

# Perennial Western Asset Management Global Bond Trust

Monthly Report as at 31 July 2010

	Month %	Quarter %	FYTD %	1 Year %	2 Years % p.a.	3 Years % p.a.	5 Years % p.a.
Perennial Western Asset Management Global Bond Trust*	1.91	2.52	1.91	17.29	9.59	5.61	4.87
Barclays Capital Global Aggregate Bond Hedged Index	1.14	3.62	1.14	11.07	10.70	9.80	7.52
Value Added (Detracted)	0.77	-1.10	0.77	6.22	-1.11	-4.19	-2.65
Net Performance	1.85	2.34	1.85	16.55	8.95	5.00	4.29

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

- The excess return was driven by positive contributions from overweight allocations to corporate debt, including high yield, with an emphasis on the financial sector and duration and currency strategies.
- Markets were calmed by positive earnings announcements and reasonable results from the European stress tests.

## Performance

The Perennial Western Asset Management Global Bond Trust (the Trust) strongly outperformed the Barclays Capital Global Aggregate Bond Hedged Index (the Index) over July, with global bond returns boosted by lower yields in most developed economies and a tightening in credit spreads. The Trust exceeded the Index by 77 basis points, returning 1.91%.

The excess return was driven by positive contributions from overweight allocations to corporate debt, including high yield, with an emphasis on the financial sector and duration and currency strategies. Detracting value, was an underweight to agency mortgage-backed securities, and an underweight to peripheral European sovereigns whose spread relative to Germany, compressed.

## Market Update

Markets were calmed by positive earnings announcements and reasonable results from the European stress tests. The 'risk-off' investment sentiment of the past few months swung back toward 'risk-on'. Volatility declined, and spread sectors and equities performed well relative to risk-free government debt. Nevertheless, the fundamental debate over the state of the global economy continued, including whether inflation or deflation was the larger threat, the possibility of a double-dip recession and the need for a second round of quantitative easing.

The European bank stress test results were released by the Committee of European Banking Supervisors in the latter part of the month. Of the 91 banks tested, representing 65% of the sector, just seven banks failed

## Perennial Western Asset Management Global Bond Trust

The Trust aims to provide a total return (after fees) greater than that which exceeds the Barclays Capital Global Aggregate Bond hedged measured on a rolling three-year basis.

### Portfolio Manager:

Western Asset  
Management

### Risk Profile:

Moderate

### Trust FUM (as at 30/06/10):

AUD \$ 41.2million

### Income Distribution

#### Frequency:

Half Yearly

### Minimum Initial Investment:

\$100,000

### APIR code: IOF0118AU

### Trust Inception date:

November 2000

## Did you know?

That the Perennial Fixed Interest Team has on average 22.5 years experience per Team member.

the test as the Tier-1 capital ratio fell below the stress scenario's 6% hurdle. The seven banks that failed were comprised of one German bank, one Greek bank and five Spanish banks. Overall, most of the largest banks seemed to be strong, and the tests helped to reduce market anxiety concerning the state of the European banking system.

The financial corporate sector performed particularly well in response to the news, with issues further down the capital structure leading the rally.

One of the more surprising data releases was the advance estimate of second quarter GDP in the UK, which was nearly twice market expectations at 1.1% quarter-over-quarter. In contrast, US GDP was a much weaker than expected 2.4% on slower consumer spending and a pause in inventory accumulation. This played into the hands of those predicting a double-dip recession.

Talk surfaced about the possibility of further unconventional monetary stimulus, including a second round of quantitative easing. James Bullard, President of the Federal Reserve Bank of St. Louis, argued in a research paper that the best option would be to purchase additional treasuries rather than agency mortgage-backed securities.

Government bond markets were mixed. Yields declined in the US, across much of Europe and in Japan. However, German bund yields increased. Ten-year yields declined 2 basis points (bps) on both US treasuries and Japanese government bonds, increased 9 bps on German bunds and declined 3 bps on gilts.

Corporate bonds had a strong month. Financial issues led the outperformance, particularly subordinated issues. Tier-1 European issues generated nearly 10% excess returns. Spreads on high-yield debt compressed 58 bps in the US and 110 bps in Europe. Agency mortgage-backed securities outperformed treasuries by 0.44%.

Peripheral European government debt outperformed German bunds as spreads compressed by 40 bps in Greece, 100 bps in Spain and 44 bps in Italy at the 10-year part of the curve. US and European stocks both gained nearly 7%. The price of oil increased more than \$3/barrel while gold was down 4.9%. The euro regained over 6% against the US dollar while the pound gained 4.9% and the Japanese yen gained 2.4%.

### Investment Strategy

The 'risk-on/risk-off' investment environment will persist as long as fundamental questions about systemic repercussions continue to divide the market, including whether the US is headed for a double-dip recession, the need for fiscal stimulus or fiscal austerity, the long-term sustainability of the European Monetary Union (EMU) and whether inflation or deflation is more likely. We doubt consensus will be reached on these polarising questions anytime soon. So we will have to continue to

look through these short-term swings in sentiment and remain focused on underlying valuations.

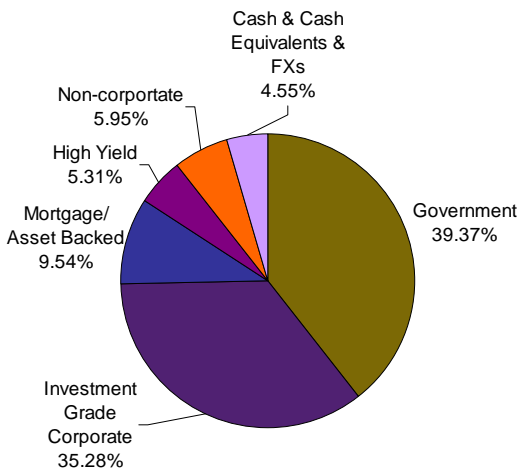
That said, the binary nature of markets may offer opportunity for tactical scaling of our positions. While the underlying investment thesis has not changed, a double-dip is unlikely, the EMU should hold together for the medium term, and ongoing disinflation is the most likely outcome, we will continue to scale the size of our strategies following swings in market pricing. For example, consistent with our view of ongoing disinflation, we have retained a bias toward extra duration in the belief that the Fed, ECB and BoE will remain extraordinarily accommodative for some time. However, we have scaled down the size of the long duration strategy in response to the government bond rally over the past three months. We would look to increase duration should yields rise once again. Likewise, we recently reallocated duration from the US toward Europe, given that the rally was much stronger in the US. Within currency markets, the short position in the euro against the US dollar was scaled down as the euro weakened through the second quarter; we are currently looking to reintroduce a more meaningful euro short now that the euro has strengthened in recent weeks. Despite these tactical adjustments, the underlying thesis remains unchanged and continues to guide positioning.

A number of critics argued that the European bank stress tests were not stringent enough. Nevertheless, the information released provided greater transparency of bank balance sheets, enabling independent analysts to scrutinise risks more concretely. This enhanced clarity seems to have led to a more sober assessment of tail risk, which, in turn, has enabled spreads to grind tighter. We believe this will continue. Profitability remains strong, driven more by traditional banking business rather than investment banking business. Net interest margins should remain high and banks should continue to benefit from a general improvement in economic activity. As a result, we remain convinced that the financial subsector will be a significant driver of outperformance over coming months. July was a strong month, accordingly, we have been looking for opportunities to move up the capital structure into more senior issues, or to reduce outright the size of the overweight. Consistent with the tactical approach to scaling positions, we will look to trim the amount of risk should spreads compress further. As a further balance to the overweight financials position, we continue to target an underweight position to industrial and utility issues that we believe offer insufficient concessions for downside risks to growth.

We will maintain an underweight to the periphery of the euro-zone, based both on our scepticism of the long-term health of the EMU and currently poor market liquidity. That said, there is now significant dispersion across countries, and this has opened up far greater scope for active management down the road. We still do not find compelling valuations in agency mortgage-backed securities.

**Trust Snapshot**

**Sector Allocation**



**Duration Contribution by Region**

