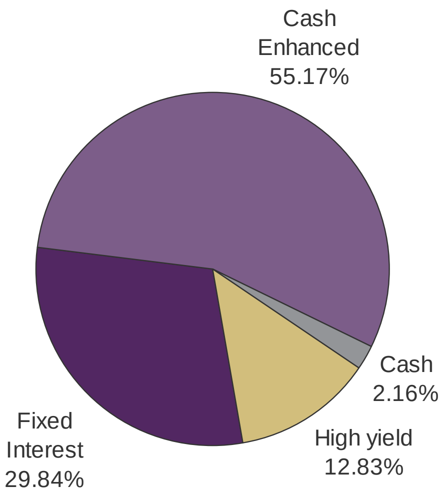
Sector allocation: overweight credit.
In our view, relative to risk free assets, corporate debt provides investors with opportunities that are both fundamentally sound and attractively priced. Corporate balance sheets remain healthy, while cash flows continue to exhibit stability. While we acknowledge that corporate debt is a little more exposed to the volatility of 'risk on, risk off' episodes, the higher running yield should more than compensate for any capital price fluctuations over 12 month investment horizons. Accordingly, we remain overweight this sector and expect that it will outperform risk free assets over the medium term. Our favoured sub-sectors are low risk AAA rated senior covered bonds from the 'big four' Australian banks as well as senior bonds, listed property trusts and infrastructure debt.

Trust Snapshot

Asset Allocation



Sector Allocation



Rounding accounts for small +/- from 100%.

Signatory of: PRI Principles for Responsible Investment

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