PERENNIAL GROWTH MANAGEMENT

Perennial Socially Responsive Shares Trust

Monthly Report
31 December 2014

	Month	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	1.3	0.2	-0.4	4.5	13.4	15.3	5.9
S&P/ASX 300 Accumulation Index	2.0	2.9	2.4	5.3	12.3	14.7	6.5
Value Added (Detracted)	**-0.7**	**-2.7**	**-2.8**	**-0.8**	**1.1**	**0.6**	**-0.6**
Net Performance	1.2	-0.1	-0.9	3.5	12.3	14.3	4.9

* Gross Performance. Past performance is not a reliable indicator of future performance.

Perennial Socially Responsive Shares Trust

The Trust aims to provide a total return (after fees) that exceeds the S&P/ASX 300 Accumulation Index measured on a rolling three-year basis, by investing in a selection of listed companies which also embrace and engender social performance in their corporate culture.

Portfolio manager:

Lee Mickelburough

Risk profile:

High

Trust FUM (as at 31 December 2014):

AUD48.8 million

Income distribution frequency:

Half yearly

Team FUM (as at 31 December 2014):

AUD2.4 billion

Minimum initial investment:

$25,000

Trust inception date:

December 2001

APIR code:

IOF0117AU

- **The market finished the month of December strongly despite a weak start.**
- **The key contributors to Trust performance were BHP, Sims Metal Management and James Hardie.**
- **Companies which possess strong fundamentals for growth can continue to outperform**

Trust performance overview

The Perennial Socially Responsive Shares Trust (the Trust) underperformed the S&P/ASX300 Accumulation Index (the Index) by 0.7% in December, finishing up 1.3% against the Index which was up 2.0% for the month.

The market finished the month of December strongly despite a weak start. Industrials (up 6.0%) led the rally, while Health Care (up 5.6%), A-REITS (up 4.5%) and Telecommunications (up 4.3%) provided strong support thanks to their exposure to falling bond yields. Following on from recent months, both Energy (down 1.7%) and Materials (down 0.3%) continued their slide.

The key contributors to Trust performance were BHP, Sims Metal Management and James Hardie. Some of the key detractors included Karoon Gas and Mermaid Marine.

Investment Themes and Stock Performance

Companies which possess strong fundamentals for growth will continue to outperform.

We continue to hold Brambles (up 9.4%) in our portfolio as it continues its path of global growth through superior provision of supply chain logistics predominately via its CHEP and IFCO branded products and associated services. The divestment of Recall in December 2013 has allowed Brambles to focus on the higher returning and growth segments of the business. Brambles has a high quality management team, a strong growth outlook (guidance is for FY15 underlying profit growth of 7-10%), greater than 12% valuation upside and is leveraged to a weaker Australian dollar with less than 15% of earnings coming out of Australia.

As well as possessing solid fundamentals, CSL (up 4.9%) is also clearly a beneficiary of the weaker Australian dollar. CSL held its annual Research and Development (R&D) Investor Day during the month, which pointed to a number of exciting near term products that could add materially to profit. For example, the first of CSL's three recombinant clotting product therapies (Factor IX) will be launched next financial year. Factor VIII will follow in FY17, and a subcutaneous delivery of Berinert could expand the market opportunity in that segment also. Longer term, the trial for the heart protecting reconstituted high-density lipoprotein drug has commenced and is a potential game-changer if successful. CSL expenses all R&D spend and is in a particularly high spend phase currently, given the recombinant trials. When this round of trials are completed spend is likely to plateau or fall which, when combined with revenue from product launches, is expected to accelerate profit growth.

We opened a position in Stockland (up 2.85%) this month. Stockland is a diversified property group in Australia which develops and manages residential communities, retirement living villages, retail centres, office buildings and industrial sites. Stockland is well managed and we are attracted to its strong medium-term earnings growth underpinned by improving residential volumes, gradually recovering margins, and returns on invested capital. Further, we see its low retail occupancy costs and strong relative productivity as positive drivers.

We acknowledge that the road to growth is not always going to be free from potholes. Vocation (down 55.0%) is one such example. It is a company we continue to hold as we believe it has significant future growth potential, although we acknowledge it has issues to overcome as it progresses forward. Since the announcement of a settlement with the Department of Education and Early Childhood Development (DEECD) and the completion of the Victorian review, the company has altered its enrolment mix as it works to regain firmer footing. The company has also moved to bolster its executive ranks by recently announcing the appointment of Stewart Cummins as interim CFO. We are confident that given his background and skill set Stewart will be a valuable asset to the business.

We reduced our position in Fonterra (up 2.7%) during the month. While we have benefited from our position in Fonterra for some time, we became uncomfortable with the level of fundamental business risk as they continue to ramp up capital expenditure. We are also concerned about the near term impacts on trade sanctions on Russia which is a significant market for dairy produce from Europe.

The economic recovery in the US continues as evidenced by the third quarter GDP upward revision and generally supportive economic data.

This remains a central theme in our portfolio construction. We are seeing the gradual normalisation of US monetary policy, ongoing recovery in the USD dollar and general upward pressure on US interest rates. We have chosen to play this central theme through tilting the portfolio towards those companies that have operations whose fundamentals will be supported in this environment.

Reflecting this theme, Westfield Corporation (up 8.8%) and Goodman Group (up 6.3%) are currently held in the portfolio. Westfield is a global leader in the property sector with an outstanding management team and a world class global redevelopment pipeline with key flagship assets including the World Trade Centre retail precinct in New York and Westfield London. Goodman is one of the global leaders in the industrial property sector with strong businesses in property development, funds management and property expanding into new markets such as China, USA, and Brazil. As well as possessing strong fundamentals, we are attracted to both companies' offshore earnings and the positive building development, retail sales and leasing environment in the countries in which they operate.

James Hardie (up 9.9%) is another beneficiary of the US recovery. The company's predominantly US dollar earnings base has benefited directly from a lower Australian dollar and falling US bond rates have consequently reduced the costs of mortgages for American borrowers. James Hardie is also a beneficiary of lower energy prices through the use of gas in manufacturing and extensive use of heavy haulage to distribute its product. We believe that James Hardie continues to have a superior growth outlook as US housing construction recovers from below trend levels and the company achieves further success with its market penetration strategies.

While the US economic backdrop has provided a strong environment for QBE Insurance Group (up 3.2%), we elected to use the market strength to reduce our holding. While we continue to be supporters of the company, we believe that the impact of the recent fall in US bond yields on their investment earnings is not reflected in the current share price.

Chinese economic data has remained underwhelming.

The Chinese leadership face the reality of balancing long term reforms on corruption, the environment and market liberalisation with maintaining economic growth. Despite the weaker growth we have not observed any change of government policy; this is consistent with our view that the leaders are maintaining a long term view of China's growth trajectory.

As a result of the weaker Chinese economic growth and the subsequent supply/demand imbalance in bulk commodities, we have seen declines in the large mining companies, namely BHP (down 5.0%) and Rio Tinto (down 1.9%). While both companies are low cost producers of bulk commodities and will likely weather the current weak patch, their softening cash flows mean that any significant capital return to shareholders are likely to be associated with rising debt levels which we do not think is prudent at this point of the cycle.

In contrast to the misfortunes of the broader metals sector, the position we hold in Sims Metal Management (up 13.3%) performed strongly over the month. Sims is currently undertaking a strategic plan focussing on internal initiatives in the form of cost-outs, productivity improvements and supply chain optimisation to generate earnings growth. We are comfortable with the progress that the company is currently making.

Orecobre (up 7.3%) is another company that we hold that bucked the December resources trend. Orecobre is a lithium development company whose primary asset is the Salar de Olaroz Lithium-Potash project in north-western Argentina. We remain attracted to the company's low cost position and large expandable resource base given the positive lithium industry dynamics. Our positive outlook is predicated on growing demand for mobile batteries and the increased penetration of electric vehicles which we see as a benefit for both the company and the global environment.

Domestically, consumer confidence and business conditions have continued to weaken and the Australian dollar will likely continue to slide.

There will be a transitory period between the current weakness and subsequent recovery as the falling Australian dollar should assist in rebalancing the Australian economy in the longer term. As such, we have maintained a general underweight position to the Australian retail sector.

In line with this theme, Woolworths (down 1.4%) is a company that we have elected not to own and this decision has been a solid driver of recent portfolio performance. Woolworths' decline started following the release of a disappointing Q1 sales number in their Food and Liquor department. The weak growth supported our thesis that Woolworths is not well equipped to deal with the rising level of competition in the markets in which it operates and is losing market share as competition escalates (namely between Aldi, IGA, Coles and Costco) in a weaker retail environment. Other Woolworths businesses: Petrol, New Zealand Supermarkets and Hotels have been reporting softer comparable sales in recent times and we remain concerned about the ongoing poor execution in Home Improvement.

Oil has entered a period of structural supply/demand imbalance in favour of supply.

This will create economic imbalances between countries leveraged to production and those leveraged to consumption.

Entering December with an overweight portfolio position in the oil and gas sector, we moved to exit Santos (down 18.3%), Worley Parsons (down 9.3%) and Mermaid Marine (down 17.0%). We believe that in the current environment there is an increasing probability that Santos will need to raise equity as its cash flow leverage to lower oil prices places its capacity to refinance in some doubt. This doubt has spread and was further reflected by the lowering of Santos' credit rating by S&P to BBB from BBB+. Along with Santos, we strategically made the decision to exit Worley Parsons on the basis that we would likely see extensive cuts to capital expenditure stemming from the decline in oil prices and these are yet to be reflected fully in the share price. On a similar note we felt that the relationship of the operating environment relative to the debt levels of Mermaid Marine had deteriorated to a point where we could not safely hold the company for its future growth prospects.

Despite the slump, we continue to hold Sundance (down 25%). Sundance's current drilling program levels have been reduced to align the company's operating cash flows with its capital expenditure and thereby preserve the company's strong balance sheet. While this has negatively impacted our forecast production growth profile, we believe that it is the most sensible course of action for the company to take at this point in the cycle. The decision gives us confidence that CEO Eric McCrady can navigate the turbulent waters ahead and ensure the company emerges from this period of volatility in good shape.

We also continue to hold Karoon Gas (down 13.2%) as they continue to investigate their recent oil discovery at Kangaroo-2 in offshore Brazil. Flow rates expressed so far support an economic discovery and we expect further news in coming weeks. We continue to see significant valuation upside in Karoon even with lower long term oil price assumptions and note that the company remains well capitalised with a forecast cash balance as at 31 December 2014 of $644m or $2.61/share versus the share price as at 31 December 2014 of $2.44/share.

At the end of the month the Trust held 41 stocks and had an effective cash balance of 2.9%.

Market Overview

The 'Santa Rally' provided much needed relief for the Australian market as midway through December the bourse sat firmly in the red. Eventually finishing up 2.1% on an accumulated basis, Australia was one of the better performing global markets for the month. The S&P 500 slipped 0.4%, the Euro Stoxx 50 fell 3.2% and the Nikkei 225 and FTSE 100 were both flat. The Hang Seng fell 1.6% while the best performer of the major bourses, the Shanghai Composite Index, surged 20.1% on hopes of economic stimulus.

US Economic data was once again generally positive prompting the FOMC to phase out the 'considerable time' guidance at December's meeting. The data was led by third quarter real GDP which was revised upward 1% to an annual rate of 5.0% while consumption was also revised upward to a very strong reading of 3.2%. The ISM manufacturing PMI slipped to 58.7 in November from 59 in October and a little ahead of the 58 expected. The ISM non-manufacturing PMI arrived at 59.3, well ahead of the 57.5 expected. Non-farm payrolls registered a true surprise of 321,000, significantly ahead of 230,000 expected. The participation rate with a reading of 62.8% and the unemployment rate at 5.8% remained unchanged. Housing starts fell 1.6% for the month of October, missing the 3.1% growth expected, and volatility in the series remains high. Existing home sales fell 6.1% well behind the estimated 1.1% decline predicted. CPI for November fell 0.3%.

Chinese economic data was a mixed bag in December. Industrial production was strong, rising 7.2% year on year, while CPI was marginally better than the 1.6% expected coming in at 1.4%. The recently released HSBC Manufacturing PMI was weaker at 49.6, just ahead of the 49.5 expected, while Non-manufacturing came in at 54.1, ahead of the November reading. M2 money supply growth ticked up to 12.3% year on year, just below the 12.5% expected. New loan creation came in at 852.7B Yuan for November well ahead of the 655B Yuan expected. The Chinese housing market remained under pressure with 67 cities of the 70 city house price index recording month on month declines.

Domestically the RBA kept the cash rate on hold for a 15th consecutive meeting. The RBA minutes were consistent with previous months and reinforced their outlook of a period of interest rate stability. NAB business confidence decreased 3 points to 1 point, a 16 month low, while the NAB business conditions fell to 5 points, normalising from the extraordinary gain of 12 points in the month prior. The Westpac MI consumer confidence index sank 5.7% to 91. The economy added 42.700 jobs in November well ahead of the 15,000 increase forecast, while the participation rate ticked up to 64.7%. The jobless rate increased to 6.3% indicating the likelihood that the job increases were predominantly part time. Retail sales increase 0.4% in October, while building approvals soared 11.4% in October following on from September's 11% slump.

The Australian dollar fell 3.9% against the US dollar over the month. The trend of a stronger US dollar has continued in recent months as the currency markets continue to transition to a more normal US monetary policy.

Following on from the meeting of the Organization of the Petroleum Exporting Countries (OPEC) on November 28, spot Brent crude oil continued to plunge, finishing the month down 19.2%. Meanwhile iron ore paused as prices finished flat for the month. Base metals were broadly weaker over the month with aluminium down 10.1%, lead down 8.9% and nickel down 7.1%. Spot gold rallied 1.4%.

Top 10 Holdings		
Stock name	Trust weight %	Index weight %
National Aust. Bank	8.5	5.9
Commonwealth Bank	8.4	10.1
ANZ Banking Grp Ltd	7.4	6.4
Telstra Corporation.	7.2	5.3
Westpac Banking Corp	6.9	7.5
CSL Limited	5.7	3.0
Westfield Corp	3.4	1.2
James Hardie Indust	2.7	0.4
Sims Metal Mgmt Ltd	2.5	0.1
Challenger Limited	2.5	0.3

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	2.2	5.1
Materials	10.7	15.0
Industrials	12.1	7.4
Consumer Discretionary	2.1	4.1
Consumer Staples	0.6	7.4
Healthcare	10.1	5.9
Financials-x-Real Estate	39.3	38.6
Real Estate	9.9	7.7
Information Technology	0.5	1.0
Telecommunication Services	7.2	5.8
Utilities	2.5	1.9
Cash	2.9	-

Rounding accounts for small +/- from 100%.

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

Signatory of:

PRI Principles for Responsible Investment