Perennial Value Australian Shares Trust

Quarterly Report
30 June 2016

	Quarter	FYTD	1 year	3 years	5 years	Since Inception*
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Australian Shares Trust*	2.7	-3.1	-3.1	8.4	7.4	10.5
S&P/ASX 300 Accumulation Index	4.0	0.9	0.9	7.7	7.2	7.6
Value Added (Detracted)	**-1.3**	**-4.0**	**-4.0**	**0.7**	**0.2**	**2.9**
Net Performance	2.5	-4.0	-4.0	7.4	6.5	9.7

*Gross Performance. ^Since inception: March 2000. Past performance is not a reliable indicator of future performance.

Perennial Value Australian Shares Trust

The Trust aims to grow the value of your investment over the long term via a combination of capital growth and tax effective income, by investing in a diversified portfolio of Australian shares, and to provide a total return (after fees) that exceeds the S&P/ASX 300 Accumulation Index measured on a rolling three-year basis.

Trust manager:
John Murray

Risk profile:
High

Trust FUM (as at 30 June 2016):
AUD 1.3 billion

Income distribution frequency:
Half yearly

Team FUM (as at 30 June 2016):
AUD 9.1 billion

Minimum initial investment:
$25,000

Trust inception date:
March 2000

APIR code:
IOF0200AU

- **Markets rallied over the June quarter, with the S&P/ASX300 Accumulation Index (the Index) up 4.0%.**
- **The Perennial Value Australian Shares Trust (the Trust) returned 2.7%, underperforming the Index by 1.3%.**
- **The key reason our value portfolio of stocks underperformed the broader Index is the outperformance of supposedly 'earnings certain' stocks, in turn driven by the uncertain global macro environment.**

Trust performance

The 2016 financial year has been very difficult for true-to-label value investors such as Perennial Value. What is clear to us however, is that value as a style is a proven performer over the long term, as is our investment process. This is reflected in our long term outperformance of 2.9% per annum above benchmark over 16 years. There have been periods where we have seen value perform poorly in the past, such as at the tail end of the pre-financial crisis boom and during the 2012 flight to safety. However, on each occasion, we have remained disciplined, stayed true to our process and have been rewarded by subsequent strong outperformance. We have no reason to believe that this will not be the case going forward as relative market valuations inevitably normalise.

Market activity

Globally markets were volatile, with fears for Chinese growth and the impact of the unexpected outcome of the Brexit referendum. The S&P500 finished the quarter up 1.9% along with the FTSE100 up 5.3% while the Shanghai Composite closed down 2.8% and the Nikkei 225 was weak, down 7.1%. The Federal Reserve left rates unchanged. Iron ore finished up 3.0%, though 21.0% below April peaks, oil remained strong up 24.0% and the Australian Dollar (AUD) closed weaker down 2.7% at 74.5 US cents.

Sector performance was mixed. Defensives and rate sensitive sectors such as healthcare (up 10.2%), REIT's (up 9.2%) and utilities (up 9.0%) all performed strongly on the likely postponement of US interest rate rises and heightened economic uncertainty. The outperformance of supposedly 'earnings certain' stocks, in turn driven by the uncertain global macro environment, has been the overriding market theme over the past year and has been the key reason as to why our value portfolio of stocks has underperformed the broader Index over the past quarter and twelve months. Key outperformers such as CSL (up 30.0% over the past twelve months), Transurban (up 29.0%) and Sydney Airports (up 39%) have simply not satisfied our value criteria over this period. Metals & mining (up 15.3%) and energy (up 4.9%) also outperformed on improving commodity prices.

Trust activity

The strongest Trust performers included Newcrest Mining (up 35.6%) which rallied on the stronger gold price, Aristocrat (up 35.0%) which delivered a very strong interim result and continues to take share from competition in a flat market and AWE (up 23.0%) on higher oil prices and a take-over proposition. Graincorp (up 15.5%) and Stockland (up 13.2%) also performed well.

Holdings which underperformed included Flight Centre (down 26.9%) following a profit warning and subdued outlook, Henderson Group (down 20.1%) reflecting concerns for UK-exposed stocks and AMP (down 10.9%) as a result of generally cautious sentiment towards global equity markets. We are comfortable with the outlook for each of these companies.

During the quarter, we exited Fairfax Media, and reduced our holdings in the banks, reflecting lesser confidence in the domestic economic outlook. Proceeds were reinvested in Resmed and Westfield Holdings, which performed comparatively well, notwithstanding its UK exposure. Prior to the Brexit announcement, our Trust exposure to UK financials, CYBG plc and Henderson Group, was substantially reduced by selling at an average price of $5.43 and $5.08 respectively. Following the announcement, the portfolio repurchased both stocks at prices some 20.0% lower. The Trust has been increasing its holding in AGL Energy, where the outlook is solid and the NSW electricity wholesale price continues to strengthen. Gas prices have recently spiked in the cold weather which should help AGL given their investments in gas storage. The Trust also increased its holding in Flight Centre at attractive prices. At quarter end, stock numbers were 47 and cash was 4.3%.

Environmental, Social and Corporate Governance (ESG)

Perennial Value remains alert and active in ESG issues. Earlier in the year, we wrote to the Board of Ansell regarding their executive remuneration policy. Our strong preference was to adopt an approach which combined hurdles tailored to company and sector specific financial metrics, earnings per share targets, and return on capital targets, and to exclude the commonly adopted total shareholder return (TSR) metric. The key reason for this is that share prices may not reflect the underlying performance of the business in the short to medium term. Pleasingly, during the quarter, Ansell advised changes to its executive remuneration framework and adopted all of our recommended changes.

Outlook

In recent months, we have become more cautious about domestic economic conditions and have reduced our overweight positions in the building and construction-related stocks as well as the banking sector. Further, the close election result is unfavourable given the policy uncertainties this creates. The Trust remains mildly overweight in the large-cap, low-cost, financially-sound resources companies. We have very selectively increased our exposure in REITs and healthcare. Infrastructure remains heavily underweight given that sector's high leverage at a time of historically low interest rates. The Trust continues to exhibit Perennial Value's true to label value characteristics, with the portfolio offering better value than the overall market on each of our four valuation characteristics; price to earnings, price to free cash flow, gross dividend yield and price to net tangible assets.

As always, our focus will continue to be on investing in quality companies which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors.

Top 10 Holdings

Stock name	Trust weight %	Index weight %
Commonwealth Bank	7.8	9.1
Westpac Banking Corporation	6.2	7.0
Telstra Corporation	6.0	4.8
BHP Billiton Limited	5.7	4.3
ANZ Banking Group Limited	5.5	5.0
National Australia Bank	5.1	4.8
Wesfarmers Limited	4.3	3.2
Woolworths Limited	3.2	1.9
Woodside Petroleum	3.1	1.4
Macquarie Group Limited	2.9	1.7

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	5.5	4.1
Materials	13.9	14.1
Industrials	1.1	8.1
Consumer Discretionary	9.7	5.3
Consumer Staples	8.7	6.8
Health Care	2.8	7.2
Financials-x-Real Estate	36.8	35.4
Real Estate	8.4	9.6
Information Technology	0.0	1.2
Telecommunication Services	6.9	5.6
Utilities	2.0	2.7
Cash & Other	4.3	-

Rounding accounts for small +/- from 100%.

Signatory of:

PRI Principles for Responsible Investment

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