PERENNIAL FIXED INTEREST

Perennial Tactical Income Trust

Monthly Report as at 31 January 2013

	Month %	Quarter %	FYTD %	1 Year %	2 Years % p.a.	3 Years % p.a.	Since Inception % p.a.#
Perennial Tactical Income Trust*	0.31	1.45	5.43	8.61	7.38	7.55	8.81
UBS Bank Bill Index and UBS Composite Bond Index (0+years) equally weighted	0.02	0.39	2.00	5.58	6.64	6.15	6.02
Value Added (Detracted)	**0.29**	**1.06**	**3.43**	**3.03**	**0.74**	**1.40**	**2.79**
Net Performance	0.27	1.33	5.15	8.12	6.90	7.07	8.32

*Gross Performance. #Since inception 30 June 2009. **Past performance is not a reliable indicator of future performance.**

- The Trust exceeded the Index return by 29 basis points.
- The Trust benefited from its underweight fixed interest allocation.
- Outperformance was driven by a combination of value added from tactical asset allocation together with outperformance in the underlying trusts.

Performance

January was another difficult month for global bond markets as increasing optimism about the US economic outlook in particular, and the resolution of the fiscal cliff fuelled a further pick-up in investor risk appetite. Bond yields moved higher amidst concern that a major rebalancing from defensive to growth assets is underway.

The rise in yields was sufficient to push fixed interest returns into negative territory with the UBS Composite Index down 0.23%, while the Bank Bill Index returned 0.27%. As a result the Perennial Tactical Income Trust's (the Trust) equally weighted Index (the Index) returned 0.02%.

The Trust exceeded the Index return by 29 basis points (bps), returning 0.31% (gross) and 0.27% (net). As has been the case over recent months, outperformance was driven by a combination of value added from tactical asset allocation together with outperformance in the underlying trusts.

In regard to asset allocation, the Trust benefited from its underweight fixed interest allocation, albeit the size of this was wound back as the sell-off extended. Performance in the underlying trusts also added value. The Perennial Australian Fixed Interest Trust outperformed by 22 bps, returning -0.01% with the excess attributable to a combination of value added from duration and sector strategies. The Perennial Cash Enhanced Trust outperformed the Bank Bill index by 17 bps (0.44%versus 0.27%) while the Perennial Income Focused Trust, despite losing some ground over the latter stages of the month still managed to produce a solid result of 0.53% as compared to its Index of 0.41%.

Perennial Tactical Income Trust

The Trust aims to provide investment returns in excess of the Trust's benchmark the UBS Bank Bill Index and UBS Composite Bond Index (0+years) equally weighted by investing in a diversified portfolio of Australian income producing assets. The Trust aims to provide a total return (after fees), that exceeds the benchmark.

Portfolio Manager: Glenn Feben	**Risk Profile:** Low
Trust FUM (as at 31/1/13): AUD384.0 million	**Income Distribution Frequency:** Quarterly
Team FUM (as at 31/1/13): AUD6.4 billion	**Minimum Initial Investment:** $25,000
Trust Inception date: June 2009	**APIR code:** IOF0145AU

Ratings: Zenith Highly Recommended, Lonsec Recommended and Van Eyk 'BB'.

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Since inception, the key features of the Trust's performance are:

- Strong absolute return with a since inception return of 8.81% p.a. (gross).
- Strong relative performance with an excess return of 2.79% p.a.
- Consistent positive monthly returns.
- A more stable return profile than traditional fixed interest.

Market Review

Fixed interest returns were negatively impacted by a moderate rise in yields over the month. There were intermittent rallies on weaker economic data but these gave way to an assessment that improvements in the global growth outlook made a near term easing in monetary conditions less likely.

At the shorter end of the curve, yields drifted higher early in the month following progress on the US fiscal front. Three year government bond yields then rallied following the release of soft labour market data, in which employment fell 5,500 and the unemployment rate rose to 5.5%. Prices pressures were softer than expected with the CPI rising by 0.2% in Q4, while the average of the Reserve Bank of Australia's (RBA) statistical measures rose 0.54%.

Following the release of the CPI, the three year government bond rallied to its month low of 2.67%. Towards the end of the month, improving expectations for global growth led markets to push back the timing of the next easing despite softer domestic economic soundings. Against this backdrop, three and six month bank bills ended the month 12 and six basis points (bps) lower, both at 2.95%. The yield on a three year government bond ended 15 bps higher at 2.82%.

At the longer end of the curve, moves mimicked those at the shorter end with the ten year treasury getting to as low as 3.27% following the release of low CPI data. Yields rose again subsequently as risk appetite remained buoyant and ended the month 18 bps higher at 3.45%. Given these moves, there was some minor steepening in the spread between three and ten year government bonds, which rose three bps, to 63 bps.

Credit markets continued to find support in January with the iTraxx index finishing four bps tighter at 121 bps. As the uncertainty surrounding the US fiscal cliff dissipated, primary markets opened up and were quite active. Issuance was dominated by financial organisations, both domestic and overseas companies. In particular the domestic banks started the year with a large amount of issuance both in Australia and abroad as they sought to get well ahead on their 2013 funding requirements. With the recent strong equity market performance credit investors are eagerly awaiting the earnings season in Australia to gauge the health of Australian corporate balance sheets.

Market Outlook

Recent data releases vindicated the decision by the RBA to ease monetary policy in December by cutting the cash rate to 3.0%. Subsequent commentary from them suggested that they were holding a reactive mindset and we suspect that the run of weak data in the interest rate sensitive sectors and easing in price pressures helps build the case for further monetary easing towards the middle of the year.

It looks like growth will be sub trend in both Q4 and Q1 with this view finding support from weak business and labour market conditions. While the RBA's forecasts allow for some lift in the unemployment rate, a rise towards 6% would most likely bring about another easing. However, if recent gains in equity markets are held onto, positive wealth effects have the potential to create a virtuous circle that drives a recovery in business and consumer spending, negating the need for further policy easing.

At the time of writing, markets were factoring in one further 25 bps easing by April/May with the chance of another over the second half of the year. Such a profile is not that far off our own view and we continue to regard the shorter end of the curve as broadly fairly valued. We still regard the longer end of the curve as being on the expensive side of fair value and offering investors' little protection against an ongoing improvement in risk appetite or further improvement in the economic outlook. While we remain of the view that a major sell-off at the long end is still some time away given offshore policy settings, we continue to hold a modest strategic defensive duration bias.

We have noted the strong rally in credit spreads which has released a large portion of the value we saw in the sector. That said, credit spreads at current levels remain moderately attractive in a low yield environment and we continue to maintain an overweight allocation to spread sectors, most notably semi-government and Corporate debt. However, given the extent to which these sectors outperformed during 2012, and mindful that corporate fundamentals may be peaking, our strategic bias is to use any further rally in spreads as an opportunity to trim exposure to these sectors.

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	1.27
Index	2.05
Active Position	(0.78)

Interest rates – Underweight fixed interest / overweight cash: While still defensively positioned we are currently running a higher allocation to fixed interest than has prevailed for much of the last year. Our thinking here is that we feel the short end of the yield curve now seems reasonable value given our expectation of further monetary easing over the first half of 2013. Our reluctance to be too aggressive reflects concern that the recent weakness in bond markets may be the start of a more significant rise in yields, especially so if the US recovery can build momentum during 2013.

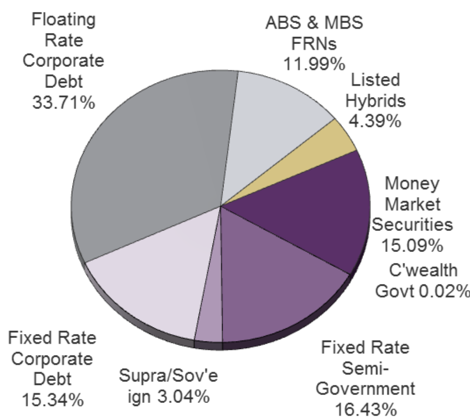
If so, we expect markets will become increasingly concerned about the potential for inflation to rise in the face of Federal Reserve that will be slow to tighten monetary policy. We are also conscious of the strong performance of credit since mid 2012 and should there be any reversal due to unexpected events offshore duration will serve to mitigate the negative impact of a widening in credit spreads.

Sector allocation – Overweight credit: While credit spreads have tightened considerably over the past six to nine months, we still believe this sector is poised to outperform 'risk free' assets on a 12 month forward looking basis due to the demand for 'yield' which should be supportive for credit spreads as well as higher running yields these securities provide. Our favoured sub-sectors continue to be 'big four' bank debt, listed property trusts, and infrastructure debt. We also see value in AAA mortgage backed securities which have somewhat lagged the rally in corporate debt and will be supported by recent indications that home prices are starting to rise.

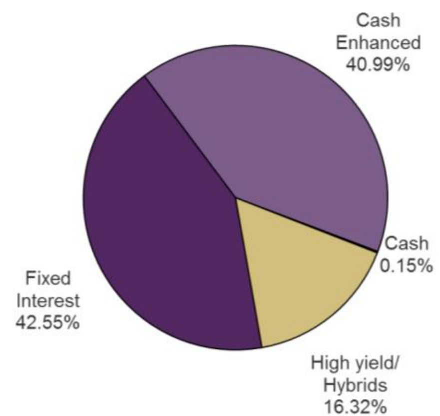
We continue to view the listed hi-yield/hybrid sector as attractive given the favourable fundamentals and ongoing demand for these assets from retail investors but are not necessarily increasing the Trust's exposure to this sector. Currently the Trust has around 16% allocated to this sector via its unit holding in the Perennial Income Focused Trust.

Trust Snapshot

Asset Allocation



Sector Allocation



Rounding accounts for small +/- from 100%.

Signatory of:

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