# Perennial Fixed Interest Wholesale Trust

**Quarterly Report** as at 31 March 2013

| | Quarter % | FYTD % | 1 Year % | 2 Years % p.a. | 3 Years % p.a. | 5 Years % p.a. |
|---|---|---|---|---|---|---|
| Perennial Fixed Interest Wholesale Trust* | 0.61 | 5.26 | 9.19 | 9.25 | 8.94 | 9.55 |
| UBS Composite Bond Index (0+years) | 0.16 | 2.36 | 7.04 | 8.51 | 7.96 | 7.83 |
| **Value Added (Detracted)** | **0.45** | **2.90** | **2.15** | **0.74** | **0.98** | **1.72** |
| Net Performance | 0.49 | 4.89 | 8.68 | 8.74 | 8.44 | 9.04 |

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

- The Trust continued its run of outperformance and exceeded the Index return by 0.45% for the quarter.
- The short duration position protected the Trust from the impact of rising bond yields and was a key influence on Trust's strong relative performance.
- We retain an overweight allocation to corporate debt, which we expect will continue to be supported by sound corporate fundamentals and demand from investors seeking high quality yield.

## Performance

The bond market in the March quarter again delivered a poor return, which was lower than expected from coupon income due to the negative impact of rising bond yields. This was driven largely by a more upbeat economic landscape offshore and some better than expected key readings, including the labour market in Australia. The short term resolution of the Cypriot banking fiasco also caused bond markets to sell off towards the end of the quarter. Credit markets performed particularly well in January and February, but slowed through March following a period of meaningful credit spread contraction.

The Perennial Fixed Interest Wholesale Trust (the Trust) finished up 0.61% and again outperformed the Index return of 0.16% by 0.45%.

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

While the global economy appears to have got off to a reasonable start this year, some political hurdles were cleared, some were not. In the US, a fiscal deal completed in early January, diluted and deferred prospective fiscal tightening that would have tipped the economy into recession. Instead, fiscal tightening looks to be a drag on 2013 growth of around 1% to 1.5%. Subsequent US data has been encouraging, with ongoing recovery in the housing sector helping to broaden the recovery.

### Perennial Fixed Interest Wholesale 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):** AUD63.2 million | **Income Distribution Frequency:** Quarterly |
| **Team FUM (as at 31/03/13):** AUD6.6 billion | **Minimum Initial Investment:** $25,000 |
| **Trust Inception date:** August 2002 | **APIR code:** IOF0046AU |

In Europe, clearing political hurdles proved more problematic. In February, markets were unsettled by an inconclusive Italian election result, while in March, the clumsy handling of the Cyprus bailout proved destabilising. After coming up with an initial €10 billion bailout package that involved "taxing" all depositors, pushback from voters saw the Cypriot Parliament reject the deal. A final deal was struck late in March which protected smaller depositors and involved significant financial restructuring and downsizing.

The gloss of a crisis averted was undone by comments from Eurogroup head Jeroen Dijsselbloem, who suggested that Cyprus was not a unique case and could be used as a template for other troubled Euro countries. Trust in a country's banking system is a critical tenant of a stable economy, any commentary from a European official undermining that trust is bound to unsettle depositors and markets. Subsequent commentary from the ECB denied that Cyprus was a template for future bailouts, but market unease remained.

Against this backdrop, global central banks remained steadfast in providing highly accommodative policy stances via conventional and non-conventional measures. This appeared to have created a buffer against volatile political developments and fiscal contraction. The overall outlook remains for a year of moderate global growth, with the pace of activity improving through the year.

In Australia, the Q4 national accounts 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.

Partial demand indicators for the March quarter point 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 a surprising 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, such as 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 a key reason behind the RBA maintaining an easing bias.

## 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 in March 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 quarter, 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 quarter, 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 quarter 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.

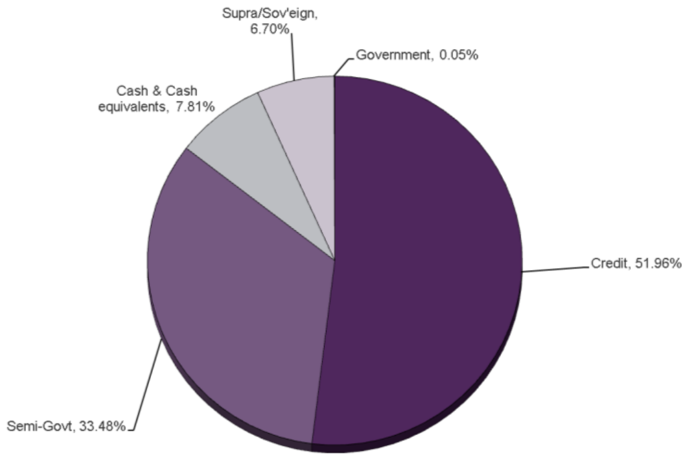
**Overweight corporate debt**:
This is probably the area where we have made some meaningful shifts in our thinking in terms of the value the sector still has to offer. While credit spreads have tightened considerably over the past six to nine months, and have provided a terrific tailwind to performance, 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

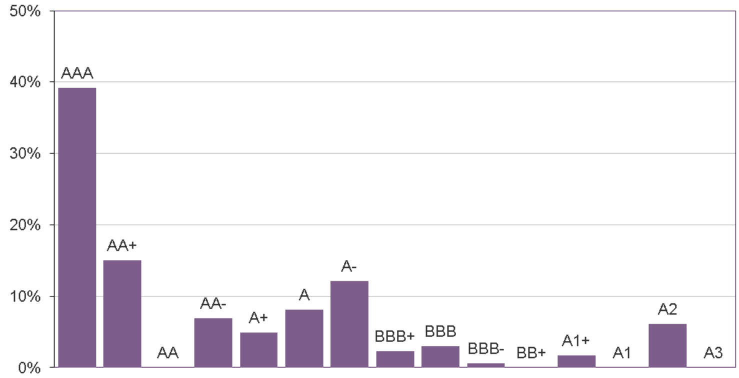
prospect of the bond/semi margin narrowing in the future as state governments work towards a more solid footing in their fiscal balances. Our largest overweight is to Queensland Treasury Corporation given its medium term commitment to restoring its AAA credit rating.

## Trust Snapshot

Sector Allocation




Credit Rating Distribution




Rounding accounts for small +/- from 100%.