Principal Global Credit Opportunities Fund

Monthly Investment Report as at 31 December 2018

Asset class

Fixed Income Securities

Investment objective

The Fund aims to achieve a total return above the benchmark, before fees, over rolling three-year periods.

APIR code

PGI0001AU

ARSN

108 685 927

Fund inception date

31 May 2004

Benchmark

Bloomberg Barclays Global Aggregate Corporate Index (hedged to Australian dollars)

Distribution frequency

Quarterly

Minimum investment

$20,000

Fund size

$170.3m

Exit price

$0.8892

Market review

December was marked by continued and, at some points, heightened volatility following a similarly volatile November. The macro choppiness and uncertainty was driven by several factors, including the potential slowdown of economic growth, US and China trade negotiations, Brexit, plunging oil prices, and concerns regarding the pace of the US Federal Reserve rate increases. The negative tone throughout the month caused risk assets to drop significantly. Rates along the US Treasury rate curve decreased significantly as the market traded with a risk-off tone.The two-year rate decreased 0.30% to 2.49% and the five-year rate declined 0.30% to 2.51%.The ten-year yield ended the month at 2.68%, also down 0.30%. The thirty-year yield dropped 0.28% to 3.01%.

The Bloomberg Barclays Global Aggregate Corporate Index had an excess return of -0.69% when compared to similar duration US Treasury securities.The Bloomberg Barclays US Aggregate Index, a proxy for the overall fixed income market, had an excess return of -0.33%. All sectors underperformed similar duration US Treasury securities. Conversly, asset-backed securities, mortgage-backed securities, and commercial mortgage-backed securities ('CMBS'), outperformed the Bloomberg Barclays Global Aggregate Corporate Index with excess returns of -0.08%, -0.15%, and -0.40%, respectively against US Treasury securities. Below investment-grade corporate bonds, investment-grade corporate bonds, and emerging market debt underperformed US Treasury securities with excess returns of -3.66%, -1.06%, and -0.72%, respectively.

Performance review

The Principal Global Credit Opportunities Fund (the 'Fund') returned -0.24% (net) for the month, underperforming the benchmark's return of 1.15% by 1.39%.

Underperformance during December was due to security selection and sector allocation. Long duration positioning on the US Treasury curve contributed positively to performance as rates fell. Within sector allocation, underperformance was driven by an out-of-index allocation to below investment-grade corporate bonds. An overweight allocation to emerging market debt and an out-of-index allocation to collateralise mortgage obligation ('CMO') securities also detracted from performance while an underweight allocation to investment-grade corporate bonds contributed positively to performance. Negative security selection was driven by issuer specific performance within investment-grade corporate bonds. Issuer specific performance within emerging market debt and CMO securities also detracted from performance.

Performance

Net returns (%)	1 month	3 month	1 year	3 years p.a.	5 years p.a.	7 years p.a.	10 years p.a.	Since inception p.a.[2]
Fund Returns	-0.24	-2.03	-3.35	3.40	4.10	6.35	8.99	4.48
Benchmark Return[1]	1.15	0.01	-1.17	4.10	4.89	5.91	5.53	5.80
Active return	*-1.39*	*-2.04*	*-2.18*	*-0.70*	*-0.79*	*0.44*	*3.46*	*-1.32*

Past performance is not an indicator of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.

[1] The Bloomberg Barclays Global Aggregate Corporate Index (hedged to AUD) was adopted as the Fund's performance benchmark on 27 December 2011. Benchmark calculations prior to this date are based on the UBS Bank Bill Index.

[2] This figure represents the annualised performance of the Fund since inception.

Fund analysis (%)

Region	Fund	Index
No. of issuers	147	1822
Effective duration (years)	6.64	6.32
Average credit quality	BBB+	A-
Yield to worst[3]	4.93	3.49
Ex-Post VaR	5.21	3.72

Fund investments (%)

Region	Physical[4]	Effective[5]	Index
Global Investment Grade Credit	55.51	55.51	96.17
Global High Yield	13.32	5.24	0.00
Emerging Market Debt	12.55	7.60	3.83
Securitised Assets	4.78	4.78	0.00
Government Debt	2.68	2.68	0.00
Cash[6]	11.16	24.19	0.00

[3] Yield to worst is calculated as the lower of the yield to call or yield to maturity for each issue.

[4] Differences between physical and effective exposure reflect the impact of credit derivative hedges the Fund has in place. These hedges are using widely traded, liquid, credit market index derivatives. Their effect is to reduce market risk in the portfolio to the following areas – global high yield, emerging market debt and global investment grade credit. This position has been taken with a view that while long-term value is attractive in these markets, there is near-term potential for volatility as the economic data continues to be very poor in the US.

[5] Effective breakdown includes hedging exposure.

[6] Effective breakdown includes the residual effect of hedging and is not representitve of the actual cash level.

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Market outlook

Fundamentals within investment-grade corporate bonds remain stable and all sectors are reporting earnings growth. In addition, profit margins remain at 15-year highs. Technicals are currently challenged due to tepid foreign demand and an expected increase in supply in the first quarter of 2019. Foreign demand is weak due to currency hedging costs and macro uncertainty. After the spread widening that occurred during the fourth quarter market volatility, valuations are attractive. Exposure to investment-grade corporate bonds was increased during the month, comprised of the best opportunities within the sector.

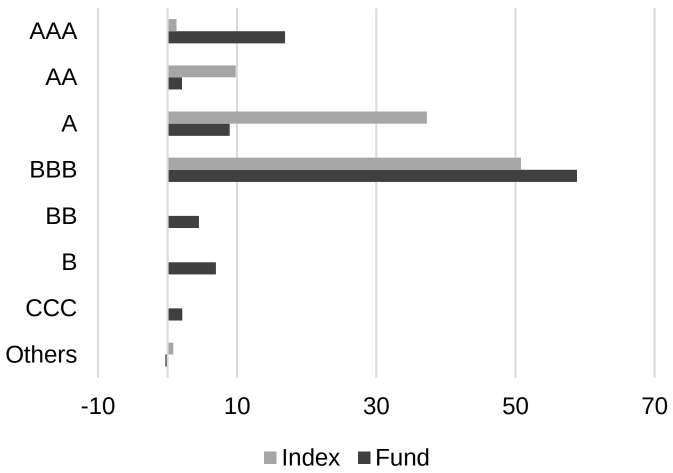
Below investment-grade corporate balance sheets and earnings remain strong and default rates are expected to remain low. Technicals are poor due to market volatility and retail fund outflows. However, this is offset somewhat by low net new issuance. Yields provide a cushion against rising rates, and spreads offer tightening potential. Due to poor technicals, the out-of-index allocation to below investment-grade corporate bonds was reduced.

Growth trends in emerging market economies have largely remained stable, although trade protectionism concerns will continue to weigh on markets. Technicals are mixed due to low net new issuance offset by negative fund flows. Valuations are attractive relative to developed market alternatives although opportunities remain company and region specific. Exposure to the sector was maintained.

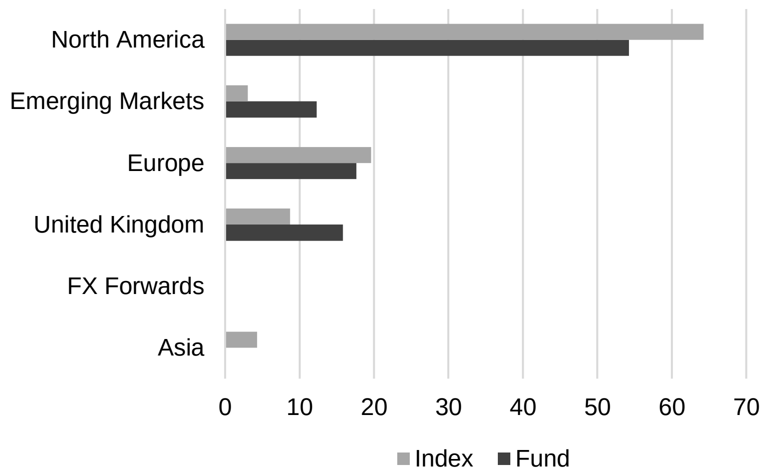
Real estate fundamentals remain solid and benefit from steady economic and job growth. CMBS technicals are balanced with supply being met with strong demand. Valuations are modestly attractive relative to alternatives. The portfolio allocation to CMBS was maintained during the month.

Asset allocation

Credit quality (%)[7]



Regional allocation(%)[8]



[7] "Other" includes the currency forwards that are used for hedging and securities that are rated lower than CCC or are not rated.
[8] Certain analytics powered by Aladdin by BlackRock. BlackRock and Aladdin are trademarks and service marks of BlackRock, Inc. and its affiliates (collectively, "BlackRock"). BlackRock owns all proprietary rights in the marks and in the Aladdin by BlackRock services. BlackRock neither approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained there from. Investors should be aware that the allocation of the investments do not always add up to 100%.

Important information

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