ASX:PCI

PERPETUAL CREDIT INCOME TRUST

Perpetual

2020 YEAR IN REVIEW

This Year in Review reflects our first full year of activity following the commencement of trading of the Perpetual Credit Income Trust (the "Trust") on the ASX on 14 May 2019.

During the financial year to 30 June 2020 (FY20), the Trust has continued to deliver to its investment objective of providing investors with monthly income by investing in a diversified pool of credit and fixed income assets.

The Trust has paid monthly distributions since inception which are in line with the target return of the RBA Cash Rate plus 3.25% p.a. (net of fees) through the economic cycle*. For FY20, 4.26 cents per unit has been paid to investors, which equates to an annual distribution return of 3.8%.

INVESTMENT PHILOSOPHY AND PROCESS

At Perpetual, we believe the key to investing in credit and fixed income assets is constructing, and actively managing, a well-diversified portfolio of quality assets.

The Portfolio Managers for the Trust, Michael Korber, Managing Director, Credit and Fixed Income and Anne Moal, Head of Corporate High Yield and Portfolio Manager for the Perpetual Loan Fund together have over 60 years' experience. They have invested through many market cycles and are supported by the broader Perpetual Investments Credit and Fixed Income team.

The team follow a robust, active and risk-aware approach to investing in credit and fixed income assets. This involves top-down market screening of the credit environment and extensive bottom up fundamental research to develop a list of approved issuers.

This research seeks to screen out issuers with poor credit quality or susceptibility to downside shock.

The formal credit review process involves consideration of where the asset sits in the capital structure and in-depth financial analysis and modelling. We look for companies that have a good balance sheet and predictable cash flows, who hold a competitive market position and have a quality management team. For unrated or sub-investment grade assets, we undertake a more extensive due diligence process which includes a number of meetings with arrangers and borrowers. We will not invest unless we have high conviction.

Our investment process aims to find the most attractive segments of the market and ensure adequate compensation is provided for investments. We actively manage risk via our thorough investment process and by diversifying the portfolio across industry sectors, maturities and credit rating bands.

* This is a target only and may not be achieved.

PORTFOLIO COMPOSITION

The Trust's investment strategy is to hold a diversified and actively managed portfolio of credit and fixed income assets. The strategy allows for a combination of domestic and global credit, floating and fixed income assets.

As at 30 June 2020, the Trust's portfolio had 102 holdings across 76 issuers[1]. Investments include corporate bonds, floating rate notes, securitised assets and private debt (for example, corporate loans).

While the investment universe for the Trust is relatively broad and includes the ability to invest in assets of foreign issuers, the focus is on Australian issuers. The Trust can hold a maximum of 30% of the portfolio in assets denominated in foreign currencies. As at 30 June 2020, 90.2% of assets were denominated in AUD and 82.1% of assets were issued by entities incorporated in Australia. This includes Australian corporations, banks, property trusts, asset backed securities (ABS) and infrastructure groups. We believe our local presence and ability to meet borrowers and their management team provides an advantage in assessing opportunities and managing credit risk for the portfolio. As the COVID-19 pandemic impacted investment markets, we were quick to move to working remotely and confirm we were fully operational during FY20, without disruption, including contacting our borrowers.

As at 30 June 2020, 54.8% of the portfolio was invested in investment grade assets which means that the issuer of those assets are in the rating bands BBB to AAA as rated by an independent ratings agency. The Trust can also invest up to 70% of the portfolio in unrated or sub-investment grade assets. We believe that unrated or sub-investment grade assets provide a point of differentiation for the Trust's investment strategy as these assets typically pay higher coupons than investment grade assets and can be a valuable source of income. As at 30 June 2020, 42.8% of the portfolio was invested in sub-investment grade or unrated assets[2]. Investments in sub-investment grade and unrated corporate bonds and loans will generally be focused on senior positions in the capital structure which means they are given higher priority in the event an issuer or company is wound-up or liquidated. Approximately 17% of the portfolio comprised secured loans (including via the Perpetual Loan Fund) at the end of FY20.

MARKET OVERVIEW

The spread of the COVID-19 pandemic, the ensuing response and its impact on financial markets has undoubtedly dominated FY20. This led to extreme volatility, particularly in late February and March with all asset classes – equities, credit and fixed income, property and commodities selling off dramatically and the global economy heading towards recession. The impact on the global economy was significant as governments around the world responded to the virus by shutting down their economies and enacting social distancing measures. Financial markets were severely impacted with volatility being elevated as a result of concerns surrounding the virus, the monetary policy response and a concurrent crisis in energy prices.

Throughout the first half of FY20, increasing valuations and slowing economic growth were supported by easing monetary policy globally. The RBA cut the official cash rate by 0.25% in July and October. In the third quarter, the cash rate was cut twice, once at the March meeting and a second emergency cut that brought the target cash rate to 0.25%.

The first seven months of the year saw credit spread tightening up until February. This meant compensation, or return provided for accepting credit risk, was lower. However, in March, credit and fixed income markets experienced the most significant widening of credit spreads since the Global Financial Crisis. A consequence of the market volatility and widening spreads was the diminished liquidity in the secondary market. It also resulted in a slow-down of domestic corporate primary market issuance from late February until mid-May.

1 Number of holdings and number of issuers reported on a full look through basis (excluding derivatives).

2 A sub-investment grade asset has a rating below BBB-/Baa3 and includes unrated assets.

The fourth quarter saw a sharp recovery in asset prices following the turmoil of late February and March. The unprecedented monetary and fiscal response to the COVID-19 pandemic supported credit spreads and equity prices. The strong financial performance was in contrast to worsening economic indicators as a raft of global Purchasing Managers' Indices (PMIs) fell below 50, indicating contraction, and the US reported record unemployment growth for the month of April. In a similar pattern to the first half of FY20, equity valuations and credit spreads were being supported by monetary policy in spite of a worsening economic outlook.

TRUST PERFORMANCE

The market and economic conditions during the second half of the year provided the ultimate test of resilience for the portfolio in its first full year of operation. The assets in the portfolio have held up well during the extremely volatile market conditions and we believe the focus on quality and defensive nature of the portfolio contributed to this result.

We recognise the importance of income to our investors and have continuously delivered on our investment objective of providing monthly income over FY20. The total distributions for the year was 4.26 cents per unit and the 30 June 2020 annual distribution return was 3.8% which is in line with the Trust's target return[3] objective of the RBA cash rate + 3.25% (net of fees) over the economic cycle. The Trust's net tangible assets (NTA) position remains strong and there has been no permanent impairment of underlying security values, meaning the Trust's ability to generate income remains intact.

Prior to 28 February 2020, the Trust had been trading at an average premium to NTA of 2.8% since the Trust's inception. Unfortunately, the market volatility led by COVID-19 resulted in the Trust trading at a discount to NTA. We believe the NTA for the Trust is more reflective of the Trust's performance during the volatility and are comfortable with the composition of the portfolio, only seeing a decrease of -3.5% between 28 February and 30 June 2020. The Trust minimised the impact of credit spread volatility by diversifying assets across asset type and maintaining high aggregate credit quality.

Importantly, the Trust maintained its running yield which was 4.0% at the end of June 2020. The Trust's income was primarily generated by coupon payments and interest income from investments in loans. The Trust predominately collected income return from non-financial corporates, prime RMBS, domestic banks and non-bank financials. This assisted in offsetting widening credit spreads in challenging conditions.

We aim to build a portfolio in which overall interest rate exposure is floating and duration is relatively short. The portfolio weighted average life as at 30 June 2020 was 4.4 years which is short and less sensitive to credit spread movements than longer dated securities. Further, the securities in the portfolio are typically bonds and floating rate notes which are tradeable with daily pricing and liquidity. The loan assets are valued at fair value having considered any impairment. Critical to our investment process is also having regular access to information to enable credit risk to be monitored on an ongoing basis. Accordingly, we did not experience, nor did we expect any default from borrowers in the portfolio.

We encourage investors to remain patient and have a long-term view. This will generally provide time to ride out market woes and profit from market rises. We believe the assets in the portfolio have proven their defensive capabilities, as indicated by the modest decrease in NTA during the market volatility. The full value of the portfolio's assets is also reflected in the Trust's NTA released to ASX daily[4], providing investors with transparency as to the portfolio value. We are confident that our robust, active and risk-aware investment process will translate to attractive opportunities for the Trust which will be rewarded over the long-term.

We would like to take this opportunity to thank you for your continued support and trust and we look forward to providing you with further updates on the progress of the Trust's investments over the coming year via our regular ASX announcements.

Perpetual Investments

3 This is a target only and may not be achieved.
4 The NTA released to ASX daily is unaudited and approximate. Past performance is not indicative of future performance.

INVESTMENT OBJECTIVE

To provide investors with monthly income by investing in a diversified pool of credit and fixed income assets.

TARGET RETURN

Total return of RBA Cash Rate plus 3.25% per annum (net of fees) through the economic cycle^.

INVESTMENT STRATEGY

The Perpetual Credit Income Trust (PCI) (the "Trust") will hold a diversified and actively managed portfolio of credit and fixed income assets.

The Trust will typically hold 50 to 100 assets.

30% - 100%	Investment grade assets
0% - 70%	Unrated or sub-investment grade assets
70% - 100%	Assets denominated in AUD
0% - 30%	Assets denominated in foreign currencies (which are typically hedged back to AUD)
0% - 70%	Perpetual Loan Fund

The Trust will diversify exposure and will have maximum exposure limits to issuers.

Typical investments will include corporate bonds, floating rate notes, securitised assets and private debt (for example, corporate loans). Exposure to corporate loans may be gained indirectly through the Perpetual Loan Fund.

ABOUT THE MANAGER

The Trust is managed by Perpetual Investment Management Limited. The Manager has one of the most experienced, proven and stable credit and fixed income teams in the Australian fixed income market. The Manager and the Responsible Entity are wholly owned subsidiaries of Perpetual Limited.

PORTFOLIO MANAGERS

MICHAEL KORBER

Managing Director, Credit & Fixed Income

Portfolio Manager:
Perpetual Credit Income Trust
Perpetual Pure Credit Alpha

Michael has over 38 years' experience, having been involved in credit markets since their development in Australia during the 1990's. Unlike many other fixed income portfolio managers in this market, Michael has a background in lending and banking, understanding credit risk in a fundamental way.

ANNE MOAL

Head of Corporate High Yield

Portfolio Manager:
Perpetual Loan Fund

Anne is an experienced credit markets specialist, having worked for 23 years in credit and fixed income markets in research, origination and trading roles. Anne joined the Credit and Fixed Income Team at Perpetual Investments in 2014. Anne is the portfolio manager of the Perpetual Loan Fund with a focus on higher yielding income opportunities.

CONTACT

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