Perennial Value Australian Shares Trust

Quarterly Report
30 September 2015

	Quarter	FYTD	1 year	3 years	5 years	Since Inception*
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Australian Shares Trust*	-8.1	8.1	0.0	11.5	6.4	10.7
S&P/ASX 300 Accumulation Index	-6.5	6.5	0.7	9.1	6.3	7.5
Value Added (Detracted)	**-1.6**	**-1.6**	**0.7**	**2.4**	**0.1**	**3.2**
Net Performance	-8.3	8.3	-0.9	10.5	5.5	9.8

*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 September 2015):
AUD1.4 billion

Income distribution frequency:
Half yearly

Team FUM (as at 30 September 2015):
AUD8.1 billion

Minimum initial investment:
$25,000

Trust inception date:
March 2000

APIR code:
IOF0200AU

- **Globally, the quarter was dominated by extreme gloominess about the prospects for growth in China.**
- **The other main focus of the quarter was reporting season. Results were generally in line with expectations, with industrials delivering modest Earnings per Share (EPS) growth while resource company earnings fell sharply due to lower commodity prices.**
- **The best performing stock in the Trust for the quarter was Asciano (up 26.3%) following a takeover offer from Brookfield.**

The market sold off in the September quarter, with the S&P/ASX300 Accumulation index (the Index) ending the quarter down 6.5% and the Perennial Value Australia Shares Trust (the Trust) underperforming the index by1.6%. The sell-off, in our view, has been very much led by global macro funds taking a very bearish view on the outlook for China and therefore Australia. The Trust's underperformance was primarily due to the sell-off in housing and resource stocks. This is discussed in more detail below. The resultant downward move in share prices has also been magnified by unusually low stock turnover levels during the quarter, particularly in September, where the market fell down 2.9%. Investors should note that while the market has fallen down13.9% from its peak in April, it has delivered a largely flat return of - 0.7% for the last 12 months.

Globally, the quarter was dominated by extreme gloominess about the prospects for growth in China. Key data disappointed, including the latest monthly production and investment prints, alongside the manufacturing Purchasing Managers Index (PMI) and many investors seem to be losing faith that China can maintain growth of close to the 7.0% target. This is despite even more stimulus being announced and further exchange rate depreciation. The weakness in China is reverberating through the region, with Taiwan, Singapore and now Japan in technical recession. Outside Asia, however, the news was better, with European growth seemingly tracking close to 2.0%, although inflation across the region has dropped back close to zero. Similarly, the US economy is doing well, although employment growth was unexpectedly weak early in the month. The Federal Reserve (the Fed), however, baulked at raising interest rates, citing offshore "wobbles" as a key reason for caution. Equity markets had a very tough quarter, with most indexes losing further ground, as many investors reassessed the prospects of a world without the same momentum in China's growth engine.

In Australia, the biggest development was not in economics, but in politics, with Malcolm Turnbull successfully challenging incumbent Tony Abbott to become Australia's fifth Prime Minister in as many years. There has been no significant policy change yet, but consumer and business confidence likely will lift on hopes of a fresh start, particularly around economic reform. The domestic data was a mixed bag. Retail sales growth was weak and consumer and business confidence fell, but the August employment report was much better than expected and the jobless rate fell slightly to 6.2%. The Q2 Gross Domestic Product (GDP) report was also underwhelming, showing that growth was barely positive, albeit after a decent Q1. The Australian Dollar (AUD) weakened further over the quarter, in line with Reserve Bank of Australia (RBA) expectations, dropping below 70 US cents, and the RBA leaving the cash rate steady.

The other main focus of the quarter was reporting season. Results were generally in line with expectations, with industrials delivering modest Earnings per Share (EPS) growth while resource company earnings fell sharply due to lower commodity prices. Low top-line growth was again a feature of results, with a significant proportion of earnings improvement being driven by cost-out and internal improvement programs.

Currency was also a major driver, with many companies beginning to see benefits from the lower AUD. This particularly favoured companies with significant offshore earnings. Outlook statements were again cautious given the uncertain economic environment and weak demand conditions both domestically and globally.

Of the Trust's holdings, 34 companies representing 70% of the Trust reported. Of these, the majority showed earnings and dividend growth, with 21 companies increasing their EPS and 23 companies increasing their Dividend per Share (DPS). This ongoing increase in dividends is particularly pleasing as it reflects the generally strong financial position of corporate Australia and allows shareholders to be rewarded while they wait for stronger earnings growth. Holdings which showed particularly pleasing earnings growth were Boral (EPS up 45%, DPS up 20%), Amalgamated Holding (up 44%, up 26%), Henderson Group (up 31%, up 19%), Orora (up 26%, up 25%) and Harvey Norman (up 25%, up 143% inclusive of a special dividend).

In this risk-off environment with concerns over Chinese growth, industrial and defensive sectors tended to outperform, with industrials (up 3.6%), utilities (up 1.8%), consumer staples (up 1.5%), REITs (up 1.1%) and consumer discretionary (up 1.1%) while resources (down 16.4%) fell sharply, with energy (down 24.1%) and metals and mining (down 12.8%) and financials (down 9.6%) with the major banks falling an average of 11.3%.

The best performing stock in the Trust for the quarter was Asciano (up 26.3%) following a takeover offer from Brookfield. Other strong performers included BlueScope Steel (up 21.0%), Aristocrat Leisure (up 12.5%), Brickworks (up 12.5%), Orora (up 12.4%), Fairfax (up 11.0%), CIMIC Group (up 10.2%), Flight Centre (up 8.7%), Graincorp (up 6.9%), Henderson Group (up 5.6%) and Amalgamated Holdings (up 5.2%).

In terms of stocks which detracted from performance, the sell-off in housing-related companies held in the Trust has been significant and, we believe, often indiscriminate, including Boral (down 23% off August highs), Harvey Norman and Lend Lease (both down 20%) and Stockland (down 11%). Perennial Value does not subscribe to this sudden and negative change in sentiment, which appears to be driven by an overheated apartment building sector. Each of the building-related companies has diversified earnings streams. Boral's domestic housing exposure represents 21% of total profits, Lend Lease around 10% and Stockland 30% to 35%. Stocks held also generally have a far greater reliance on detached housing and renovations, where the cyclical upturn to date has been more muted. These companies have their largest presence in the eastern seaboard, especially New South Wales (NSW) where the detached housing cycle most likely has at least two years to run. Queensland is only starting to improve while Victoria is likely to slow from a high level. During the quarter, Brickworks (up 12.5%) delivered a record FY15 profit result and highlighted strong momentum in building approvals on the east coast, with an "extremely strong order book in most east coast divisions". Further, this group of companies offers significant value at current levels. Harvey Norman, for example, is currently trading on a prospective FY16 gross yield of 8.0%, Lend Lease on a FY16 P/E of 11.2x and Stockland on a FY16 price to NTA of 1.0x. Thus, we continue to retain these stocks in the Trust.

With regards to our materials and resources exposure, the Trust has held a range of companies providing select, diversified industry exposure. From a portfolio construction perspective, given global macro uncertainties, we have ensured in recent times that the Trust was not overly exposed to any one stock. Notwithstanding, this sector took the brunt of the global macro sell-off. Stock holdings which were hardest hit included AWE (down 48.8%), Origin Energy (down 47.0%), Orica (down 29.3%), Downer (down 27.6%), South32 (down 23.7%), Iluka Resources (down 18.4%) and BHP (down 14.6%).

In terms of Trust movements during the quarter, we sold out of Ansell on valuation grounds at an average price of $25.00, having bought in at an average price of around $18.60 in mid-calendar year 2014. We also took profits and reduced our holdings in a number of stocks which had performed strongly including AMP, Asciano, BlueScope Steel, Henderson Group, Macquarie Group and Sims Metal.

We used the weaker market to reinvest the proceeds into existing holdings where we believed the share price falls to be overdone, including AWE, Harvey Norman, Flight Centre, Newscorp, Sandfire Resources and Woolworths. We also increased our holdings in ANZ and CBA, with the Trust participating in their capital raisings as well as Westpac. In mid-September, we reduced the Trust's exposure to Origin at an average price of $7.13 and it closed the month at $6.10. On 30 September, Origin announced $4.7 billion of capital initiatives, including a $2.5 billion capital raising, to strengthen its balance sheet. This comes on top of recently announced $2.2 billion in capital initiatives, including capex reductions, reduced cost of doing business and asset sales.

Perennial Value Management (PVM) remains alert to Environmental, Social and Corporate Governance (ES&G) issues in the Trust. During the quarter, Harvey Norman announced an investment in a dairy farming operation. In our view these types of non-core investments are not in the interests of shareholders and we expressed this to management and the board and will take the issue up again ahead of the AGM.

At quarter end, stock numbers were 45 and cash was 2.3%.

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	4.1%	4.0%
Materials	20.0%	14%
Industrials	3.2%	8.0%
Consumer Discretionary	10.8%	4.7%
Consumer Staples	6.6%	7.1%
Health Care	0.0%	6.4%
Financials-x-Real Estate	40.3%	38.4%
Real Estate	4.1%	8.4%
Information Technology	0.0%	1.1%
Telecommunication Services	6.3%	5.7%
Utilities	2.5%	2.3%
Other	2.3%	-

Rounding accounts for small +/- from 100%.

Top 10 Holdings		
Stock name	Trust weight %	Index weight %
Commonwealth Bank	8.2%	9.3%
Westpac Banking Corp	8.0%	7.1%
National Aust. Bank	7.8%	5.9%
ANZ Banking Grp Ltd	6.6%	5.9%
Telstra Corporation.	6.2%	5.2%
BHP Billiton Limited	6.0%	5.4%
Macquarie Group Ltd	3.5%	1.9%
Woolworths Limited	3.0%	2.4%
QBE Insurance Group	2.8%	1.3%
Woodside Petroleum	2.5%	1.5%