PERENNIAL FIXED INTEREST

Perennial Cash Enhanced Wholesale Trust

Monthly Report as at 31 August 2012

	Month %	Quarter %	FYTD %	1 Year %	2 Years % p.a.	3 Years % p.a.	5 Years % p.a.
Perennial Cash Enhanced Wholesale Trust*	0.66	1.79	1.26	6.14	6.24	6.48	6.44
UBS Bank Bill Index	0.30	0.88	0.59	4.44	4.72	4.55	5.17
Value Added (Detracted)	**0.36**	**0.91**	**0.67**	**1.70**	**1.52**	**1.93**	**1.27**
Net Performance	0.63	1.70	1.19	5.74	5.82	6.06	6.02

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

- The Trust outperformed the Index return by 0.36%.
- Our view still has the cash rate falling to 3.00% late this year or early next year.
- Corporate debt remains our preferred sector and we maintain an overweight position, with an emphasis on large financials

Performance

Australian bond and money markets ended the month at slightly lower yields than at the start of the month. However, August was a story of two very different halves. The earlier part of the month was characterised by a sharp sell off in bonds (rise in yields) as confidence returned following comments from the president of the European Central Bank (ECB) that the ECB would do 'whatever it took' to save the Euro. This also saw spreads on non government securities narrow and outperform treasuries. The second half of the month was characterised by some negative developments from China. This caused falls in commodity prices, in particular iron ore, and led to questions about Australia's capex outlook as miners such as BHP Billiton Limited delayed or cancelled some large projects including Olympic Dam. These developments caused yields to fall sharply below the levels seen earlier in the month. Interestingly, non government securities, including corporate credit, held their ground well through this period.

The UBS Bank Bill Index (the Index) returned 0.30% over the month. High quality corporate Floating Rate Notes (FRNs) materially outperformed bank bills, with the narrowing of the credit margins adding to the running yield advantage these securities offer. The Perennial Cash Enhanced Wholesale Trust (the Trust) outperformed the Index, returning 0.66% over the month.

Interest rate strategies had a neutral impact on performance over the month. Sector strategies were the primary reason for the outperformance. Spread sectors, such as overweight allocations to semi-governments and corporate FRNs, performed particularly well over the month. Security selection, including overweight allocations to banks as well as their covered bonds and diversified financials, also added value.

Perennial Cash Enhanced Wholesale Trust: Fund Facts

The Trust aims to provide a total return that exceeds the benchmark, UBS Bank Bill Index, over rolling three-year periods by 0.50% p.a. (before fees).

Portfolio Manager: Glenn Feben	**Risk Profile:** Low
Trust FUM (as at 31/08/12): AUD89.6 million	**Income Distribution Frequency:** Quarterly
Team FUM (as at 31/08/12): AUD6.0 billion	**Minimum Initial Investment:** $25,000
Trust Inception date: August 1994	**APIR code:** IOF0047AU

Ratings: Lonsec Recommended

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At month end, the weighted average yield of the Trust was 4.67%, as compared to the Index yield of 3.62%.

Market Review

The Australian bond market recorded moderate returns over August, with yields slightly lower. At the shorter end of the curve, three year government bonds were volatile, with yields rising to as high as 2.88% on firmer domestic data. The commentary from the Reserve Bank of Australia (RBA) suggested it was happy with current policy settings and expectations of deeper ECB support for troubled European sovereigns. However, yields rallied over the second half of the month as it became clear that Chinese growth was moderating and the lack of follow up detail on the ECB's plans began to unwind earlier optimism. By month end, the yield on a three year government bond was 10 basis points (bps) lower at 2.47%. Expectations of near term easing were pushed back, with the yield on a 90 and 180 day bank

bill rising by 7 bps and 2 bps, respectively, to close the month at 3.65% and 3.59%.

Domestic data readings were mixed over the month. On the stronger side were June retail trade and June quarter capital expenditure data, which pointed to a significant lift in spending over 2012/2013. On the weaker side, business conditions in the NAB Survey fell, as did consumer sentiment. July building approvals fell sharply, while June quarter residential building was also very weak.

At the longer end of the curve, the yield on an Australian ten year government bond ended the month 2 bps lower at 3.09%. Intra month directional moves were similar to the three year bond, with the long bond yield reaching a high of 3.48%, before rallying over the latter part of the month. However, as the long bond rallied less than the three year bond, there was an 8 bps rise in the spread between them, which ended the month up 62 bps.

Credit markets again performed well with spreads on almost all sub sectors outperforming government bonds. The early part of the month was especially strong as the expectation of significant developments in Europe resulted in strong demand for higher yielding investments. This strength dissipated somewhat late in the month as concerns about a slowdown in the Australian resources sector pushed spreads a touch wider. Primary markets were active throughout the month, with the trend of ASX listed debt securities continuing. Both the APA Group and Crown Limited launched new issues. Four separate residential mortgage backed securities (RMBS) deals were also launched, signaling a return to life for this sector, and global energy company BP launched its inaugural AUD deal.

Market Outlook

Recent commentary from the RBA suggests that its base case outlook remains for trend rates of growth for both the global and domestic economy, along with inflation rates consistent with target rates over the next two years. However, the RBA sees downside risks to the global growth outlook, flagging the drag in confidence from events in Europe and the impact of sluggish growth in China on Australia's commodity prices. The policy conundrum of the exchange rate has also made it on to its worry list, with the RBA noting that safe haven flows are holding up the exchange rate when it would normally be falling in line with commodity prices. If sustained, this potentially robs the economy of one of its shock absorbers and places a greater burden on monetary policy. The pressure on monetary policy is being compounded in the near term by the government's singular focus on returning the budget to surplus to suit its political agenda.

Given the dynamics, we still maintain our base case view of two further easings with the cash rate bottoming at 3.00% late this year or early next year. Thereafter, we see a long pause and then a gradual modest tightening cycle as fiscal policy no longer remains a significant drag on growth, the global economy responds to recent and prospective stimulus and the Australian economy responds with a lag to recent and prospective monetary easing. Market expectations for the nadir in this cash rate easing cycle have pushed lower, from 2.75% by April 2013 at the end of July, to 2.50% by mid 2013 in early September. This is more than we expect, so we see the shorter end of the curve as expensive. At the longer end, we see little value in a long bond at around 3.00%, with investors vulnerable to any improvement in the economic outlook or recovery in risk appetite and on a longer timeframe, any lift in inflation. We continue to persist with defensive interest rate strategies

Despite the recent tightening in sector spreads relative to government bonds, we remain favourably disposed to sectors other than government bonds, most notably semi-government and corporate debt. This view in part reflects our expectation that the low interest environment we are currently in will persist for some time and in such an environment additional yield becomes increasingly valuable. Further to this, spreads remain at levels well above longer term averages. We maintain an overweight allocation to these sectors. Within the corporate sector our emphasis is on large financials and in particular, the senior debt of the 'big four' Australian banks, listed property trusts and selected infrastructure/utility debt.

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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	0.13
Index	0.12
Active Position	0.01

Interest rates – Neutral duration. Following the meaningful sell off in bonds and money market securities earlier in the month of August, we moved the Trust's duration in line with the Index, as yields headed towards our assessment of 'fair value'. However, based on current market pricing, cash rate expectations are for a 100 bps easing in monetary policy by mid 2013. This is certainly more pessimistic than our expectation of where cash rates are likely to head over the next 12 months given our forecasts for the economy and inflation outlook. Notwithstanding this, bank bill pricing still has some funding premiums embedded and are not necessarily as expensive as one might conclude. Accordingly, we have a broadly neutral duration stance.

Corporate Debt and asset backed – Overweight. Spread sectors, particularly corporate FRNs, continued to be favoured over risk free assets on a forward looking basis given the handsome running yield advantage and some potential for capital gains through spread contraction. In our view, these valuation characteristics coupled with the fact that company fundamentals are relatively healthy, make this area of the debt market the sweet spot for investors. Accordingly, we remain overweight this sector and expect that it will outperform risk free assets over the medium term. Our favoured sub-sectors are low risk 'AAA' covered bonds from the "big four" Australian banks as well as senior bonds, listed property trusts, and infrastructure debt. More recently, we have been switching some of our covered bond exposure for prime AAA rated fully documented Australian RMBS and receiving almost double the credit spread.

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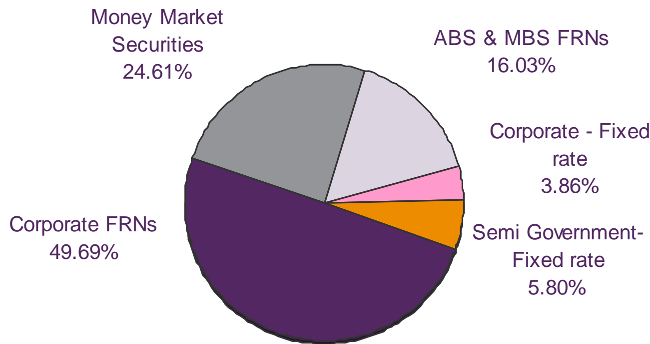
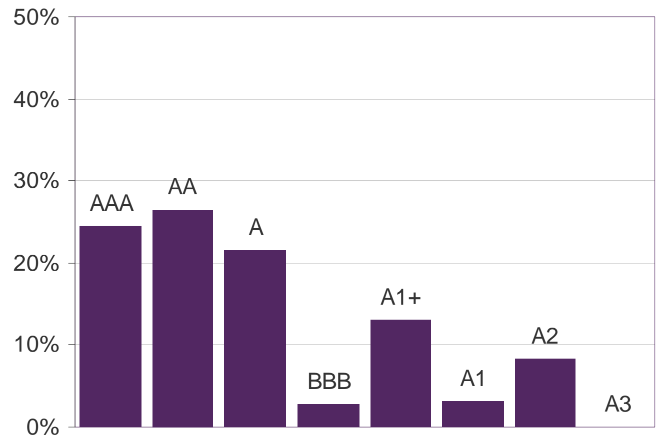
Trust Snapshot





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