Perennial Value Shares for Income Trust

Monthly Report
31 August 2016

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Shares for Income Trust*	-0.5	1.4	5.1	3.2	6.3	11.7	6.8
S&P/ASX 300 Accumulation Index	-1.6	2.1	4.7	9.7	6.6	9.5	5.7
Value Added (Detracted)	**1.1**	**-0.7**	**0.4**	**-6.5**	**-0.3**	**2.2**	**1.1**
Capital Growth	-0.5	-2.5	4.9	-6.6	-0.7	4.7	0.4
Income Distribution	0.0	3.7	0.0	9.1	6.2	6.1	5.6
Net Performance^^	-0.5	1.2	4.9	2.5	5.5	10.8	6.0

*Gross Performance. ^Since inception: December 2005. ^^This refers to the Trust's gross performance net of investment management fees. Past performance is not a reliable indicator of future performance.

Perennial Value Shares for Income Trust

The Trust aims to provide investors with an attractive level of tax effective income, which the Trust aims to pay via quarterly distributions. The Trust aims to provide a dividend yield, adjusted for applicable franking credits and before fees, above that provided by the S&P/ASX 300 Accumulation Index*.

Portfolio manager:
Stephen Bruce

Risk profile:
High

Trust FUM (as at 31 August 2016):
AUD $37 million

Income distribution frequency:
Quarterly

Team FUM (as at 31 August 2016):
AUD $9.3 billion

Minimum initial investment:
$25,000

Trust inception date:
December 2005

APIR code:
IOF0078AU

*Gross dividend yield.

- **Over the 12 months to August 2016, the Trust has delivered a pre-tax distribution yield (i.e. including franking credits) of 11.4%.**
- **Since inception in December 2005, the Trust has delivered a pre-tax distribution yield of 7.6% per annum.**
- **The market fell in August, with the S&P/ASX300 Accumulation Index (the Index) down 1.6%.**

Trust characteristics

In line with the objective, the Trust continues to invest in a portfolio of financially sound companies which demonstrates superior dividend yield characteristics to the overall stock market.

Trust Performance

The Index fell in August, finishing the month down 1.6%. The Perennial Value Shares for Income (the Trust) fell 0.5%, outperforming the Index by 1.1%.

The international markets were mixed with the S&P500 down 0.1%, FTSE100 up 0.9%, Nikkei 225 up 1.9% and the Shanghai Composite up 3.6%. Metal prices eased post their recent rallies, with nickel down 8.6%, copper down 5.2%, gold down 3.4% and iron ore down 2.8% over the month. The oil price closed up 8.4%, having rallied 21.0% intra-month. The Federal Reserve left rates unchanged and the Reserve Bank of Australia (RBA) reduced rates by 25 basis points to 1.5%, with the Australian Dollar (AUD) finishing the month down 0.5 cents at 75 US cents.

Reporting season was the highlight of the month. As expected, results were generally subdued, with soft revenue growth, an ongoing focus on cost control and weak earnings growth. Industrial earnings were mixed but overall flattish, while bank earnings declined slightly and resource earnings fell sharply on lower commodity prices.

In terms of overall dividend outcomes, 67.0% of the Trust holdings which reported increased or maintained their dividends, while 33.0% - predominantly our resource exposures - reduced their dividends.

The reporting season saw a reversal of the trends of the past twelve months, with many of the "expensive defensive" parts of the market underperforming, having failed to meet the market's very high expectations. Notable examples of stocks which we have not held on the basis of overvaluation include Blackmores (down 21.5%), REA Group (down 9.5%), Transurban (down 8.8%), Brambles (down 8.4%) and CSL (down 8.4%). Interestingly, despite the share price falls, these stocks are still trading on demanding valuations, with FY17 price to earnings (P/E) ratios of 20 to 30 times, suggesting further downside risk.

By contrast, we were pleased to see strong performances from some of the out of favour stocks we hold which we believe offer very good value. Holdings which performed particularly strongly included Downer EDI (up 20.4%) which delivered a solid result in challenging conditions and guided for FY17 profits significantly higher than market forecasts, as it manages the transition from a mining services focus towards public infrastructure and services provision.

Flight Centre (up 14.6%) performed well despite reporting slightly lower earnings as a result of discounting by airlines. Despite this headwind, the company is continuing to invest and expand its global footprint to underpin future growth. Harvey Norman (up 11.2%) outperformed after delivering a very strong result, with profit up 20.0% and the dividend increased by 50.0%. All of these businesses have strong market positions, good management and are trading at attractive valuations. Further, they are underpinned by strong balance sheets which allowed them to maintain or increase their dividends.

Resource stocks Woodside Petroleum (up 9.6%) and BHP (up 4.7%) performed well. Despite reporting earnings which were down significantly on last year, the large resources companies have achieved significant unit cost and capex reductions. Combined with recent rally in commodity prices this should see stronger cash generation going forward. CBA (down 4.3%) was the only major bank to report, with flat earnings per share (EPS) and dividends highlighting the earnings pressure the sector is facing, and the reason the Trust has reduced its exposure to the sector.

Stocks which detracted from performance included AGL Energy (down 8.1%) which declined after indicating the benefit of stronger wholesale electricity prices is expected to moderate, QBE Insurance (down 7.7%) which fell on a rise in Australian claims costs and AMP (down 7.1%) which slipped after a disappointing result from the life business. We remain comfortable with the outlook for each of these businesses and note that each has internal initiatives underway to address these issues and improve performance.

Trust Activity

During the month we took profits and reduced our holdings in Stockland and Scentre Group. These stocks had performed very strongly, delivering total returns of 30.3% and 36.0% respectively over the last 12 months. We also further reduced our holdings in the major banks on the basis that, while they are fundamentally strong businesses, they face a number of near-term headwinds which, cumulatively, will likely depress earnings growth. Proceeds were used to initiate a position in Platinum. The stock was sold off following a weaker than expected result, allowing us an attractive entry price. However, this stock offers an attractive FY17 gross yield of 7.6%, has a very strong balance sheet and is also leveraged to a lower AUD as this would boost its assets under management. Further, the relative performance of its funds would be expected to improve should the current rotation into value stocks continue. At month end, stock numbers were 25 and cash was 3.5%.

Outlook

The Trust remains exposed to the theme of ongoing transition to the East coast economy through overweight positions in consumer discretionary, building and construction-related stocks. The Trust remains overweight in the large-cap, low-cost, financially-sound resources companies. We remain underweight the "expensive defensive" sectors of the market such as healthcare, infrastructure and REITs. These sectors have become a crowded trade and valuations remain stretched as a result of historically low interest rates. The portfolio continues to exhibit Perennial Value's true to label value characteristics, 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. Further, we believe the current very low interest rates highlight the relative attractiveness of financially-sound, high dividend yielding equities.

Top 10 Holdings

Stock name	Trust weight %	Index weight %
Commonwealth Bank	9.0	8.5
Telstra Corporation	8.9	4.4
Westpac Banking Corporation	6.9	6.8
Wesfarmers Limited	6.0	3.3
BHP Billiton Limited	5.6	4.5
ANZ Banking Group Limited	5.4	5.4
National Australia. Bank	5.3	5.0
Event Hospitality	4.9	0.0
Woodside Petroleum	4.4	1.4
AGL Energy Limited	4.0	0.9

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	4.4	4.1
Materials	11.9	14.7
Industrials	1.2	7.4
Consumer Discretionary	10.6	5.5
Consumer Staples	6.0	7.2
Health Care	0.0	7.3
Financials-x-Real Estate	43.7	35.4
Real Estate	6.0	9.4
Information Technology	0.0	1.3
Telecommunication Services	8.9	5.1
Utilities	4.0	2.6
Cash & Other	3.5	-

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

Signatory of:

PRI Principles for Responsible Investment