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Income and diversification key to achieving quality returns in tightening credit markets

A combination of diversification across issuers, industries, asset type, credit quality, maturities and countries remains crucial given credit markets will continue to face a challenging environment with tightening financial conditions, according to Perpetual's Managing Director, Credit & Fixed Income, Michael Korber.

“The recent events involving the US regional banking sector was just a further headwind in a market environment already facing up to a spike in inflation and lower economic growth.

“All of these headwinds lead to liquidity pressures in financial markets, making it harder to borrow money in the short term, but also raising refinancing risks for even good borrowers over the next couple of years.

“I think we are going to have a tighter, more challenging environment going forward, but it's also an environment that creates real opportunities for quality investors.

“At the same time, the rising interest rate environment provides the potential for rising income and distributions in a floating rate portfolio which can contribute significantly to returns.”

Mr Korber manages the Perpetual Credit Income Trust (ASX: PCI) which aims to provide monthly income by investing in a diversified pool of credit and fixed income assets. Perpetual has a long history in investing in credit and fixed income and specialises in Australian corporate credit given its local presence, ability to meet borrowers and manage credit risk for the portfolio.

Focus on diversification

“Diversification is not just about having a large number of issuers or different types of credit quality. It's also important to spread the risk in portfolios across a variety of sectors, industries and asset types such as bonds, RMBS/ABS and corporate loans.

“In challenging environments it's important to be unconstrained and maintain the ability to invest broadly across the fixed income universe,” said Mr Korber.

As at 31 March 2023, PCI holds 130 assets across 91 issuers with 40.0% investment grade, 54.8% high yield (sub investment grade and unrated) and 5.2% cash.

Michael Murphy, Perpetual Senior High Yield Analyst and Portfolio Manager of the Perpetual Loan Fund, highlighted the importance of fundamental research when identifying quality issuers.

“In terms of what we look for in the portfolio, the borrowers are typically large corporates with a strong market position, significant economic moats and high recurring revenues that are resilient to economic downturns.

“We have very little exposure to consumer discretionary companies, and we also seek to avoid exposure to property development, which is more dependent on economic cycles, and we’re mindful that many investors are already heavily weighted to the property sector with their own direct investments.”

Corporate loans and other high yield assets can also offer higher yields than other fixed income assets. Due to Perpetual’s size and market position, PCI can offer access to these credit and fixed income assets not typically available to individual investors.

“Our continued focus on maintaining a healthy running income and diversification positions us well looking ahead and the market volatility will continue to provide some attractively priced fixed income opportunities to generate returns for the portfolio,” said Mr Murphy.

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Perpetual owns leading asset management brands including Perpetual, Pandal, Barrow Hanley, J O Hambro, Regnan, Trillium and TSW.

Perpetual’s private wealth business services high-net worth clients, not for profits, and small businesses through brands such as Perpetual Private, Jacaranda Financial Planning and Fordham.

Perpetual’s corporate trust division provides services to managed funds, the debt market and includes a growing digital business, encompassing Laminar Capital.

Headquartered in Sydney, Perpetual services its global client base from offices across Australia as well as internationally from Asia, Europe, the United Kingdom and United States.

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Prior to making any investment decisions in relation to the Trust you should consider the product disclosure statement (PDS) of the Trust, issued by PTSL, dated 8 March 2019 and the Trust’s other periodic and continuous disclosure announcements lodged with ASX available at www.perpetualincome.com.au.

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