



Perennial Value Wealth Defender
Australian Shares Trust

Perennial Value Wealth Defender

Our Approach to Dynamic Protection



The aim of dynamic protection strategies

The dynamic protection strategies used within the Perennial Value Wealth Defender Australian Shares Trust (the Trust) are designed to cost effectively and efficiently manage downside protection, in the case of significant falls in the Australian equity market. The protection strategies aim to cushion the impact of falls in the market – but do not eliminate them. The philosophy behind the dynamic protection strategies is that we only spend a small amount, but carefully target this spending to protect against the most likely and frequent losses (usually equity market falls within the 5 to 20% range).

Dynamic protection can provide peace of mind. If you can limit the downside, investors can feel empowered to stay invested in equities even if markets get choppy, when they might otherwise just panic and exit the market, quite possibly at the wrong time. Avoiding capital losses in a market downturn is equally, and possibly even more important, than maximising outperformance in rising markets, due to the effects of compounding. By reducing the impact of a fall in the market on your equity investments, you should have a higher level from which your capital can grow, all thanks to the effects of compounding. Compounding works best if you stay invested. By maintaining market participation, and having protection strategies in place, capital can be better preserved in the long run across varying market conditions.

Types of protection strategies

Dynamic protection utilises various option strategies to protect against significant losses. Some of the strategies used include:

Put option – buy put options at a specific strike price to protect the portfolio against falling markets below the strike level.

Put spread – buy put options at a specific strike price while also selling the same number of puts at a lower strike price. A put spread protects the portfolio in falling markets, but to a more limited degree compared to a buying a put option alone, and therefore costs less.

Put spread collar – purchase a put spread while simultaneously selling (writing) an out of the money call option. A put spread collar allows for some upside potential, with less downside risk when there is a decline in the market, for relatively little cost.

Put time spread – buy a put with a shorter-term expiration and simultaneously sell a put with a longer-term expiration. A put time spread allows the portfolio to gain if there is a fall in the market. It is also one of the lowest cost protection strategies used within the Trust.

The table below shows some examples of the most commonly used protection strategies, what they can achieve on both the downside and upside, and how they compare to each other on a relative cost basis.

Table 1: Protection examples

	Put Option (Higher strike)	Put Option (Lower strike)	Put Spread	Put Spread Collar
Example	Purchase 3 month 95% put	Purchase 3 month 85% put	Purchase 3 month 95%/85% put spread	Purchase 3 month 95%/85% put spread and sell 105% call
Cost	Most expensive	Lower strike decreases cost	Selling lower strike significantly decreases cost	Generally cheapest (due to limiting the upside)
Downside Protection	100% protection below 95% of spot	100% protection below 85% of spot	Protection between 95% and 85% of spot	Protection between 95% and 85% of spot
Upside Participation	Full	Full	Full	Up to 105% of spot

Source: Perennial Value

The options utilised within the Trust can be index options or single stock options. Index options are generally cheaper, however single stock options may be used, for example, in cases where the cost of insurance in a particular stock held is relatively low. When selecting option strategies the underlying share portfolio characteristics are considered as a whole. Therefore index options are suitable for risk managing the portfolio overall, including the small cap component.

Typically the majority of options utilised within the Trust are exchange traded although the portfolio manager is permitted to use over-the-counter options as well. Over-the-counter options may include lookback or contingent puts. With regards to over-the-counter instruments, we have procedures in place to assess counterparties (ensuring they are suitably creditworthy), monitor exposure and minimise any risks. Formal agreements governing derivatives transactions (eg. an ISDA Master Agreement), are entered into with approved counterparties.

How and when protection strategies are used

Dynamic protection will vary over time, depending on Perennial Value’s market outlook (bearish/neutral/bullish) and the levels of volatility in the market (low/medium/high) which in turn is correlated with the cost of protection. Importantly, the Trust will always have some degree of protection in place in order to try and limit losses from any unexpected market downturns of a certain magnitude (generally greater than 5%).

The matrix below details how Perennial Value’s market view and assessment of market volatility will guide the level and types of protection in the portfolio at various points in time.

Table 2: Dynamic Protection Matrix

Volatility (and protection costs)	High	High cash (25 -50%) “Risk off” Eg. 85/95/105 Put Spread Collar Put time spread	Moderate Cash (5 -30%) “Normal risk” Low levels of protection Eg. 80/90/105 Put Spread Collar Put time spread	Low cash (0 -20%) Low levels of protection Eg. Put time spread Lookback or Contingent Put
		Moderate Cash (15 -30%) Average level of protection Eg. 95/85 Put Spread	Moderate Cash (5 -20%) “Normal risk” Some protection Eg. 90 Put 80/90 Put Spread	Low cash (0 -15%) Some degree of protection Eg. 80/90 Put Spread Lookback or Contingent Put
	Low	Low cash (10 -20%) Higher level of protection Eg. 95 Put Cash + Call	Low Cash (5 -15%) “Normal risk” Average levels of protection Eg. 90 Put	Low cash (0 -10%) “Risk on” Some degree of protection Eg. Crash protection 85 Put
	Bearish	Value	Bullish	
	Market View			

Source: Perennial Value. NB: Cash weightings are indicative only. Perennial reserves the right to vary these at its discretion.

In rapidly rising markets the Trust would still generally own protection, most likely in the form of put spreads or put time spreads. It may also own call options from time to time to protect upside risk.

Cost of dynamic protection

The cost of dynamic protection will vary over time. The costs can be impacted by factors such as the overall level of volatility in the market, the term of an option and the strike price. In times of high volatility the cost of protection will increase, and vice versa in times of low volatility. Furthermore, an option with a longer term will be more expensive than one with a shorter term (and the same strike price). Lastly, a put option with a higher strike will cost more than one with a lower strike (assuming the same term).

Importantly, there are risk management techniques that can be used to reduce the cost of protection. For example, the Trust may utilise a put spread or put spread collar, instead of a put option, as protecting a range (down to a nominated floor level) is cheaper than protecting unlimited downside. The table below shows how option pricing can differ, depending on the type of strategy, the term or the strike.

Table 3: Indicative option costs

Strategy	Term	Protection Level %	Floor Level %	Cap Level %	Indicative Cost %
Long Put	3 months	95	N/A	N/A	0.86
Long Put	6 months	95	N/A	N/A	2.31
Long Put	3 months	85	N/A	N/A	0.21
Long Put	6 months	85	N/A	N/A	0.78
Put Spread	3 months	95	85	N/A	0.66
Put Spread	6 months	95	85	N/A	1.56
Put Spread Collar	3 months	95	85	105	0.06
Put Spread Collar	6 months	95	85	105	0.21

Source: Perennial Value. For illustrative purposes only, costs will vary over time.

While we cannot predict the exact level of protection costs within the Trust due to varying market conditions, we aim to limit protection costs in any one year period. In any event – we expect the costs of protection to be approximately one third of the targeted long term outperformance of the underlying share portfolio versus the benchmark. The goal is not to overspend on protection and risk eroding value added at the underlying portfolio level. The cost of protection is an important consideration for the portfolio manager when determining the most appropriate protection strategy to implement at any point in time, but this must also be weighed up against the objective of outperforming the Trust's benchmark, the S&P/ASX 300 Accumulation Index. It is here that the expertise of Perennial Value's risk management team comes to the fore, as well as the team's access to protection strategies at professional derivative market prices, which are typically only available to institutional investors.

The costs of protection are reflected in the performance of the Trust. Index option premiums and any associated profits are recorded against the income account whereas for stock options these are recorded against the capital account. While the premiums paid may reduce the income of the Trust at times, we expect that this will be outweighed in the longer term by the profits from the protection strategies held.

Managing and monitoring protection strategies

In terms of managing and monitoring the dynamic protection within the Trust we use the Imagine Trading System (Imagine). Imagine consolidates all stock holdings and derivative positions so that they can easily be monitored in real time. Another advantage of the software is that at any point in time we can estimate the impact on the portfolio of a specified fall in markets. As can be seen in the example below, if the market fell 15% overnight, it would be expected that the portfolio would only be down 7.2%.

Table 4: Portfolio snapshot

The screenshot displays the Imagine Trading System interface. On the left, a 'Totals' sidebar shows portfolio metrics for 'PWDEF' (Perennial Value Wealth Defender). The main window shows a table of holdings with columns for Name, Value AUD, ESP \$, Delta (AUD), Gamma (AUD), Theta (AUD), Vega (AUD), P&L/FUM2, Day P&L, and Avg Beta. A text box is overlaid on the main table, providing a summary of the portfolio's estimated performance during a market fall.

Totals	Value
# Holdings	125
Name	PWDEF
Hedge	AXKD
Value AUD	9,762,884
ESP \$	8,106,416
Delta (AUD)	8,123,530
Gamma (AUD)	335,279
Theta (AUD)	-803
Vega (AUD)	3,488
Day P&L	5,872
HedgeUChg%	0.1690
P&L/FUM	0.0601
XJO -2% of FUM	-19.57
XJO -10% of FUM	-5.76
XJO -15% of FUM	-7.20
XJO -20% of FUM	-10.57
Portf Avg Beta Total	1.09
EE	0.8332
AUD Cash	331,568.13

Totals	Value
# Holdings	18
Name	PWDEF O...
Hedge	AXJD
Value AUD	10,404
Delta (AUD)	-1,297,342
Gamma (AUD)	335,279
Theta (AUD)	-803
Vega (AUD)	3,488
GammaThetaRatio	417
XJO -2% of FUM	0.34
XJO -5% of FUM	1.19
XJO -10% of FUM	3.76
XJO -10% ATM +3%	3.83
XJO -15% of FUM	7.09
XJO +10% of FUM	0.34

Security	-KC	Long Security Name	Quantity	ESP	Avg Cost	Last	Mit	Expiry	PIC	Delta	Gamma %	Vega D	ModVol	Imple
AXJ05400T4 AX-14	96	XJO AUG4 5400 P	0	0	0.0000	2.000	1.4733	20140821P		-3.91	5.5436	0.903	14.29	1
AXJ05250U4 AX-14	94	XJO SEP4 5250 P	55	-65	64.4875	0.000	14.0250	20140918P		-11.82	4.7550	3.411	14.14	1
AXJ04800U4 AX-14	95	XJO SEP4 4800 P	-40	7	15.8000	0.000	2.3948	20140918P		-1.75	0.6657	0.750	22.09	2
YAPM-14	100	SPI 200 JUN4	0	0	0.0000		0.0000	20140619		0.00	0.0000	0.000	0.00	
AXJ05650G4 AX-14	100	XJO JUL4 5650 C	0	0	0.0000		0.0000	20140717C		0.00	0.0000	0.000	0.00	
SUN1275T4 AX-14	84	SUN AUG4 1275 P	20	-157	0.2457	0.000	0.0450	20140828P		-7.85	1.8209	0.004	46.77	4
AXJ05150T4 AX-14	92	XJO AUG4 5150 P	20	0	22.0000	0.000	0.0172	20140821P		-0.95	0.9852	0.913	20.00	2
TL8525G4 AX-14	100	TLS JUL4 525 C	0	0	0.0000		0.0000	20140724C		0.00	0.0000	0.000	0.00	
YAPM-14	200	SPI 200 SEP4	-5	-125	5.402,0000	5.578	5.519,0000	20140918		100.27	0.0000	0.000	0.00	
TL8535H4 AX-14	104	TLS AUG4 535 C	77	7.294	0.0779	0.000	0.2515	20140828C		94.73	3.8135	0.001	17.91	1
OR02250J4 AX-14	90	ORI OCT4 2250 C	24	524	0.3933	0.000	0.2578	20141030C		21.83	2.7909	0.028	22.95	2
AXJ05350U4 AX-14	95	XJO SEP4 5350 P	30	-59	44.6286	23.000	23.2044	20140918P		-19.77	7.6268	4.763	12.33	1
AXJ05000U4 AX-14	89	XJO SEP4 5000 P	0	0	0.0000	5.000	5.3321	20140918P		-4.96	1.5705	1.511	18.91	1
AXJ05800U4 AX-14	95	XJO SEP4 5800 C	0	0	0.0000	0.000	3.4674	20140918C		5.07	3.3806	1.700	9.82	1

Source: Perennial Value, as at August 2014

It is important to remember that the level of protection will vary over time, depending on the protection strategies in place. So a fall of 15% in the market at different points in time will not necessarily translate into a 7.2% fall in the portfolio – the outcomes will vary due to the dynamic nature of the protection strategies.

Our Wealth Defender team

Portfolio management team

The Trust has direct holdings in up to 100 large and small capitalisation stocks. The neutral allocation is 90% large caps and 10% small caps, with the potential for a maximum allocation of 25% to small caps. There are four portfolio managers responsible for stock selection, with Dan Bosscher being the dedicated portfolio manager of the Trust. The final decision regarding the risk management and asset allocation of the Trust lies with Dan.



John Murray
Managing Director
of Perennial Value
Perennial Value: 14 years
Industry: 29 years



Dan Bosscher
Portfolio Manager
Perennial Value: 2 years
Industry: 18 years



Grant Oshry
Senior Small Cap Portfolio
Manager/Analyst
Perennial Value: 10 years
Industry: 15 years



Andrew Smith
Small Cap Portfolio
Manager/Analyst
Perennial Value: 5 years
Industry: 13 years

*As at 1 July 2014

Risk management team

Perennial Value's dedicated risk management team of three is led by Dan Bosscher. Collectively they have over 30 years experience in managing derivatives, providing ample back up for the management of the dynamic protection strategies within the Trust.



From left to right, Scott Stewart (Portfolio Manager), Dan Bosscher (Portfolio Manager) and Mike Zhang (Analyst).

For more information, please contact your Investment Specialist:

Andrew Davies (NSW/ACT/QLD/NT) Mobile 0418 617 418

John Negri (VIC/SA) Mobile 0401 140 719

Angelo Saltarelli (VIC/TAS/WA) Mobile 0448 364 449

Phone 1300 730 032

Email invest@perennial.net.au



For up to date information of the Trust, including the latest performance and asset allocations, please visit www.perennial.net.au/wealthdefender

Issued by: The Investment Manager, Perennial Value Management Limited, ABN 22 090 879 904, AFSL: 247293. Responsible Entity: IOOF Investment Management Limited ABN 53 006 695 021, AFSL: 230524. This promotional statement is provided for information purposes only. Accordingly, reliance should not be placed on this promotional statement as the basis for making an investment, financial or other decision. This promotional statement does not take into account your investment objectives, particular needs or financial situation. While every effort has been made to ensure the information in this promotional statement is accurate; its accuracy, reliability or completeness is not guaranteed. Past performance is not a reliable indicator of future performance. Investments in the Perennial Value Wealth Defender Australian Shares Trust must be accompanied by the application form attached to the product disclosure statement. The current relevant product disclosure statement and application form can be found on Perennial's website www.perennial.net.au/wealthdefender.

Issued: May 2015