Perpetual Investments

# ANNUAL UPDATE 2019

**Your enclosed annual statement for 2018/19 details how we have managed your money and the transactions you have made over the past year.**

**On the following pages, you will find an overview of how markets have performed over the past 12 months, insights from the heads of our investment teams about what to expect in the year ahead and answers to some frequently asked questions.**

## This is my first opportunity to write to many Perpetual investors after joining Perpetual as CEO late last year.

**ROB ADAMS**
Managing Director and CEO
Perpetual

Perpetual commenced operations in 1886, and the name 'Perpetual' was chosen very deliberately, as the founders of the business said that the original core purpose of providing trustee services for clients must operate into perpetuity. Throughout this time, Perpetual has been focused on delivering to clients and being true to that original promise of our founders.

It is a great privilege to now lead this business, and the first thing I want to do is thank you for entrusting us to manage your investments.

In today's environment, the financial services industry in which our business operates, has been, and remains, in the eye of regulatory, political and media focus.

At Perpetual, we have always been driven to earn the trust of our clients over time. We do this by remaining true to our fiduciary heritage, being true to label in the way we invest, our discipline and consistency in how we invest your funds, and ultimately, our philosophy of protecting and growing wealth.

You should expect that when dealing with Perpetual, we will continue to strive to earn your trust, in all our interactions with you.

We will continue to apply the prudent investment principles and financial diligence that Perpetual has become known for over the past 130 years.

We continue to have one of the most experienced investment teams in Australia, with an active, value investment philosophy and process. As global investment markets have continued to favour a 'growth' approach to investing in recent years, our value approach, which has operated for more than 50 years now, through various market cycles, has struggled to deliver the returns to our investors that we would typically expect. However, given our investment approach has proved successful over such a long period of time, we are confident it will deliver into the future.

At Perpetual, we won't be distracted by what is happening around us, but we will remain committed to delivering quality investment outcomes over time and we will remain 'true to label' as we apply our investment process that has served our investors so well for more than half a century. Whilst we cannot guarantee investment outcomes, we are confident that we will deliver strong performance to you over time.

Once again, thank you for your investment in Perpetual. I look forward to continuing to work with those who manage your money to deliver investment solutions that meet the changing needs of our investors, without ever losing sight of the values that have underpinned our success for clients over decades.

Perpetual

# INVESTMENT MANAGER VIEWPOINT

**We asked Perpetual's experts what's in store for the coming year and where they are seeing challenges and opportunities for investors.**

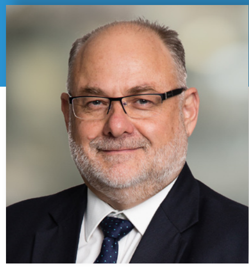
**PAUL SKAMVOUGERAS**
Head of Equities

This passing financial year marks the seventh consecutive year the S&P/ASX 300 Accumulation Index (+11.4%) has posted a positive return. As the current economic cycle continues to mature, we are starting to observe an increasing number of warning signs in the economy and the equity markets, what we consider 'red flags', that make our roles as fiduciaries more difficult but also more important than ever. What we see are slowing economies, a mature business cycle, exhausted policy stimulus, historically low interest rates, piles of debt, trade wars and political disruption. Yet markets are trading at record highs.

In fact, the price to earnings multiple (P/E) of the Industrials Ex-Financials Index is now higher than it was at the height of the dotcom bubble.

In terms of financial market behaviour, the risk reward argument is no longer balanced. Market participants are too focused on what can go right and are less focused on stock fundamentals. It's all about the upside with very little consideration for the downside. Whilst this may be fertile ground for the growth style of investing – and as it happens, Australian growth stocks are the most expensive globally – it is not conducive for the value investment style which continues to struggle in an investment climate where market risks remain underappreciated.

Importantly, at Perpetual, having invested in Australian shares for over 50 years, we have witnessed these types of behaviours before including at the height of the dotcom bubble and prior to the global financial crisis (GFC). As such, this is familiar territory we are navigating and with the benefit of hindsight, we remain confident that when the market does indeed reach an inflection point, our tried and tested investment process and philosophy which emphasises quality and value will deliver as it has over many market cycles. We believe it's in times like these, especially late in the cycle where we are starting to witness silly investor behaviours, that it's important to have sensible, conservative and consistent managers of your money.



**MICHAEL KORBER**
Head of Credit and Fixed Income

Over the 2019 financial year, the Perpetual suite of cash and fixed income strategies achieved continued robust performance despite a period of variable credit conditions and continued low interest rates.

In fact, just two days after the financial year ended, the Reserve Bank cut interest rates further to just 1%; the lowest level in Australian history.

This is perhaps reflective of global market conditions, where the macroeconomic outlook is not as supportive as it was even 12 months ago. Improvements that we had seen earlier in US, European and some Asian country economic data has fallen away, resulting in the market downgrading economic and inflationary expectations. This outcome has resulted in central banks globally now discussing the possibility of halting quantitative tightening and reducing official interest rates over the coming financial year to support economic growth.

Our overall outlook for corporate credit is currently negative, with the team vigilant towards potential market risks. Our valuation indicators are at fair value levels as corporate spreads continue to trade tight relative to their long-term averages across major credit markets.

Despite some of these challenges in markets, our team have continued to be able to find attractive opportunities in credit and fixed income for investors throughout the year, by actively seeking out and buying attractively priced securities on a relative valuation basis. Over the financial year, some of these exciting opportunities have emerged in the private loan space and we have added additional investment professionals to our team to bolster our ability to deeply research these investment opportunities for our investors.

As a brief aside, many of you, as long-term Perpetual investors have told us in the past that you have had an unmet need for a solution that could offer a more sustainable, regular income stream for your portfolios. So I was delighted by how well-received Perpetual's first ASX-listed credit and fixed income product – the Perpetual Credit Income Trust (ASX:PCI) – was this year when it first launched and commenced trading on the Australian Securities Exchange in May.

As always, across all our funds, the team continues to closely monitor data and information flows that may influence market sentiment in the coming year to position us to be able to take advantage when offered attractively priced securities with superior income, whilst constructing our portfolios with the aim to reduce risk through careful diversification.

### MICHAEL O'DEA

Head of Multi Asset

Low interest rates have been a key support to economic growth over the past ten years. In fact, since the GFC, central banks globally have cut interest rates over 700 times and purchased an unprecedented $14 trillion of financial securities.

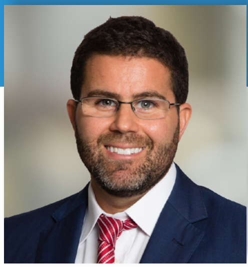
While all that firepower pushed the valuations of every asset class higher, it only resulted in the weakest global economic recovery in history.

Worryingly, it has only taken nine interest rate hikes in the US before investors became concerned about a slowdown in economic growth. This, combined with growing US China trade tensions, led to a sharp selloff in equity markets of about 20% in the December quarter before it bounced back strongly when the Federal Reserve in the US (joined by other central banks) moved to a more accommodative stance. Despite the strong rebound in markets, the global economy continues to look fragile, so, it looks like interest rates are going to stay lower for longer.

Low interest rates are a problem for retirees as they are faced with a difficult choice: accept very low returns on cash or fixed income or accept a lot more volatility in the hope of generating higher returns. German and Japanese investors are faced with negative cash rates and negative 10-year bond yields!

Australian house prices have fallen since the peak of 2017, due to the tightness in the availability of credit, and this means households may save more and spend less – a significant risk to economic growth as consumption is a key driver of the Australian economy. The RBA responded to this risk by cutting the cash rate to 1% (at the time of writing) and is willing to cut more if necessary. The early signs are positive that this is helping to stabilise house prices. In addition to interest rate cuts, the iron ore price has doubled in the past year, which has boosted Australia's tax revenue, allowing the Australian government to deliver tax cuts, providing the Government plenty of flexibility to do more fiscal stimulus if required. This significantly improves the outlook for Australia but risks, such as what happens to the unemployment rate, remain.

The next few years will be challenging but will also offer huge opportunities for clients that are well prepared for increased volatility. Our role is to help clients safely navigate these risks, so they can capitalise on those opportunities when they present.



### GARRY LAURENCE

Global Equities Portfolio Manager

The financial year was dominated by rising economic and geopolitical risks. Hopes of an early resolution to the trade war were dashed when negotiations suddenly broke down in May 2019. Meanwhile, the US Federal Reserve maintained a robust monetary tightening schedule raising the Fed Funds rate to 2.5% in December 2018 as it concurrently continued a program of quantitative tightening. Fed Chairman Powell indicated that the central bank had reached the "lower end of neutral" in terms of interest rate settings. The market interpreted this news badly, foreseeing more than expected rate hikes, with the Dow and S&P500 recording their worst December since 1931 and the Dow's worst Christmas Eve ever. Subsequently, the Fed adopted a more dovish tone and the following month the equity market recorded its best January in three decades.

The zig zagging by the Fed from hawkishness to an easing bias saw bond proxies and growth sectors like Utilities, Telecommunications, Real Estate, Consumer Staples and Healthcare return to vogue. Energy and Materials sectors fell the most as metals and oil closed the year lower than they had started. Financials, Industrials, Consumer Discretionary and IT meandered along with single digit returns. After some tentative signs of the long-awaited comeback in value investing, growth stocks outperformed value stocks over the full year aided by the Fed's dramatic turnaround.

Our quality value style kept reasonable pace with market indices despite the style headwinds and the continued gazumping of market fundamentals by macroeconomic events. As the US economic cycle enters the final stages of its longest ever expansion, with corporate debt levels at record levels and many risks across Europe and the emerging markets flaring, we believe our focus on strong balance sheets, undervalued opportunities and catalysing value through activism puts us in a great position to deliver good relative returns for clients despite the inevitable turbulence that will likely accompany the end of the current business cycle.

## FINANCIAL YEAR AT A GLANCE 2018/19

**CREDIT SPREADS 63.5BPS**
Credit spreads tightened this year, ending at a rate of 63.5 basis points to the end of the financial year.

**INTEREST RATE 1.25%**
Interest rates dropped this financial year, with the Reserve Bank Cash Rate at a low of 1.25% as at 30 June 2019.

**INFLATION 1.3%**
The inflation rate fell this year to 1.3% to the end of March 2019.

**GLOBAL SHARES 12.0%**
The global sharemarket, as measured by the MSCI World Index, rose 12.0% in the 12 months to 30 June 2019.

**AUSTRALIAN SHARES 11.4%**
The Australian sharemarket, as measured by the S&P/ASX 300, rose 11.4% in the 12 months to 30 June 2019.

# YOUR KEY QUESTIONS ANSWERED

### WHY DID THE UNIT PRICE OF MY FUND GO DOWN AFTER 30 JUNE?

The unit price of a fund reflects the value of a fund's investments, including any income that has been accrued but not yet distributed. When distributions are paid, the unit price of a fund will usually decrease by an amount equal to the distribution. As a result, if your fund pays a distribution on 30 June, for example, the unit price will generally decrease after the close of business by the same amount.

### WHAT DOES 'DISTRIBUTIONS AWAITING REINVESTMENT' MEAN ON MY STATEMENT?

Many of our clients choose to reinvest their distributions in order to grow their investment – it has been a proven strategy. Any distributions that will be reinvested are referred to as a 'distribution awaiting reinvestment'. For example, if you receive a distribution for the period ending 30 June 2019 that you intend to reinvest, that amount is referred to as the 'distribution awaiting reinvestment' on 1 July 2019. Once all processing has been completed this will appear as 'distribution reinvested'. On your annual statement for the 2019/20 financial year, the reinvestment amount will be incorporated into the opening balance and will not appear as a separate transaction.

### WHERE CAN I FIND THE FEES I PAY ON MY ACCOUNT?

It's important that fees are transparent and that you understand what you are paying. The fees you are charged will be shown in a dollar amount on your annual statement. They can also be found in the current Product Disclosure Statement (PDS) or Offer document, available on the 'Forms, PDSs and Offer Documents' section of our website at: www.perpetual.com.au/Resources-and-documents

### MY STATEMENT REFERS TO 'ATTRIBUTION MANAGED INVESTMENT TRUST (AMIT)'. WHAT DOES THIS MEAN?

Perpetual elected into the Attribution Managed Investment Trust (AMIT) regime for the majority of Perpetual's investment funds for 2017/18 and subsequent years. Each fund that has elected into the AMIT regime is now referred to as an AMIT. No change has been made to the way in which distributions for the 2018/19 year have been paid to you.

### HOW CAN I UPDATE MY CONTACT DETAILS?

If you already have online account access, then simply log in to provide us with your updated contact details.

Otherwise, call us on 1800 022 033 and we'll change your details over the phone.

**FOR ALL YEAR-END FAQ'S PLEASE VISIT:**
https://www.perpetual.com.au/resources-and-documents/frequently-asked-questions/information-for-end-of-financial-year



**MORE INFORMATION**
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