PERENNIAL FIXED INTEREST

Perennial Australian Fixed Interest Trust

Monthly Report as at 31 December 2012

	Month %	Quarter %	FYTD %	1 Year %	2 Years % p.a.	3 Years % p.a.	5 Years % p.a.
Perennial Australian Fixed Interest Trust*	0.46	1.24	4.63	10.70	10.23	9.31	9.71
UBS Composite Bond Index (0+years)	0.18	0.21	2.20	7.70	9.52	8.35	8.26
Value Added (Detracted)	**0.28**	**1.03**	**2.43**	**3.00**	**0.71**	**0.96**	**1.45**
Net Performance	0.43	1.15	4.44	10.31	9.84	8.94	9.32

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

- The Trust outperformed the Index return by 0.28%.
- Current market pricing has the cash rate falling to about 2.5% by mid next year.
- Corporate debt and listed property trusts are our preferred sectors.

Performance

The bond market in December again delivered a lower return than expected from coupon income due to the negative impact of rising bond yields. This was driven largely by a more upbeat economic landscape offshore, albeit some of the rise in bond yields was reversed later in the month as market concerns grew over the US fiscal cliff. Credit markets continued to perform well over the month, with a flurry of new issuance vindicated by the strong investor demand that followed.

The UBS Composite Bond Index (0+years) (the Index) returned 0.18% over the month. The Perennial Australian Fixed Interest Trust (the Trust) continued its run of outperformance exceeding the Index return by 0.28%.

Interest rate management, including a short duration stance relative to the Index, helped protect the Trust against rising bond yields. Yield curve positioning, which concentrated the underweight duration positioning in longer term maturities, added further value as long bond yields rose the most. In relation to sector allocation, an overweight allocation to credit added value, as credit spreads narrowed on the back of investor demand chasing the running yield advantage this sector has to offer.

Market Review

Despite an interest rate cut from the RBA, sluggish economic data and US fiscal cliff uncertainty, yields ended the month slightly higher, though the sector still managed to generate a modest positive return.

The RBA cut the cash rate to 3% in early December, with subsequent commentary suggesting that the central bank is in a reactive mindset and will need to see fresh evidence of slowing before being prompted into action again.

Perennial Australian Fixed Interest Trust:

The Trust aims to provide a total return (after fees) greater than cash and inflation, and that exceeds the UBS Composite Bond Index (0 + years), measured on a rolling three-year basis.

Portfolio Manager: Glenn Feben	**Risk Profile:** Medium
Trust FUM (as at 31/12/12): AUD1.3 billion	**Income Distribution Frequency:** Quarterly
Team FUM (as at 31/12/12): AUD6.3 billion	**Minimum Initial Investment:** $100,000
Trust Inception date: August 2002	**APIR code:** IOF0113AU

Data releases since the RBA's move have been mixed. Consumer sentiment reversed the previous month's gain despite the rate cut. Retail sales were flat in October, while building approvals recorded a sharp fall. Credit demand remains muted and business conditions and confidence were weak in November. With such a start, it is unlikely the economy will grow much faster than the 0.5% gain recorded for the September quarter. Against this backdrop, three and six month bank bills ended the month 19 and 22 basis points (bps) lower at 3.07% and 3.01%, respectively. The yield on a three year government bond ended 5 bps higher at 2.67%.

At the longer end of the curve, the ten year government bond yield ended the month 11 bps higher at 3.27%. Long bond yields got as high as 3.39% on an improving global growth outlook, before rallying into the close of the month on fears that US politicians would not be able to avert a draconian tightening in fiscal policy in early 2013. Given these moves, there was some steepening in the spread between three and ten year government bonds which rose 6 bps to 60 bps.

Credit markets continued their recent tightening trend in December, with the Australian iTraxx Index about 3 bps tighter over the month. Physical credit securities performed better than the Australian iTraxx Index. This was primarily driven by a number of new issuances rushed through before the potential US fiscal cliff, as companies sought to future proof their balance sheets and funding prior to year end. The residential mortgage backed securities (RMBS) market was also quite active, with three large primary deals all pricing at tighter levels than their previous transactions - a sign of health for this sub-sector.

Market Outlook

The latest run of data shows that the economy was most likely running at a sub trend rate at the end of the year. In a significant development, the government stepped back from its commitment to deliver a budget surplus in 2012/2013. This is a welcome development for the economy as it avoids an unnecessarily aggressive tightening in fiscal policy over the first half of 2013 and takes some of the burden off monetary policy.

We continue to hold the view that the growth and inflation outlook will allow room for further modest monetary easing in the first half of 2013. With the mining boom peaking earlier than expected and business and consumers holding a defensive mindset, further easing would help underpin a recovery in the interest rate sensitive sectors of the economy.

At the time of writing, markets were pricing in a low in the cash rate of around 2.5% over the second half of 2013. This is not that far from our own view and in the main, we continue to regard the shorter end of the curve as fair value. We still regard the longer end of the curve as expensive, offering investors insufficient protection against an improvement in risk appetite or an improvement in the economic outlook. The sell-off over the first half of December was a reminder of the price action that can occur on an improving economic outlook and a pick up in risk appetite. While we believe a major sell-off at the long end of the curve is still some time away, given offshore policy settings, we continue to hold a modest strategic defensive duration bias.

We continue to hold our structurally positive view on credit during periods of prolonged low interest rates given strong investor demand for any yield pick-up. While credit spreads have come in, they remain at, or above, longer term levels. We continue to maintain an overweight allocation to these sectors. Within the corporate sector, our emphasis is on large financials and particularly the senior debt of the 'big four' Australian banks, listed property trusts and selected infrastructure/utility debt.

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	3.51
Index	4.04
Active Position	-0.53

Interest rates – underweight duration:
Only minor changes were made to the Trust's duration position during December, including taking some profit when bonds sold off and slightly reducing the magnitude of our short duration stance. Current market pricing has the cash rate falling to about 2.5% by mid next year and remaining there until well into 2014. This is not too different from our assessment of 'fair value' at the shorter end of the yield curve. However, we have a more cautious view on longer term yields as they can be susceptible to better economic data and policy settings offshore although we acknowledge the risks are not imminent. Accordingly, we maintain a strategic defensive bias especially in longer term maturities, but with a willingness to tactically alter the magnitude of this position as yields move towards the upper and lower levels of their expected trading range.

Overweight Corporate Debt:
While credit spreads have continued their rally, we continue to believe that this sector is poised to outperform risk free assets on a 12 month forward

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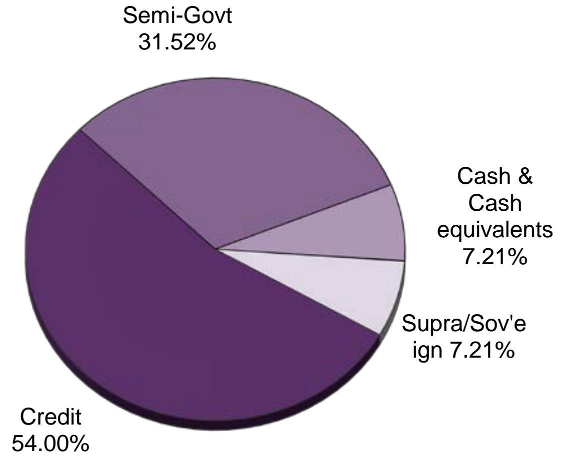
looking basis. This view is based on the demand for 'yield', which should be supportive for credit margins, as well as the higher running yields these securities provide. While we are not looking to add to our positions, we are comfortable with our overweight allocation to this part of the market. Our favoured sub-sectors continue to be the 'big four' Australian banks senior bonds, listed property trusts and infrastructure debt. We added exposure to prime AAA rated fully documented Australian RMBS and will continue to do so while their spreads remain attractive and fundamentals are supportive.

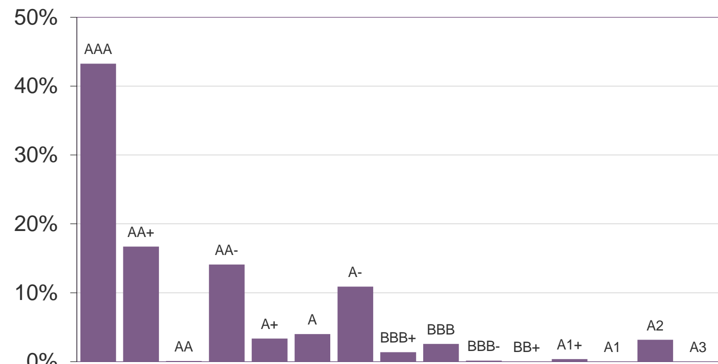
Overweight semi-governments (including government guaranteed):
Our government exposure is concentrated in semi and government guaranteed securities. This not only provides a yield advantage relative to government bonds, but also participates in the bond/semi margin contraction which we believe will occur at some stage as the state governments work towards a more solid footing in their fiscal balances. Our largest overweight is to Queensland Treasury Corporation, given its medium term commitment to restoring its 'AAA' credit rating.

Trust Snapshot

Sector Allocation



Credit Rating Distribution



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