PERENNIAL FIXED INTEREST

Perennial Australian Fixed Interest Trust

Monthly Report as at 31 March 2013

	Month %	Quarter %	FYTD %	1 Year %	2 Years % p.a.	3 Years % p.a.	5 Years % p.a.
Perennial Australian Fixed Interest Trust*	-0.03	0.61	5.26	9.19	9.21	8.79	9.49
UBS Composite Bond Index (0+years)	-0.20	0.16	2.36	7.04	8.51	7.96	7.83
Value Added (Detracted)	**0.17**	**0.45**	**2.90**	**2.15**	**0.70**	**0.83**	**1.66**
Net Performance	-0.06	0.52	4.98	8.80	8.83	8.41	9.10

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

- Despite a renewal of the sovereign crisis in Europe, global bond markets continued to lose ground during March.
- While the Index and the Trust were pushed into negative territory, the Trust outperformed the Index return by 0.17%.
- The key influence on the Trust's strong relative performance was its short duration.

Performance

Despite a renewal of the sovereign crisis in Europe, this time in regard to Cyprus, global bond markets continued to lose ground during March as confidence in the global macroeconomic environment strengthened. This was also evident in the local market, where surprisingly strong employment data together with signs of recovery in retail spending and housing led markets to question whether we had reached the end of the monetary easing cycle. This dragged bond yields higher, with the adverse valuation impact associated with rising yields pushing the UBS Composite Index 0+ years (the Index) into negative territory.

The Index finished down 0.20% taking its return for the current financial year to a meagre 2.36%. While not immune to the impact of higher yields, the Perennial Australian Fixed Interest Trust (the Trust) finished down 0.03% and comfortably outperformed the Index return by 0.17%. Financial year to date, the Trust's return is 5.26%, outperforming the Index by 2.90%.

The key influence on the Trust's strong relative performance was its short duration, which served to protect the Trust from the impact of rising bond yields. Sector and security strategies also added value, given the Trust's overweight allocation to corporate debt which outperformed government bonds. At the security level, exposure to the senior debt of property trusts, infrastructure and selected higher rated financials also added value.

Market Review

Bond yields rose over the month and negatively impacted bond market returns. The key driver was the market reducing the amount of monetary easing it expected. This shift in thinking more than offset spasmodic rallies off the back of the uncertainty caused by the clumsy journey to a €10 billion bailout deal for Cyprus.

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 31/03/13): AUD1.3 billion	**Income Distribution Frequency:** Quarterly
Team FUM (as at 31/03/13): AUD6.6 billion	**Minimum Initial Investment:** $100,000
Trust Inception date: August 2002	**APIR code:** IOF0113AU

On the data front, the release of Q4 national accounts early in the month confirmed that the private sectors of the domestic economy finished the year on a weak note. Thanks to a sharp lift in public final demand and a rebound in export volumes, overall GDP growth posted a respectable 0.6% gain over the quarter and 3.1% over the year.

Subsequent releases pointed to some tentative improvement in private sector conditions. Retail sales rose by a much stronger than expected 0.9% in January. Labour force data also surprised on the upside, with an unbelievable 71,500 gain in employment over February, while the unemployment rate remained unchanged at 5.4%. Consumer sentiment rose again in March, with forward looking components, like time to buy a house or major appliance, quite buoyant. On the softer side, business surveys reported a fall in forward orders and difficult conditions caused by ongoing currency strength. The latter is likely to help keep inflation low and open the door for further easing in H2.

Against this backdrop, the three year government bond yield reached a high of 3.15% following the release of the labour force data before ending the month at 2.87%. Yields at the shorter end of the curve were higher as markets became less convinced of near term easing. Three and six month bank bills ended the month 13 and 19 basis points higher at 3.10% and 3.12%, respectively.

At the longer end of the yield curve, the ten year government bond yield reached a high of 3.68% mid-month on stronger domestic and offshore data. The rejection of the initial bail out deal for Cyprus led to renewed risk aversion and helped push long bond yields lower over the latter part of the month. The long bond yield finished the month 7 basis points higher at 3.42%. Given these moves, there was some further flattening in the spread between three and ten year government bonds, which came in 6 basis points, to +55 basis points.

Credit markets gave up all of the previous month's gains, with the iTraxx index closing 7 basis points wider at 121 basis points. The weakness seen over the course of the month was in-line with the weaker tone seen in domestic equity markets. Primary markets were steady, with financials being the main issuers over the month. The Bank of China and Rabobank priced deals that were very successful, while GE Capital increased its 2022 line, which again demonstrated the domestic market's willingness to lend out to 10 years.

Market Outlook

RBA commentary suggested that it continues to hold an easing bias and our view remains that the growth and inflation outlook allow them room to ease further if activity levels in the interest rate sensitive sectors of the economy remain lacklustre. We continue to believe that on balance the RBA is likely to ease further in H2 and recent currency strength, if maintained, will continue to create significant head winds in the certain parts of the economy. From 2014 onwards, we look for the RBA to gradually begin removing policy accommodation.

We remain on the lookout for evidence of a positive feedback loop developing between improving asset markets and the real economy that would negate the need for further easing. Our view remains that we are very close to the end of the easing cycle and the rise in yields across the curve this month is a reminder of the capital loss that occurs when expectations shift. We continue to hold a strategic defensive duration bias and regard further rallies in yields from current levels as an opportunity to extend that position.

We retain an overweight allocation to corporate debt, which we expect will continue to be supported by sound corporate fundamentals and keen demand from investors seeking high quality yield. Nevertheless, with investment grade spreads approaching their lowest level since the GFC we trimmed our overweight position slightly and have a bias to trim further during periods where spreads are very tight. More generally, we view the current level of spreads as being around "fair value" and expect future outperformance to be driven more by the higher income the sector offers as opposed to capital gain that occurs as spreads tighten.

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:

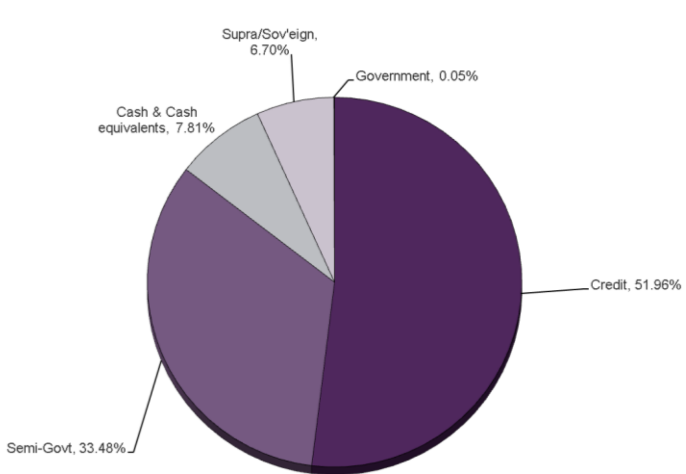
Modified Duration	Years
Trust	3.15
Index	3.97
Active Position	-0.82

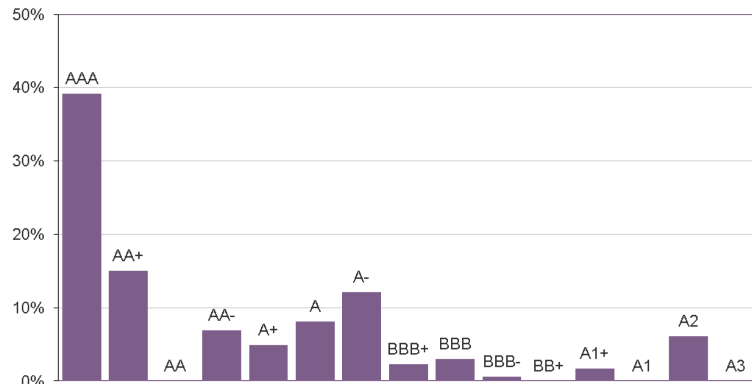
Interest rates – underweight duration:
During the course of the month, as bond yields rose, we temporarily reduced our short duration position having protected capital. However, in the latter part of March when bond yields fell somewhat during the Cyprus fiasco, the short duration stance was increased again to about 0.80year underweight by month end. While we find the short end of the yield curve reasonably priced, including the path of cash rates priced in by markets, we continue to be concerned about long term bond yields and the prospects of a material selloff at some stage. Accordingly, we continue to manage portfolios with a short duration focus.

Overweight Corporate Debt:
This is probably the area where we have made some meaningful shifts in our thinking in terms of the value the sector still has to offer. While credit spreads have tightened considerably over the past six to nine months, and have provided a terrific tailwind to performance, we find it harder to justify aggressive overweight positions at current levels. We would describe credit spreads at the moment as 'fair value' and have taken some of the previously overweight allocation out of the sector favouring government sectors such as semi-governments. Our overweight allocation to the credit sector has been trimmed by about one third of what it has been for much of the past year, but we still run an overweight position to take advantage of the running yield advantage the sector has to offer.

Overweight semi-governments (including government guaranteed):
Our government exposure is concentrated in semi-government and government guaranteed securities.
We have recycled some funds from other sectors, such as credit, into what we believe to be this relatively stable and very attractive sector within the bond market. In our view, the yield advantage, relative to government bonds, justifies a meaningful allocation to the sector with some prospect of the bond/semi margin narrowing in the future as 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





Rounding accounts for small +/- from 100%.

Signatory of:

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