Direct Equities Portfolio Performance

Responsible Investment Portfolio – December 2024 Quarter

Perpetual Direct Australian Equities Responsible Investment Portfolio

Returns including dividends*	3 months (%)	1 year (%)	3 years (%†)	5 years (%†)
Responsible Investment model portfolio	-4.0	9.5	3.1	6.0
S&P/ASX 300 index	-0.8	11.4	7.1	8.0
Excess return (model return above benchmark)	-3.2	-1.9	-3.9	-2.0

*Past performance is not indicative of future performance. Client performance may differ due to timing of alignment with the model portfolio, advice fees, administration fees and transactional costs associated with the client's portfolio. Performance is indicative of the total return of the model portfolio's stocks over the period.
†Per annum, compounded.

The December 2024 quarter was influenced by the long-awaited US presidential election with an unequivocally clear mandate given to Donald Trump for his second term as President. A 'Trump-bump' initially saw markets rally strongly perceiving a Trump administration as pro-business (lower taxes), bolstered by a Republican majority across Congress. The US share market kept grinding higher until well into December before the US Federal Reserve spoiled the party with its outlook for 2025 interest rates. The Australian share market had already slipped from its peak by this stage and finished the quarter relatively flat. The timing of an initial rate cut in Australia was also topical, with pundits seeing possibilities as early as February 2025.

The Responsible Investment (RI) Portfolio delivered a -4.0% total return during the quarter, below the benchmark ASX 300 Index by 3.2% as travel stocks and technology names in the portfolio came under considerable pressure. We view the outlook for equity markets as positive but relatively benign, with a mix of economic and geopolitical risks being largely offset by the reintroduction of economic stimulus globally.

'Market melt-up' was the term used widely through the December quarter. After a strong September quarter where the global economic path ahead became clearer and a soft-landing more entrenched, momentum favoured an upward bias despite increasingly full valuations. This melt-up was tempered in mid-late December robbing investors of a widely hoped for Santa Claus rally.

In a soft-landing scenario, activity should be constrained by cost-of-living pressures and a return to low wage growth however, a recession would be avoided. This would likely result in low but positive GDP growth which would support earnings across a range of cyclical sectors that have thus far been under pressure and out of favour with investors. Many

Meet your Portfolio Manager

Daniel Nelson, Portfolio Manager

Daniel Nelson manages the Responsible Investment portfolio in Perpetual Private. Daniel is also the analyst responsible for research and advice on the Mining, Energy and Materials sector. Daniel joined Perpetual in 2011. He is a CFA charterholder and holds the CFA Institute Certificate in ESG Investing.

CERTIFIED BY RIAA

The Perpetual Direct Australian Equities Responsible Investment Portfolio has been certified by the Responsible Investment Association Australasia according to the operational and disclosure practices required under the Responsible Investment Certification Program.
See www.responsiblereturns.com.au for details[1].

Perpetual

corporates remain in a protection mindset, preserving profit margins, defending market share and divesting underperforming businesses. We have observed that the market has generally rewarded this conservatism while punishing more aggressive moves like large-scale acquisitions. Small caps have underperformed and should see a reasonable recovery in Australia during 2025 with a small boost from moderately lower interest rates.

The need for active portfolio shifts across large companies during the quarter was minimal as we found a solid base of portfolio holdings that continued to perform well (**Brambles**, **Computershare**, **ResMed**). In addition, for the first time in five years, we believe that **CSL** is more attractively valued when combined with a much improved and sustainable double digit earnings growth outlook ahead. As such, we have moved above its natural market index weight in our portfolios.

However, we continue to experience volatility in the performance of small company names, namely **Webjet** and **Audinate**. Nonetheless, we have sought new high conviction ideas and have actively taken profits in some holdings to fund these. New stocks in the portfolio include **Hansen Technologies** (**HSN**), and **Cuscal** (**CCL**).

Investment outlook

The immediate investment outlook continues to be dominated by the direction of inflation and interest rates. This remains dynamic and is dictated by monthly economic data trends. In December, as broadly expected the Federal Open Markets Committee (FOMC) cut US interest rates 25 basis points (0.25%) to 4.50% (upper bound), bringing the total cut in this cycle to date to 100 basis points (1.00%).

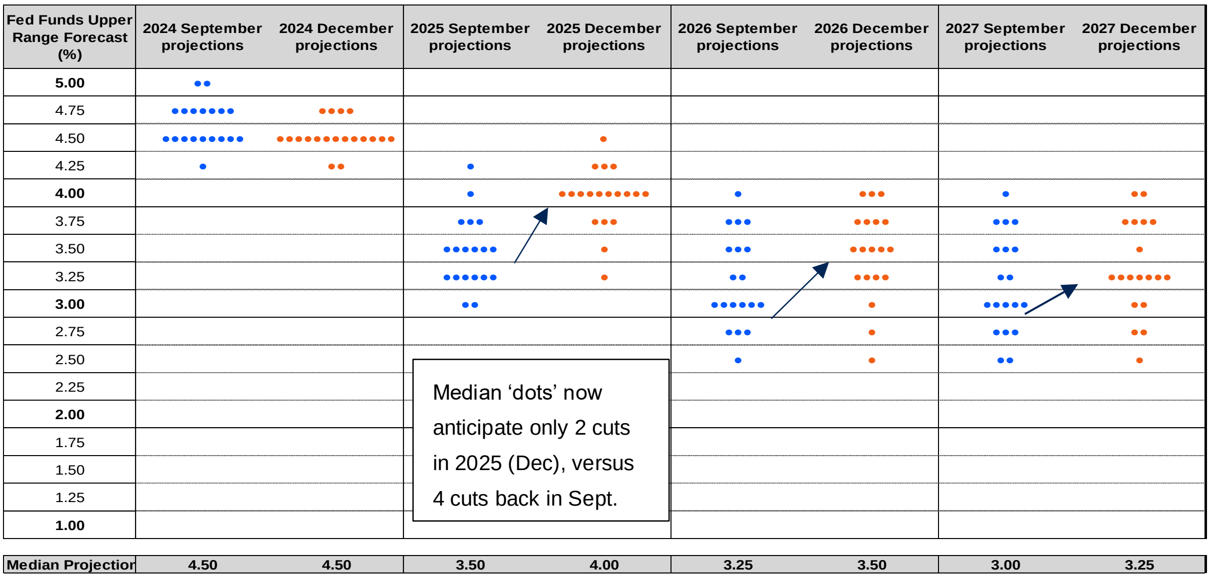
However, importantly Chair J. Powell indicated at their press conference, that monetary policy is now entering a "*new phase*" where the Committee will move more cautiously. He stated, "*With today's action, we have lowered our policy rate by a full percentage point from its peak and our policy stance is now significantly less restrictive*" …

"*We can therefore be more cautious as we consider further adjustments to our policy rate*." He also noted that inflation is still on track to get down to 2% [target] but may take a year or two longer.

This hawkish tone was also reflected in other information released, including the 'median dot plot' which shows the Committee member's predictions of forward interest rates, which **now looks for only two cuts in 2025 instead of the four cuts expected last September** (refer to chart below). This represents 'higher for longer' interest rate settings which we believe will manifest globally, a scenario that Perpetual Private's portfolios have been positioned for.

This is a classic case where 'good news' is 'bad news'. In other words, this is good news as it indicates that the economy remains resilient with inflation under control. In fact, in the press conference Powell was, in his own words, "*very optimistic*" on the economy, calling its recent performance "*remarkable*". However, it was seen as bad news by markets that were positioned for more aggressive rate cuts, which all other things being equal, would stimulate company profits and thus share prices.

Figure 1: US FOMC median dot pot (comparing Sept '24 vs Dec '24 projections)



Source: FOMC dot plot Sept & Dec 2024

We expect that the near-term performance of the Australian equity market will continue to be influenced by inflation data, as well as the pace of interest rate changes both domestically and globally. With recent US dollar strength (A$ weakness) this becomes more challenged. Thus domestically, the market is still in a quandary over the likely interest rate trajectory over the next 12 months. Nonetheless, it appears likely to follow the 'higher for longer' US scenario. This may continue to drive volatility and negative near-term sentiment around equities, as investors recalibrate expectations around valuation and the risk of another rate hike before the cycle turns. We also anticipate the Australian Federal election to create some noise and potential market inaction in the June quarter 2025.

We expect that markets could continue to lack clear direction for some time, against the backdrop of economic and geopolitical uncertainty. However, increasingly this should evolve into a stock picker's market, and while equity markets may be vulnerable to a near term correction, this would present bottom-up fundamental active managers with opportunities to deploy capital into quality companies at more attractive valuations.

Portfolio strategy

The global macro-economic environment and potential policy considerations (mainly monetary, ie. interest rates) have dominated the market's mood and ultimately its direction over the last twelve months and more. While we believed that an economic 'soft landing' was more likely than not, by mid-2024 sentiment remained volatile and data inputs which influence policy decisions (eg. inflation) were hard to predict.

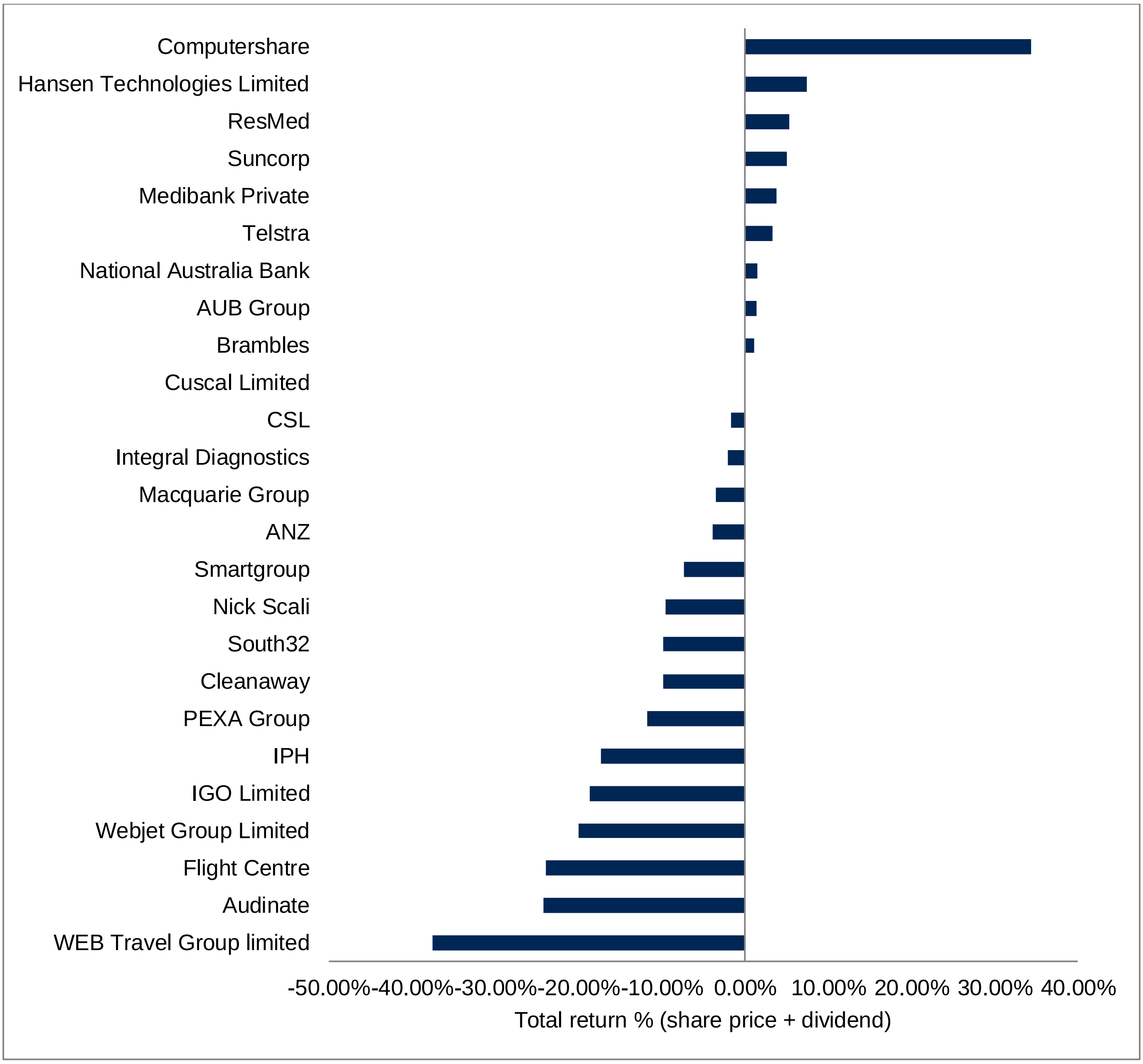
Our December quarter portfolio positioning was less active for large companies as many of these pre-existing changes started to pay-out as monetary policy positioning became more definitive, particularly in the US. The main change was to continue moving overweight in CSL. Fundamentally, we view profit growth as being quite strong for CSL over the next few years and valuation more attractive now than in a long while.

However, we continue to experience volatility in the performance of small company names, namely **Webjet** and **Audinate** in the December quarter. Nonetheless, we have sought new high conviction ideas and have actively taken profits in some holdings (eg. **Integral Diagnostics**) to fund these. New stocks in the portfolio include **Hansen Technologies** (**HSN**), and **Cuscal** (**CCL**).

Looking forward, with our 'soft landing' economic scenario thesis and 'higher for longer' interest rate settings starting to play-out we are comfortable with current portfolio positioning. Particularly from a bottom-up fundamental perspective on a significant handful of large cap (Top 100 index) companies that have delivered for our clients in 2024 – Brambles, Computershare, and ResMed.

The outlook for potential threats on the one hand, or opportunities on the other, in the global economic landscape remains fairly evenly balanced but has a reasonably strong foundation of resilience. We remain focused on finding long-term growth stories driven by the quality criteria that lie at the heart of our investment philosophy. Sustainable profitability, dominant market positions, conservative balance sheets and experienced management teams remain vital to the kind of medium-term outperformance that we are seeking to deliver. We seek to maintain concentrated portfolios of high conviction positions that reflect our best ideas at all times.

Figure 2: Responsible Investment model portfolio total return for the December 2024 quarter



Source: FactSet, December 2024. Past performance is not indicative of future performance.

Stock in the spotlight

Computershare: Higher for Longer

Having previously owned Computershare (CPU) in the past, we know the company well. It was only recently that we re-acquired a position in the Perpetual Private Direct Equity portfolios (March/April 2024), as we noted a fundamental improvement in its business structure, an attractive valuation relative to history, and potential upside from 'higher for longer' global interest rate settings. As we explain below, our active investment approach for CPU delivered a total return of 33.1% to 31 December, 2024 (Core Portfolio).

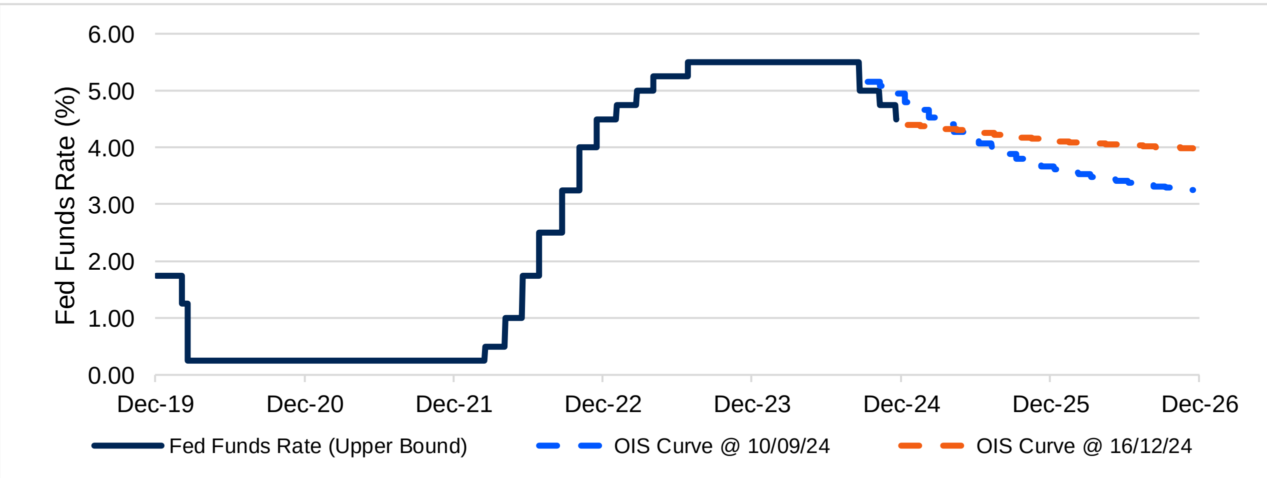
CPU specialises in handling essential but tedious administrative tasks that other companies don't want to do, yet are instrumental to running those businesses. This 'cost of doing business' can be better scaled by CPU across many corporate clients who have a demand for processing the same tasks. Computershare's suite of services can therefore be described as Business Process Outsourcing (BPO), the main one being share registry maintenance.

The Buy trigger for us was CPU management's stated intention to sell the US Mortgage Services business by mid-2024 (of which we were never a fan), thus de-risking its balance sheet and improving cash generation. With a simpler business unit structure, a de-geared balance sheet and US$2.5b of acquisition firepower to add scale or capability in its existing core divisions, and at a deep valuation discount to the broader market - the investment case was compelling.

With our portfolio management 'hat' on we also identified 'interest rate optionality' as a by-product of owning CPU. This could act as a hedge against other economically cyclical companies that we hold in the portfolios, such as James Hardie (that is, if other portfolio companies fell in value due to certain macro settings, it would be likely that CPU would move in the opposite direction adding value as an offset in the portfolio). Cyclical companies tend to rally on the expectation of significant interest rate cuts (and vice-versa) which was the market's expectation at the time. But what if global economies remained robust, executed a softer than anticipated landing and interest rates didn't fall as much as expected (ie. higher for longer)?

That's where CPU's margin income would be relatively better positioned. Margin income is interest revenue earned on ~US$30b of Trust funds held on behalf of its clients, which is directly correlated with global cash interest rates with 100% profit margin. Two events brought this to life as a successful portfolio hedge. The first was Donald Trump's emphatic victory in November. In the two days after the election CPU bounced substantially (~10%) as expectations of higher inflation from Republican policies (eg. tariffs) would lead to higher for longer interest rates. Secondly, in December the US Fed Reserve dropped its anticipated 2025 interest rate cuts from four cuts to just two. The US S&P500 index fell by ~3% in response. In Australia over the next two days, our market also fell by ~3%, with Computershare holding up better (down only 0.6%) while cyclically exposed James Hardie was much worse (down 5.5%). Analysts now expect that CPU's earnings could surprise on the upside during 2025 relative to current forecasts

Figure 3: Higher for Longer interest rates (orange dash)



Source: FactSet. Data as of 16 Dec 2024.

Portfolio changes – December Quarter 2024

Weight changes	Date	Previous weight %	New weight %	Sector
⊘ Flight Centre	22/11/2024	2.6	0.0	Consumer Discretionary
★ Cuscal Limited	22/11/2024	0.0	2.6	Non-bank Financials
★ Hansen Technologies Limited	22/11/2024	0.0	2.5	Communications & Technology
▲ CSL	22/11/2024	6.7	7.2	Health Care
▲ Webjet	22/11/2024	1.9	2.4	Health Care
▼ Integral Diagnostics Ltd.	22/11/2024	4.5	2.5	Health Care
▼ Brambles	22/11/2024	5.7	5.1	Industrials
▼ Macquarie Group	22/11/2024	7.4	6.9	Non-bank Financials
⊘ Webjet Group Limited	22/11/2024	0.4	0.0	Health Care

Top 5 high-conviction holdings – as at 13/01/2025

Model portfolio stock	Relative weight‡ %	Holding weight %	Sector
Resmed Inc. (RMD)	+5	5.9	Health Care
National Australia Bank (NAB)	+4.8	9.4	Banks
Telstra (TLS)	+4.6	6.5	Communications & Technology
Computershare Limited (CPU)	+4.4	5.1	Non-bank Financials
ANZ Banking Group (ANZ)	+4.3	7.8	Banks

‡Reflects portfolio manager conviction. Represents the percentage held above the stock's weight in the ASX 100 index.

[1] The Responsible Investment Certification Program provides general advice only and does not take into account any person's objectives, financial situation, or needs. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Because of this, you should consider your own objectives, financial situation and needs and also consider the terms of any product disclosure document before making an investment decision. Certifications are current for 24 months and subject to change at any time.

More information

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