PENDAL

Fund Manager Commentary

Month ended 31 May 2018

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Australian Shares

Pendal Australian Share Fund

Market Review

The domestic equity market, as measured by the S&P/ASX 300 Accumulation Index extended gains from the previous month, closing May 1.2% higher. News from offshore dominated investor attention, not the least of which was the formation of a populist coalition government in Italy between the Lega Nord and the Five Star parties which prompted a bout of market volatility towards the month's end. The market focused ultimately on the risk that Italy might look to leave the Euro. Italian bond yields spiked, as did speculation over the potential for a parallel currency, presidential impeachment and a potential showdown between Italy and Germany over debt and fiscal discipline. However, for all the concerns and uncertainty the episode proved short-lived, with most assets reverting towards their commencement value over the period.

Domestically, **Resources (+2.6%)** remained elevated despite a volatile oil price during the month, amid concerns around Iran's near future supply cut following the US' withdrawal from the nuclear deal. As the Royal Commission continues to scare some investors out of **Financials (-0.1%)**, there is a sense that this has been benefiting the Resource sector due to a lack of alternatives within the local market. Performance from the big four banks was mixed, ranging from -4.1% **(NAB)** to +4.3% **(ANZ)**. The latest results release from NAB was largely shadowed by weaker loan margins as well as higher expenses due to the ramp up in investment.

The other sector that also finished May with a negative return is **Telecommunication Services (-10.1%)**, which was the largest detractor from index performance. Telstra **(TLS, -11.9%)** saw its share price fall after delivering an underwhelming market update. The company now expects its FY18 earnings (EBITDA) to be at the bottom end of guidance, while free cash flow is now set to finish at, if not above, the top end of guidance. The market remained wary of the increasingly competitive landscape of the industry and responded negatively to the trading update. Elsewhere, the **Consumer Staples** (0.0%) sector was unchanged, although stock performance within the sector was divergent. Two of the sector heavyweights, Wesfarmers **(WES, +4.1%)** and Woolworths **(WOW, +2.2%)** both finished the month higher. The former revealed potential buyers for its embattled Homebase business in the UK, which provided investors some respite. Woolworths released its third quarter results which saw sales increase by 4.4%. Conversely, market darlings A2 Milk **(A2M, -12.2%)** and Treasury Wine **(TWE, -13.1%)** both retreated over the month. In the case of A2M, the latest trading update from the infant formula manufacturer disappointed investors, with weaker than expected revenue guidance for the second half due to planned transition to new packaging, whereas TWE confirmed delays in its shipment clearance by the Chinese Customs which impacted investor sentiment.

Meanwhile, **Healthcare (+5.5%)** led the market, both in terms of absolute returns and return contributions. It was largely attributed to the outperformance of sector heavyweight, CSL **(CSL, +9.1%)**. The pharmaceutical company upgraded its profit guidance on the basis of increasing demand across its product suite. The geographical sales mix was also in the company's favour. Other strong performers include respiratory mask manufacturer, Resmed **(RMD, +7.0%)** and biotech company, Sirtex **(SRX, +5.7%)**. Following Healthcare, **Consumer Discretionary** also finished May 5.3% higher. Within the sector, gaming operator Aristocrat **(ALL, +12.7%)** delivered a double-digit gain after reporting its first-half results. Performance from its recently acquired digital business surprised the market to the upside and helped to improve investor sentiment. However, offsetting some of the gains from the sector was Star Entertainment **(SGR, -6.1%)**. The share price pulled back over the month after the market was disappointed with the cost estimate increases for its Brisbane casino announced at the company's investor day.

Portfolio performance

The Pendal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned 0.81% (post-fee, pre-tax) in May, underperforming its benchmark by 0.38%.

Contributors

Overweight Qantas

Qantas **(QAN, +10.1%)** delivered a well-received quarterly update which saw full year guidance maintained. However, the guidance implies a material advance on consensus expectations. Demand continues to grow faster than capacity in the domestic market – and now also in international – which is supporting higher seat yields. While we suspect there could be some short-term noise around the company's share price against the backdrop of an elevated oil price which is something we keep a close eye on, we don't see that as an overwhelming issue given the hedging arrangement Qantas has in place.

Underweight National Australia Bank

We saw half-yearly results from both **National Australia Bank (NAB, -4.1%)** and **ANZ (ANZ, +4.3%)**, which were broadly in line with market expectations; although the ramp up in investment will remain an expense overhang at NAB for some time. We still see ANZ's greater focus on cost control – where they are guiding towards flat cost growth versus mid-single digit for its peers – as the key differentiator in an environment of muted revenue growth. Bank valuations are attractive in historical terms, but with conclusion of the Royal Commission not due until next year we do not see a compelling buying opportunity and remain underweight NAB across most portfolios.

Overweight BHP

Diversified miner BHP **(+6.0%)** recorded another positive month in May despite a retreat in both the oil price and iron ore prices from their recent highs. As the Royal Commission continues to scare some investors out of the Financials sector, this may have benefitted the Resource sector to some degree given a lack of alternatives within the local market. We suspect this offered some support to BHP's share price over the month. It remains our most preferred player within the miners.

Overweight Aristocrat

Gaming operator Aristocrat **(ALL, +12.7%)**, realised its first-half results during the month, which saw earnings surpass market expectation. Management is now guiding towards double digit growth in net profits (NPATA) for FY18. ALL remains one of our preferred growth names and its underlying earnings strength justifies the valuation multiple. Its core business has been strong and the prospects for continued growth are strong, considering the pipeline of new casinos and social apps. That said, we are conscious that the additional rolling out of apps and functionalities, whilst providing a platform for improved revenues, is also likely to compress margins.

Detractors

Overweight Metcash

Metcash **(MTS, -19.4%)** saw its share price fall following news that Drakes Supermarkets chain, the largest independent chain in South Australia, would leave the MTS supply network. MTS has been in negotiations with their customers in South Australia to sign contracts that will allow them to proceed with the development of a new distribution centre. However, they have been unable to

come to an agreement with Drakes, which have announced the intention to move to self-supply with a new warehouse when their current contract expires in June 2019.

The MTS price reaction went well beyond the simple financial impact of this potential loss – particularly given that any impact will not come through until 2020. The IGA wholesale business is approximately 55% of MTS' value, with the remainder in liquor and hardware, while the South Australian business is no more than 20% of the total supermarket division. We estimate a roughly -4% impact on MTS earnings from the potential loss of Drakes, whereas the implied share price reaction wipes out the value of the entire South Australian business several times over. The risk – which we do not dismiss – is that this is the first of many contract losses which could impair the MTS wholesale model. However, we believe there are several factors which support the MTS model, including the significant cost of capital and weakened buying terms that supermarkets would face if they too shifted to independent supply. At this point the market will be looking for news that the other key customers in South Australia have signed up to the new agreement. At this price, we see the risk/reward is to the upside and have used this as a buying opportunity.

Overweight JB Hi-Fi

JB Hi-Fi **(JBH, -6.7%)** downgraded full-year guidance at the beginning of May due to weaker gross margins on white goods at Good Guys. Some have been quick to conclude that the downgrade is a sign of Amazon-induced stress – and JBH is among the most-shorted stocks on the exchange at the moment. However, the downgrade was driven by a case of old-fashion competitive pressure from Harvey Norman (HVN) which has taken advantage of the fact that long-term buying contracts at Good Guys limit its flexibility to recoup price discounts from their suppliers. This forced them to take the hit of lower prices in their margins. This is one of the issues that we believe the franchise's new owners will be able to fix – we continue to believe that the JB Hi-Fi team are among the most astute retailers in the country. Ultimately, we also believe that the pressure on price from HVN is a temporary issue. Good Guys represents about 20% of JBH's value and the 8% fall is an overreaction, driven by broader fears about the effect of Amazon, in our view. The core JBH business continues to perform well, delivering sales growth on top of what was already a very strong prior year. We continue to maintain our conviction in the stock.

Overweight Telstra

Telstra **(TLS, -11.9%)** released its trading update in May. The country's largest telecom player now expects its FY18 earnings (EBITDA) to arrive at the bottom end of guidance, while free cash flow is now set to finish at, if not through, the top end of guidance. The market remained wary of the increasingly competitive landscape of the industry and responded negatively to the trading update. In our view, management's guidance was conservative in terms of the business' underlying earnings decline, and inconsistent with our own analysis of the market dynamics and company fundamentals. However, given this latest trading update, we are now revisiting our investment thesis to gauge if the deterioration in earnings is worse than what we had anticipated. The majority of the weakness/decline has come from the mobile business, where firstly, Telstra no longer over-earns from overseas roaming data usage; and secondly, earns less from domestic out-of-bundle data charges due to more data allowance provided as users renew their mobile contract. This combination has resulted in a continuous decline in the Average Revenue per User (ARPU). Despite a healthy profit margin of around 40% which Telstra has been able to maintain to date for its mobile business, the environment is becoming more challenging, with new players like TPG entering the market. We are cautious that Telstra might start to become more aggressive in mobile contract pricing to defend against the competition. This has the potential to erode its short-term profits before leading to a long-term market share gain. This will have to be accompanied by a cost-out program.

Overweight CYBG

Then NAB spin-off, CYBG **(CYB, -7.4%)** declined over the month on the back of its latest results release as well as an update on its bid to acquire Virgin Money. Profit margins fell short of market

expectation due to some deposit products that were overpaying customers with bonus interest which had subsequently been closed. The market also reacted negatively to speculation that CYB is likely to sweeten the takeover bid it made for Virgin Money in early May. Ultimately, we believe the market will focus on the emergence of CYB as a stronger competitor within the UK market. Even under potentially revised terms we see the deal as positive and earnings accretive for CYB.

Strategy and outlook

The portfolio made gains in May, despite underperforming the Index, with the late-month drag from Metcash (MTS) outweighing the strong performance of some of the Fund's other largest positions, including Qantas (QAN), BHP (BHP) and ANZ (ANZ). However, it remains ahead of the Index over the year to date and longer term periods.

The underlying environment remains attractive for bottom-up active managers and two key features of the current market play to our strengths. The first is the dispersion within sectors. During the bond yield-driven environment of 2012 to mid-2016, dispersion was significant between sectors, but more muted between stocks within the sector. However, as this thematic has waned and company-level factors have resumed greater importance in driving stock returns, we have seen stock performance dispersion return.

In turn, this dispersion has been driven to a large degree by the ability of individual companies and management teams to respond to what is, in many ways, a challenging environment. For example, as at the end of April 2018 Nine Entertainment (NEC) was +104% over 12 months, versus -23% for rival Seven West Media (SVM). Santos (STO) was up +76% while fellow energy provider AGL (AGL) was down -15%. And notwithstanding May's fall, MTS remains well ahead of WOW over 12 months. The key point is that in this environment of relatively moderate overall returns, there is significant underlying dispersion. This is driving opportunities for active investors.

The second feature is that of over-reaction. While we estimate the potential hit to Metcash earnings from losing the Drake contract is in the order of 4% and we recognise the potential risk of this signalling broader-based pressure from MTS customers, the stock reaction was equivalent to several times the implied valuation of its entire South Australian operation. We have seen the mis-pricing that occurs from investors extrapolating the effect of a recent event – both positive and negative – many times in recent years.

The ability to identify and invest in a company such as NEC when near-term challenges saw it being priced for oblivion – even as fundamental research suggested it was able to stage a turnaround – has been an important source of excess returns for our Funds in recent years. QAN – and, indeed, MTS – also provide similar examples. Likewise, the avoidance of several highly-rated growth stocks being priced for perfection and subsequently de-rated has also helped drive relative performance.

Pendal Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation Index finished May with a gain of 3.7%, outperforming its large cap counterpart by 2.5%. **Industrials (+3.9%)** fared better and contributed the most to the Index return and performance of the **Resources (+3.3%)** sector was also positive.

All of the 11 GICS sectors finished the month higher, with **Industrials (+7.6%)** taking the lead in absolute return terms while **Consumer Discretionary (+4.5%)** was the largest contributor to the headline index return. Within the former, Reliance Worldwide **(RWC, +25.4%)**, Emeco **(EHL, +26.5%)** and IPH **(IPH, +23.0%)** all recorded double-digit gains. The plumbing solution provider,

RWC, saw its share price soar after announcing the acquisition of John Guest, a manufacturer of plastic push-to-connect (PTC) products that are sold in the UK, Europe and US. The deal represented a 12.4x EBITDA multiple, or 10.3x including the targeted synergies. The transaction was funded via a combination of an entitlement offer and a syndicated loan facility. It was well received by the market, as the acquisition is considered strategically sound to RWC due to better diversification across regions, products and customers. The strong performance was somewhat offset by losses from Monadelphous **(MND, -10.2%)**, RCR Tomlinson **(RCR, -15.5%)** and GWA Group **(GWA, -7.3%)**. For Monadelphous, while there was no material new news flow during May, some observers raised questions around MND's slow pace in securing contracts this year.

Within the index heavyweight Consumer Discretionary sector, a number of strong performers contributed to returns, including IDP Education **(IEL, +26.0%)**, Seven West Media **(SWM, +47.8%)**, Bapcor **(BAP, +13.6%)**, the long embattled Super Retail Group **(SUL, +17.8%)** as well as fashion retailer, Lovisa Holdings **(LOV, +20.4%)**. IEL provides student placement and English testing services both in Australia and overseas. Its strong gains since February this year saw the company become a member of the S&P/ASX 200 Index during the month, which helped to propel its share price higher. Both SUL and LOV provided trading updates during the month that were well received by the market. LOV announced an increase of 32 stores this year and a solid uplift in gross profit, driven by improvements in margin. Meanwhile, SUL now expects FY18 Group EBIT margin to be flat compared to last year. Also providing the market with an update was Greencross **(GXL, -15.3%)**, which was one of the largest detractors within the sector over the month. The pet and vet care retailer saw its share price fall as management downgraded profit guidance by 9% and unveiled plans to cut costs by 5% as part of a strategic review.

Sectors that delivered relatively weaker performance for May include **Telecommunication Services (+0.6%)** and **Real Estate (+1.3%)**. Within the former, Superloop **(SLC, +23.7%)** recorded a strong gain, while poor performance was registered from Amaysim **(AYS, -32.6%)**. The Australian Stock Exchange recently queried the mobile operator in regard to the significant drop in its share price and the consequent increase in trading volume. While AYS confirmed disclosure compliance in its reply without revealing any new information, it did reiterate the negative market sentiment across the whole industry due to increased competition.

Portfolio performance

The Pendal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned 3.48% (post-fee, pre-tax) in May, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.22%.

Contributors

Overweight IDP Education

IDP Education **(IEL, +26.1%)**, a provider of university placement and English language testing services in Australia, New Zealand, Canada and the US, rallied in response to a significant sell-side upgrade in May. The upgrade was based on the view that IDP has the potential to become a global leader in its market, given its position across language testing and university placement industries, as well as the limited and fragmented nature of its direct competition. We like the company for the combination of structural tailwinds, conservative management and the steps they are taking to drive greater efficiency through digital solutions.

Overweight Reliance Worldwide

Reliance Worldwide **(RWC, +36.7%)** makes plumbing supplies including the popular SharkBite system of fittings in Australia, Europe and North America. The company delivered a trading update in May which reaffirmed its underlying earnings growth guidance and also announced a capital raising to fund the acquisition of John Guest Holdings Limited, a UK-based competitor. This should

provide the potential to push further into the European market, complementing its already strong position in the US market, and prompted earnings upgrades from sell-side analysts.

Detractors:

Overweight Technology One

Technology One (**TNE, -12.9%**) provides cloud-based enterprise software for businesses and government. Its half-yearly earnings report fell short of consensus expectations, with net profit after tax up 1% versus the corresponding six months of the previous year. Management had warned that profit growth might actually be slower in this period, given the base effect of a high number of deals last year, so the result was actually an improvement on their guidance. The stock reaction suggests some fears remain that TNE may struggle to meet their full year targets. At this point management remain confident, citing a skew towards the second half in licence fees.

Overweight Automotive Holdings Group

Automotive Holdings Group (**AHG, -18.4%**), a network of 110 auto dealerships across Australia and New Zealand, issued a profit warning for the second half of FY18 in May, citing the effect of tougher government regulation around the sale of insurance and financing services. The recovery in sales in Western Australia has also been slower than expected. While this presents a near-term challenge, we believe that this is captured in the price. Fundamentally, we expect AHG to adapt to the new regulatory environment, while the economic backdrop in Western Australia should continue to improve. AHG is also well place to benefit from a consolidating industry.

Strategy and outlook

The portfolio delivered a gain in May, helped by strong performance from plumbing supplies maker, Reliance Worldwide, vitamin company, Blackmores, and IDP Education, a global provider of university placements and language testing systems. The return was a touch behind the benchmark's, as positions in Technology One, Automotive Holdings Group, and an underweight in Wisetech Global created a slight drag on performance.

The Fund has bounced back from a softer period and has delivered material outperformance over the past 12 months. Key contributions have come from Reliance Worldwide, Mineral Resources, and IDP Education as well as from dairy plays - Synlait Milk and A2 Milk. We have sold out of the latter after it extended beyond our valuation target; however, we retain our exposure to Synlait. There has been a rise in M&A activity in the last 12 months, and the takeover of Programmed Maintenance Services and Mantra Group have also been beneficial to performance.

The current environment for small caps remains one of pockets of strong growth against a broader backdrop of modest economic momentum and significant disruptive challenges. The cycle is supportive for sectors such as infrastructure, mining services, insurance, renewable energy, tourism, agriculture, and technology. The larger representation of these industries within the small cap sector, as opposed to their larger peers, is the reason the small cap index has returned 25.4% over the 12 months to the end of May, versus a 7.5% gain for the S&P/ASX 50. However, the key here is to distinguish between those companies with sustainable earnings and valuation support and those which have been re-rated to extreme valuations by sentiment and momentum. Examples of our exposure to these industries include Austbrokers (insurance), Seven Group (infrastructure and mining services), Webjet (tourism and travel) and Technology One (technology).

We also have positions where we believe there is mis-pricing on the back of fears over disruption. Our largest holding is in auto-parts distributor, Bapcor, which we believe has less sensitivity to the threat of online competition which has weighed on the broader retail sector in recent times. Government scrutiny and intervention has also seen greater uncertainty in sectors such as aged care, education, and child care, prompting periodic buying opportunities in companies with strong long-term demographic tailwinds such as IDP Education and Ryman Healthcare.

International Shares

Pendal Concentrated Global Share Fund

Market review

Performance across the major equity markets was mixed in May, reflecting a range of economic and political influences. A fair degree of attention remained on the cross-border trade dynamic, as further episodes of brinkmanship were witnessed between the US and its trading partners – Canada and China. Adding to this was the tenuous situation between the US and North Korea and the on-again-off-again peace summit. Investors kept these talks in perspective and focused on the domestic issues facing companies. The Brent crude oil price continued to advance above US$80 a barrel amid signs of further tensions with Iran and the economic crisis facing Venezuela which stoked supply concerns.

Despite the trade rhetoric, US stocks advanced during the month, buoyed by continuation of its economic expansion. Labour market and gross domestic product data remained strong, with the nation's unemployment rate falling to 3.9% - the lowest level since 2000. Gross domestic product was revised down to a still strong 2.3% for March quarter. At a sector level, the bond sensitive sectors – Consumer Staples, Real Estate and Utilities – shifted into negative territory on the back of expectations for higher interest rates, while Health Care and Energy sectors advanced. The market closed May with the S&P500 delivering a total return of 2.4%, while the NASDAQ rallied with a return of 5.3%.

The performance of European equity markets was divergent, reflecting localised issues with potential ramifications for the broader region. Late in the month, political developments in Italy came to the fore when the government formation process was halted after the president vetoed the anti-euro candidate nominated for the Finance ministry. The uncertainty created led to a spike in volatility and a blow-out in Italian bond spreads. Meanwhile in Spain, a no confidence motion was put forward by the socialist opposition party and both events stoked fears of a new euro crisis, which saw the regional currency fall in value. Italy's equity markets fell 8.5% in May and Spain's dropped by 6.1%. In stark contrast, the UK's FTSE 100 rose by 2.3% and France was little changed from the prior month.

Most Asian equity markets ended the month lower, with China the region's best performing markets, while Malaysia and Singapore lost value. Uncertainties over trade renegotiations, political developments in Italy, US dollar strength and a higher oil price weighed on sentiment across the region.

The Australian dollar rose by a marginal 0.2% against the US dollar in May, but was 3.8% stronger against the euro and British pound while being 0.5% weaker against the Japanese yen.

Portfolio performance

The Pendal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned 0.22% (post fee, pre-tax) in May, underperforming its benchmark by 0.15%.

The month can be described as a period of political high drama, with trade wars, North Korea summit on / off, a Spanish no confidence vote and political uncertainty in Italy. The resulting index move on the month was effectively unchanged, as was the overall performance of the fund. Our European financials were impacted by the geo-political issues in Spain and Italy, and our cash position increased from 2% at fund launch in August 2016 to its current 10% position. We have

allowed fund inflows to dilute a small number of holdings which have re-rated significantly since fund inception, as well as selling a small number of companies where valuations were no longer compelling. We note that peer global equity funds are holding on average 4% cash, the lowest level since 2012. As contrarian stock pickers we are happy to be different from the herd and believe as volatility stays elevated and the US 10-year yields hover around 3% that we will be able to deploy our cash holdings in dominant franchise businesses that are trading below replacement value.

Our holding in Eastern US railway company Norfolk Southern outperformed this month, returning +5.7%. On the back of strong first quarterly result at the end of April, we met with the CEO, James Squire in the US in May. Confidence in the near term outlook was obvious at the recent quarterly results, with pricing in the quarter up strongly and the buyback target increased to $1.5 billion from $1billion. The company is benefiting from an increase in truck prices due to supply constraints and higher fuel prices. However, while the CEO remarked that is the “best environment” he had seen for top line growth since 2006 it was not the confidence in the near term outlook that impressed us, rather it was the operational focus of management and their prudence in adding permanent cost to the business, focused firstly on maximising operational efficiencies in order to meet demand. The longer term approach by management and their ability to increase prices in the near term we believe makes their 2020 operating ratio target appear conservative.

Our holding in Analog Devices also outperformed this month. The stock rose by 11% after reporting strong second quarter results. Revenue at $1.51 billion was at the top end of management’s guidance and implies year-on-year growth of 25%, reflecting strength in the industrial division in particular. The industrial division, which accounted for 52% of sales in the quarter, is benefiting from the continued trend for the automation of manufacturing processes. While the communications division, which accounts for 19% sales, continues to grow at mid-single digits, management have strategically positioned themselves to have a dominant share in the release of 5G market technology in 2020 and beyond. Overall, operating margins for the company are at over 42% and remain the best amongst peers. The combination of strong top-line growth and margins is allowing the company to rapidly pay down debt and we expect capital returns to be a feature during the coming quarters.

Strategy and outlook

Our view at fund inception was that the next five years would be unlike the previous five years, and that the tailwinds over the last five years which included, falling interest rates, quantitative easing, and compelling valuations post the global financial crisis would be reversed. To that end, we expect further sector rotation and increased volatility. Our investment process and philosophy is based upon taking a long term approach to our investments and having a deep understanding of the companies we invest in. That understanding gives us the confidence to initiate positions in companies that may be out of favour in the near term, yet offer more significant longer term rewards for patient investors.

Pendal Core Global Share Fund

Market review

Performance across the major equity markets was mixed in May, reflecting a range of economic and political influences. A fair degree of attention remained on the cross-border trade dynamic, as further episodes of brinkmanship were witnessed between the US and its trading partners – Canada and China. Adding to this was the tenuous situation between the US and North Korea and the on-again-off-again peace summit. Investors kept these talks in perspective and focused on the domestic issues facing companies. The Brent crude oil price continued to advance above US$80 a

barrel amid signs of further tensions with Iran and the economic crisis facing Venezuela which stoked supply concerns.

Despite the trade rhetoric, US stocks advanced during the month, buoyed by continuation of its economic expansion. Labour market and gross domestic product data remained strong, with the nation's unemployment rate falling to 3.9% - the lowest level since 2000. Gross domestic product was revised down to a still strong 2.3% for March quarter. At a sector level, the bond sensitive sectors – Consumer Staples, Real Estate and Utilities – shifted into negative territory on the back of expectations for higher interest rates, while Health Care and Energy sectors advanced. The market closed May with the S&P500 delivering a total return of 2.4%, while the NASDAQ rallied with a return of 5.3%.

The performance of European equity markets was divergent, reflecting localised issues with potential ramifications for the broader region. Late in the month, political developments in Italy came to the fore when the government formation process was halted after the president vetoed the anti-euro candidate nominated for the Finance ministry. The uncertainty created led to a spike in volatility and a blow-out in Italian bond spreads. Meanwhile in Spain, a no confidence motion was put forward by the socialist opposition party and both events stoked fears of a new euro crisis, which saw the regional currency fall in value. Italy's equity markets fell 8.5% in May and Spain's dropped by 6.1%. In stark contrast, the UK's FTSE 100 rose by 2.3% and France was little changed from the prior month.

Most Asian equity markets ended the month lower, with China the region's best performing markets, while Malaysia and Singapore lost value. Uncertainties over trade renegotiations, political developments in Italy, US dollar strength and a higher oil price weighed on sentiment across the region.

The Australian dollar rose by a marginal 0.2% against the US dollar in May, but was 3.8% stronger against the euro and British pound while being 0.5% weaker against the Japanese yen.

Portfolio performance

The Pendal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned 0.52% (post-fee, pre-tax) in May, outperforming its benchmark by 0.15%.

The Fund's outperformance in May was sourced from the North American region. Somewhat offsetting this gain was a negative contribution to active returns from Europe, while developed Asia slightly outperformed its regional benchmark.

Thematically, outperformance in the US was primarily due to momentum and quality themes, outweighing the poor performance of valuation themes for stock selection. The underperformance in Europe was driven by valuation and earnings quality themes, offset by strong performance of momentum, both at the stock and industry levels. The poor performance of value and offsetting positive performance of momentum also drove results in developed Asia over May.

From a stock and industry attribution perspective, positive active returns were driven by industry positioning over the month, while stock positioning within industries detracted from active returns. Largest contributors to industry returns were the overweight to Information Technology and underweight to Financials. Stock selection was less constructive within Industrials and Consumer Discretionary sectors, offset somewhat by the positive active results within the Materials sector.

At a stock level, the largest contributors to active returns came from overweight positions in Micron Technology Inc., a US-headquartered manufacturer of semi-conductors and data storage devices; Las Vegas Sands Corporation, an American casino and resort company; and Facebook Inc., an online social media and social networking company. The largest detractors over the month were overweight positions in: UniCredit S.P.A, an Italian global banking and financial services company;

Michael Kors Holdings Limited, an American fashion designer and retailer; and Royal Mail plc, a postal services company operating in the United Kingdom.

Strategy and outlook

Moving into June, the largest sector tilts are: overweights in Information Technology and Materials, and underweights in Consumer Staples and Financials. Relative to long-term allocations, we remain mildly tilted towards higher quality companies with positive momentum and away from cheaper industry peers in the US and Europe and Japan.

Australian Fixed Income

Pendal Fixed Interest Fund

Market review

Australian bond yields rose early in May but ended the month lower as escalating geopolitical uncertainties sapped risk sentiment. This was predominantly centred on Italy and worries a new government could promote anti-euro policies. Meanwhile, developments on the Australian monetary policy front were relatively uneventful as the Reserve Bank left the cash rate on hold for the 19th consecutive month. The Board noted some progress on unemployment but reiterated further improvements were expected to be gradual. Economic data painted a mixed picture over the period. Wage growth was weak with a 0.5% increase for the first quarter and consumer confidence, retail sales and building approvals were also soft. The monthly labour market report revealed 23K jobs were added during the month, however an increase in the participation rate drove the unemployment rate higher to 5.6%. In contrast, business conditions strengthened to 21 – the previous high for the series. Finally, the Australian 10 year yield finish the month lower by 10 basis points (bp) to 2.67%, the 3 year yield dropped a more modest 7bp to 2.11% and 90 day BBSW fell 6bp to 1.98%. The BBSW-OIS spread narrowed over the period, but still ended relatively elevated.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned 1.08% in May (post-fees, pre-tax), outperforming its benchmark by 0.39%.

In the alpha overlay, all strategies performed strong, except that Yield Curve strategy made a minor loss. The government bond component outperformed its benchmark with both the Duration and Yield Curve strategies contributing to performance. In addition its physical portfolio also outperformed with gains in yield curve positions. Finally, the Credit component outperformed its benchmark, which was partly attributable to an underweight supranationals and overweight Utilities position.

Strategy and outlook

The Reserve Bank left the cash rate on hold at their meeting in early June. Inflation forecasts in their Statement on Monetary Policy (SoMP) released in May show that the Reserve Bank expects the underlying inflation rate to remain at 2% until the end of 2019. This was consistent with their

forecast in the February Statement on Monetary Policy and does not suggest that the Reserve Bank will be adjusting monetary policy anytime soon.

First quarter growth data is due for release in early June and is expected to show the economy expanding by around 3% over the past year. First quarter data is expected to be supported by net exports, whilst domestic demand remains sluggish despite ongoing employment growth. With the unemployment rate above 5.5% and wage inflation around 2% there remains ample capacity in the labour market before wage inflation pressures start to emerge. The housing market in Sydney and Melbourne in particular have shown recent price declines, although needs to be kept in context of the large increases witnessed over the past 5 years. With increasing apartment supply and tightening in lending conditions (particularly following the Royal Commission into Banking, Superannuation and Financial Services Industry) it is likely that prices remain under pressure. Net exports are expected to continue to support growth going forward, with LNG capacity coming online assisting. Public infrastructure spending will also benefit economic growth.

With such a benign inflationary environment we expect the Reserve Bank to remain on hold for the remainder of the year, despite the solid economic growth of the Australian economy.

We maintain our recently adopted neutral view on investment grade credit.

Emerging concerns are predominantly tied to European politics; specifically Italy and the risk it exits the Eurozone, as well as its expected debt load exceeding EU rules. We see this as an ongoing challenge around the eurozone construct. This leaves us cautiously positioned until we get further clarity on these developments.

There are several other factors driving our neutral position. The first is falling market liquidity due to a withdrawal on central bank stimulus, which we believe will see increased volatility in markets. The second is geopolitical concerns such as trade war fears. Thirdly, higher US interest rates could create greater concerns around levered corporates having to pay higher interest rates in the future. This would pressure corporate profitability and credit metrics, which will drive credit spreads wider and investment grade should outperform high yield.

However, given the extended period of low inflation in the US, it’s difficult to determine when and to what extent inflation will rise and the impact on bond yields and corporate interest expenses/ability to refinance. We also acknowledge strong fundamentals remain in investment grade credit with healthy balance sheets and positive earnings growth.

On balance, the uncertainty and less attractive risk-return trade-off warrants a neutral stance for now.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bond yields rose early in May but ended the month lower as escalating geopolitical uncertainties sapped risk sentiment. This was driven by Italy and worries that a new government could promote anti-euro policies. Investors fled Italian government bonds and 2 year yields spiked from -0.33% to 2.67% in the final week of May. By the last day of the month, these fears were alleviated to a degree by the announcement of a finance minister who is less sceptical to remaining in the Eurozone. Elsewhere, deteriorating situations in pockets of emerging markets as well as fears over the impact of a rising US dollar added to investor concerns. Meanwhile in the US, President Trump continued to feature in headlines regarding trade negotiations, the withdrawal of the US from an Iran nuclear deal and the postponement of a meeting between the President and North Korean leader Kim Jong Un. In terms of economic developments, the Fed left its target rate

unchanged and suggested inflation was nearing its 2% objective. Finally, the US yield curve flattened over the month with the 10 year yield falling 10bp to 2.86% and the 2 year yield declining 6bp to 2.43%.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned 0.50% in May (post-fees, pre-tax), outperforming its benchmark by 0.20%.

Over the month, the Duration, Cross Market, FX, Macro and Relative Value strategies added significantly to performance. The Yield Curve strategy was the only strategy to experience minor losses. The portfolio started the month at 7 risk units and increased risk levels to 9 risk units before finishing the month at 8 risk units.

The Duration strategy was the largest contributor over the month. The majority of the gains were from Europe where we had short duration positions in Italian BTPs, as the risks grew around Italian elections. The selloff triggered a flight to safety in German Bunds and benefited our long duration exposures there. Meanwhile the impact spilled over globally into the other markets, and we tactically increased long duration positions in the US and Korea. Approaching month end we took profit on all duration exposures in Europe and retained a small position in Korea.

The FX strategy was one of the largest contributors over the month. We maintained our long USD bias through the month and took profit on most of our positions toward the end of the month. The majority of the gains were from our short EUR positions, both in outright positions and in FX options, as the Euro sold off on renewed political concerns spurred by the Italy elections. In addition, our long JPY positions benefitted from the risk-off sentiment. Performance from EM currencies were flat over the month, with gains from short INR, MYR, PHP and CNH offsetting the losses in SGD, IDR and KRW. In the month we initiated long volatility positions in EUR-JPY, EUR-USD, NZD-USD and AUD-USD. Most of these trades were closed by the end of the month with a largely flat performance.

The Yield Curve strategy was the only strategy to experience losses, most of which was from flatteners along the USD curve, as the front-end rallied hard in the risk-off period. All the USD curve positions were closed during the month. As of the end of the month we continue to hold a JPY steepening position in the long end of the curve, with a flat performance for the month.

The Cross-Market strategy performed well over the month. All gains were from long duration in Bunds vs short duration in BTPs. We took profit on the position toward the end of the month and there are currently no trades in this strategy.

The Macro strategy added significant performance over the month. The largest gains were from buy protection positions on EM countries, and more specifically, on Turkey. The hike to 16.5% by the Central Bank of Turkey exacerbated the speculation on its worsening capital flows and the sovereign CDS spread widened aggressively. In the month, we rotated most of our CDX HY vs iTraxx Europe Main decompression trade into shorts in EM and Europe. As our outlook on Europe has changed, we can no longer count on the effectiveness of iTraxx Europe Main as a hedge, but we look to maintain a smaller outright short position in CDX HY.

The Relative Value strategy contributed positively to the portfolio over the month. The majority of the gains were from the 5-year invoice spread widener in the US. Similarly our Australian 3-year EFP spread widening positions also added to performance.

Strategy and outlook

A normalisation of the QE experiment requires adjustments. Those asset prices that have benefited the most from the abundance of liquidity are likely to be the ones that will require the greatest of adjustments. But none of this is cause for calling the next crisis, and it is still too early to call the

next recession. Instead, as the great tide of liquidity rolls back, opportunities are starting to return to our investment universe, just as they did this month. Rather than wanting to position for crash and capitulation, we simply see greater opportunity returning to all our investment strategies as the cycle plays on. In addition, we expect more growth disappointment outside the US, and positive US (front-end) real rates welcoming back cash as an asset class.

Credit

Pendal Enhanced Credit Fund

Market review

Australian credit posted a positive return for the month. This was driven by a fall in underlying yields, which more than offset a widening in credit spreads. Spreads were relatively unchanged in the first half of the month, but increased in the second half on geopolitical concerns. This was largely due to worries that a new Italian government could promote anti-euro policies, which sparked a significant reaction in Italian bonds and was felt across broader markets.

Turning to local credit market activity, issuance during May totalled $8.1b across 12 deals. This was a $3.1b increase over April and volumes for the year remain ahead of the same period in 2017. Corporates accounted for only $1b and included electricity provider AusNet and shopping mall operator QIC Shops. Financials accounted for the remaining issuance with ANZ and NAB raising a total of $5.25b in debt capital. Offshore names Lloyds, Goldman Sachs and Zurich also tapped the market.

The Australian iTraxx index (Series 29 contract) traded in an 8bp range finishing the month 5bp wider to +69.5bp. Physical credit spreads slightly underperformed widening 1bp average across the sectors. Semi-government bond spreads were also a toucher wider to government bonds over the month.

Portfolio performance

The Pendal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 0.47% in May (post-fees, pre-tax), matching the benchmark return.

Performance was driven by a fall in underlying swap rates, which more than offset a widening in credit spreads. Positions in infrastructure and utilities, where the Fund is overweight did not perform as strongly as prior months. Given a risk-off tone during the month, the fund did not participate in any new issuance.

Strategy and outlook

Our macro credit view is neutral. While we continue to remain cautiously constructive on a fundamental basis, we acknowledge risks have increased due to increasing volatility across markets. This has been driven by changing expectations on US inflation and the rates outlook. Geopolitical risks have also flared up this year and markets appear less forgiving, as witnessed by the reaction to Italian political uncertainty during the month.

Over the remainder of the year, it is expected there will be further cash rate increases in the US and that there will be further discussions by the ECB regarding ending QE. Market price dislocations will occur should expectations of central bank actions and emerging economic growth, inflation and labour data not align to market positioning.

Balancing these risks are solid corporate fundamentals and in turn we are constructive on investment grade credit. Balance sheets are generally strong and earnings are improving as evidenced by solid corporate earnings seasons in Australia, the US and Europe. Further, Australian domestic issuers have not increased balance sheet leverage over the past number of years. The major Australian banks have stronger capital ratios than previous years and should support domestic financial stability.

Domestically we expect the Australian economy to exhibit improving growth that has become more balanced in recent years. However, weak wage growth could continue to dampen overall domestic demand and housing appears to be softening. As such we continue to recommend a defensive approach with any overweights in operationally resilient sectors such as Utilities and Infrastructure that provide higher yield to index returns.

Cash

Pendal Managed Cash Fund and Pendal Enhanced Cash Fund

Market review

Australian bond yields rose early in May but ended the month lower as escalating geopolitical uncertainties sapped risk sentiment. This was predominantly centred on Italy and worries a new government could promote anti-euro policies. Meanwhile, developments on the Australian monetary policy front were relatively uneventful as the Reserve Bank left the cash rate on hold for the 19th consecutive month. The Board noted some progress on unemployment but reiterated further improvements were expected to be gradual. This was reflected in forecasts released by the central bank during the month as part of its quarterly Statement on Monetary policy. Other communication through the month did little to change the view that rates would remain on hold over the near term. In turn, markets pushed back the pricing for the first potential rate hike from August 2019 to November 2019.

Economic data painted a mixed picture over the period. Wage growth was weak with a 0.5% increase for the first quarter, the second lowest level since the series began in 1997. Consumer confidence, retail sales and building approvals were also soft. The monthly labour market report revealed 23K jobs were added during the month, however an increase in the participation rate drove the unemployment rate higher to 5.6%. In contrast, business conditions strengthened to 21 – the previous high for the series.

Looking abroad, Italian political uncertainty dominated the market's direction heading into month's end. Investor concerns began to mount after the unexpected formation of a coalition between euro-sceptic populist parties, Five Star Movement and the Northern League. These concerns were furthered when their proposed appointment of an anti-euro finance minister was vetoed by President Sergio Mattarella, threatening dissolution of the government and return to elections later in the year. This created uncertainty over how the country would be governed in the interim alongside the increasing fears of anti-euro policies and fiscal spending that would raise Italy's debt load.

In turn, investors fled Italian government bonds and 2 year yields spiked from -0.33% to 2.67% in the final week of May. By the last day of the month, these fears were alleviated to a degree by the announcement of a finance minister who is less sceptical to remaining in the Eurozone. Elsewhere, concerns over deteriorating situations in Turkey and Argentina, as well as the effect of a rising US Dollar on emerging markets more broadly, added to investor concerns.

Turning to the US, President Trump continued to feature in headlines regarding trade negotiations. A second round of trade talks between the US and China took place and levies on steel and aluminium imports from other regions were announced. Other noteworthy news included the withdrawal of the US from the Iran nuclear deal and the postponement of a meeting between Trump and North Korean leader Kim Jong Un. In terms of economic developments, the Fed left its target rate unchanged and suggested inflation was nearing its 2% objective. Meanwhile data-wise; the unemployment rate fell to 3.9% (the lowest since 2000), the ISM Manufacturing survey gained 0.1 point to 56.6 and first quarter GDP was revised lower to 2.2%.

Finally regarding market movements, the risk-off tone in the second half of the month saw the Australian 10 year yield finish the month lower by 10bp to 2.67%. The 3 year yield dropped a more modest 7bp to 2.11% and 90 day BBSW fell 6bp to 1.98%. The BBSW-OIS spread narrowed over the period, but still ended relatively elevated. Changes in the US curve were similar with the 10 year yield falling 10bp to 2.86% and the 2 year yield declining 6bp to 2.43%. In the FX arena, the AUD benefited from stronger commodity prices and gained 0.5% over the month against the USD.

In credit markets, spreads saw little change in the first half of the month before widening in the second half on the back of the aforementioned geopolitical concerns, including the political uncertainty in Italy.

The Australian iTraxx index (Series 29 contract) traded in an 8bp range finishing the month 5bp wider to +69.5bp. Physical credit spreads slightly underperformed widening 1bp average across the sectors. Semi-government bond spreads were also a toucher wider to government bonds over the month.

Portfolio performance

Managed Cash

The Pendal Managed Cash Fund (formerly the BT Wholesale Managed Cash Fund) returned 0.15% in May (post-fees, pre-tax), marginally underperforming its benchmark by 0.02%.

With a higher running yield than the index remains well positioned to outperform. Themes and credit exposure remain consistent with prior months, with excess spread from A-1 rated issuers and yield curve positioning likely to be the main driver of outperformance. The fund ended the month with a weighted average maturity of 53 days (maximum limit of 70 days). Yields further out the curve continue to offer better relative value and the weighted average maturity has consistently been longer than benchmark due to this. With longer dated yields offering better value and with Reserve Bank monetary policy tightening a distant prospect we will remain longer than benchmark. The fund is well positioned to continue to outperform its benchmark.

Enhanced Cash

The Pendal Enhanced Cash Fund (formerly the BT Wholesale Enhanced Cash Fund) returned 0.17% in May (post-fees, pre-tax) matching the benchmark performance.

Positive performance came from financials and industrial sectors. Activity during the month included a slight increase in exposure to domestic banks, infrastructure and utility sectors funded out of cash. As at the end of the month, the portfolio had a credit spread of 63bp over bank bills, interest rate duration of 0.09 years and credit spread duration of 1.63 years.

Strategy and outlook

The Reserve Bank left the cash rate on hold at their meeting in early June. Inflation forecasts in their Statement on Monetary Policy (SoMP) released in May show that the Reserve Bank expects

the underlying inflation rate to remain at 2% until the end of 2019. This was consistent with their forecast in the February SoMP and does not suggest that the Reserve Bank will be adjusting monetary policy anytime soon.

First quarter growth data is due for release in early June and is expected to show the economy expanding by around 3% over the past year. First quarter data is expected to be supported by net exports, while domestic demand remains sluggish despite ongoing employment growth. With the unemployment rate above 5.5% and wage inflation around 2% there remains ample capacity in the labour market before wage inflation pressures start to emerge. The housing market in Sydney and Melbourne in particular have shown recent price declines, although needs to be kept in context of the large increases witnessed over the past 5 years. With increasing apartment supply and tightening in lending conditions (particularly following the Royal Commission into Banking, Superannuation and Financial Services Industry) it is likely that prices remain under pressure. Net exports are expected to continue to support growth going forward, with LNG capacity coming online assisting. Public infrastructure spending will also benefit economic growth.

With such a benign inflationary environment we expect the Reserve Bank to remain on hold for the remainder of the year, despite the solid economic growth of the Australian economy.

We maintain our recently adopted neutral view on investment grade credit.

Emerging concerns are predominantly tied to European politics; specifically Italy and the risk it exits the Eurozone, as well as its expected debt load exceeding EU rules. We see this as an ongoing challenge around the eurozone construct. This leaves us cautiously positioned until we get further clarity on these developments.

There are several other factors driving our neutral position. The first is falling market liquidity due to a withdrawal on central bank stimulus, which we believe will see increased volatility in markets. The second is geopolitical concerns such as trade war fears. Thirdly, higher US interest rates could create greater concerns around levered corporates having to pay higher interest rates in the future. This would pressure corporate profitability and credit metrics, which will drive credit spreads wider and investment grade should outperform high yield.

However, given the extended period of low inflation in the US, it’s difficult to determine when and to what extent inflation will rise and the impact on bond yields and corporate interest expenses/ability to refinance. We also acknowledge strong fundamentals remain in investment grade credit with healthy balance sheets and positive earnings growth.

On balance, the uncertainty and less attractive risk-return trade-off warrants a neutral stance for now.

Australian Property

Pendal Property Securities Fund

Market review

The ASX A-REIT Index rose by 3.1% in May, outperforming the broader market (+1.1%) by 200bp. Outperformance was driven by the cash that was deployed by investors from the recent Westfield merger, M&A activity and the benchmark bond yield falling 10bp to 2.67%. Global REITs were +1.8% for the month (in US$D terms), with the US (+4.5%) the best performer and Singapore (-5.7%) the worst performing market.

During the month, Investa Office Fund received a takeover offer from Blackstone. Blackstone has offered $5.25/security cash (including the distribution for June 18) which is a 4% premium to NTA and 13% premium to the previous closing price. The Board of the responsible entity has declared their intention to support the bid, subject to an independent expert report and in the absence of a

higher offer. Also during the month, Westfield security holders voted in favour of the Unibail takeover and OneMarket demerger.

The US market was up 1.9% over the month and the Fed kept rates unchanged as data releases were broadly in line with expectations. The CPI was +0.2% (+2.5% over the year) and retail sales were +0.3% for the month. Nonfarm payrolls were up 164,000 and the unemployment rate fell to 3.9%, the lowest level since 2000. Average hourly earnings were +0.1%, with year over year gains of +2.6%.

In Australia, the RBA left interest rates on hold with the board reiterating its forecast for growth averaging a bit above 3% in 2018 and 2019. The Federal Budget delivered a slightly improved budget deficit projection for 2019 with an earlier return to surplus. There were some commitments to lower income tax brackets to reduce bracket creep. Employment increased by 23,000 jobs, however the unemployment rate rose slightly to 5.6%, the result of a slightly higher participation rate. Wage growth (+0.5%) was muted for the March quarter (representing a +2.1% annual growth rate), the second weakest in the history of the data series dating back to 1997. Retail sales were soft over the period, with the ex-food data (-0.5%) weak. Capital expenditure data (+0.4%) was also soft for the March quarter.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned 2.77% in May (post-fee, pre-tax), underperforming its benchmark by 0.21%.

The portfolio accrued positive contributions from overweight positions in Investa Office Fund, Charter Hall Group and Lifestyle Communities and underweight positions in Cromwell Property Group and National Storage REIT. Meanwhile, overweight positions in Westfield Group, Iron Mountain and Arena REIT and underweight positions in Vicinity Centres and Charter Hall Retail REIT detracted from performance.

Over the month we increased our underweight positions in GPT Group, Scentre Group and Vicinity Centres. Conversely we increased our overweights in Charter Hall Group, Dexus Property Group and Investa Office Fund. We currently have an overweight position in the new Unibail-Rodamco Westfield Group.

Strategy and outlook

The A-REIT sector is now priced on an FY18 dividend yield of 5%, a price-earnings ratio of 16.3 times and a 1% discount to net tangible assets (NTA). Office and industrial cap rates will likely compress further in the next reporting period (on the back of recent transaction evidence), but asset valuation uplift thereafter will depend on income growth and tenancy retention. We expect to see cap rates soften for retail assets in the next 6 to 12 months, especially for lower quality malls. Balance sheets are stable with sector gearing at 29%.

International Property

Pendal Global Property Securities Fund

Market review (in US$)

The global property securities market (on an ex-Australia basis) as measured by the FTSE EPRA/NAREIT Developed Index delivered a total return of 1.7% or May. North America (+1.7%) was the only positive performing region, while Asia Pacific (-1.0%) and Europe (-2.6%) declined during the month. In Asia Pacific, results were mixed. Singapore (-5.7%) was the weakest performer followed by Japan (-0.8%), while New Zealand (+2.5%) and Hong Kong (+0.3%) were positive performers. In Europe, results were mostly negative across the region. Spain (-8.1%) posted the largest decline, followed by Italy (-4.2%) and Ireland (-4.1%). In North America, the US and Canada returned 4.5% and 1.6%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund (formerly the BT Wholesale Global Property Securities Fund) returned 1.92% in May (post-fee, pre-tax), underperforming the benchmark by 0.27%.

North America

The North America portfolio returned 4.04% in May (before fees and withholding taxes), trailing the FTSE EPRA/NAREIT North America Index by 26 basis points. Underperformance relative to the benchmark was attributable to negative sector allocation results, which were partially offset by positive stock selection results. Regarding sector allocation, negative results were driven by the portfolio's underweight to the outperforming triple net lease and health care sectors. In terms of stock selection, results were strongest in the triple net lease, diversified, and regional mall sectors and were weakest in the office, hotel, and health care sectors. Among the portfolio's holdings, top individual contributors to relative performance included overweight positions in outperforming Gramercy Property Trust (GPT), Host Hotels & Resorts (HST), and Penn REIT (PEI). Detractors most notably included overweight positions in underperforming Boston Properties (BXP), Empire State Realty Trust Class A (ESRT), and American Homes 4 Rent Class A (AMH).

Europe

The European portfolio returned -2.66% in May before fees and withholding taxes, slightly outperforming the regional EPRA benchmark by two basis points. Marginal outperformance relative to the benchmark was driven by positive stock selection results, which were partially offset by negative country allocation results. In terms of stock selection, results were strongest in the United Kingdom, France and Spain and were weakest in Germany, Sweden and Switzerland. Regarding country allocation, negative results were attributable to the portfolio's lack of exposure to the outperforming Belgium, overweight to the underperforming Spain, and an underweight to the outperforming Switzerland. Conversely, the portfolio's overweight to the outperforming Norway was a notable contributor to relative performance. Among the portfolio's holdings, top contributors to relative performance included overweight positions in the outperforming Fabege AB (Sweden), Entra ASA (Norway), and a lack of exposure to the underperforming Shaftesbury PLC (United Kingdom). Detractors most notably included overweight positions in the underperforming Wihlborgs Fastigheter AB (Sweden) and Merlin Properties (Spain), and a lack of exposure to the outperforming Aroundtown SA (Germany).

Asia

The Asia portfolio returned -1.11% in May (before fees and withholding taxes), lagging the regional EPRA benchmark by 16 basis points. Underperformance relative to the benchmark was driven by negative stock selection results, while country allocation results were neutral. In terms of stock selection, results were weakest in Hong Kong and Japan and strongest in Singapore. Among the portfolio's holdings, top contributors to relative performance included a lack of exposure to the underperforming City Developments (Singapore), Tokyo Tatemono (Japan) and Hang Lung Properties (Hong Kong). Detractors most notably included a lack of exposure to the outperforming Swire Properties (Hong Kong) and overweight positions in the underperforming NTT Urban Development (Japan) and UOL Group (Singapore).

Active Balanced

Pendal Active Balanced Fund

Markets review

The domestic equity market, as measured by the S&P/ASX 300 Accumulation Index, extended gains from the previous month, closing May 1.2% higher. News from offshore dominated investor attention, not the least of which was the formation of a populist coalition government in Italy between the Lega Nord and the Five Star parties which prompted a bout of market volatility towards the month's end. The market focused ultimately on the risk that Italy might look to leave the Euro. Italian bond yields spiked, as did speculation over the potential for a parallel currency, presidential impeachment and a potential showdown between Italy and Germany over debt and fiscal discipline. However, for all the concerns and uncertainty the episode proved short-lived, with most assets reverting towards their commencement value over the period.

Domestically, **Resources (+2.6%)** remained elevated despite a volatile oil price during the month, amid concerns around Iran's near future supply cut following the US' withdrawal from the nuclear deal. As the Royal Commission continues to scare some investors out of **Financials (-0.1%)**, there is a sense that this has been benefiting the Resource sector due to a lack of alternatives within the local market. Performance from the big four banks was mixed, ranging from -4.1% **(NAB)** to +4.3% **(ANZ)**. The other sector that also finished May with a negative return is **Telecommunication Services (-10.1%)**, which was the largest detractor from index performance. Telstra **(TLS, -11.9%)** saw its share price fall after delivering an underwhelming market update. The company now expects its FY18 earnings (EBITDA) to be at the bottom end of guidance, while free cash flow is now set to finish at, if not above, the top end of guidance. The market remained wary of the increasingly competitive landscape of the industry and responded negatively to the trading update.

Elsewhere, the **Consumer Staples** (0.0%) sector was unchanged, although stock performance within the sector was divergent. **Healthcare (+5.5%)** led the market, both in terms of absolute returns and return contributions. It was largely attributed to the outperformance of sector heavyweight, CSL **(+9.1%)**.

Performance across the major offshore equity markets was mixed in May, reflecting a range of economic and political influences. A fair degree of attention remained on the cross-border trade dynamic, as further episodes of brinkmanship were witnessed between the US and its trading partners – Canada and China. Adding to this was the tenuous situation between the US and North Korea and the on-again-off-again peace summit. Investors kept these talks in perspective and focused on the domestic issues facing companies. The Brent crude oil price continued to advance above US$80 a barrel amid signs of further tensions with Iran and the economic crisis facing Venezuela which stoked supply concerns.

Despite the trade rhetoric, US stocks advanced during the month, buoyed by continuation of its economic expansion. Labour market and gross domestic product data remained strong, with the nation's unemployment rate falling to 3.9% - the lowest level since 2000. Gross domestic product was revised down to a still strong 2.3% for March quarter. At a sector level, the bond sensitive sectors – Consumer Staples, Real Estate and Utilities – shifted into negative territory on the back of expectations for higher interest rates, while Health Care and Energy sectors advanced. The market closed May with the S&P500 delivering a total return of 2.4%, while the NASDAQ rallied with a return of 5.3%.

The performance of European equity markets was divergent, reflecting localised issues with potential ramifications for the broader region. Late in the month, political developments in Italy came to the fore when the government formation process was halted after the president vetoed the anti-euro candidate nominated for the Finance ministry. The uncertainty created led to a spike in volatility and a blow-out in Italian bond spreads. Meanwhile in Spain, a no confidence motion was put forward by the socialist opposition party and both events stoked fears of a new euro crisis, which saw the regional currency fall in value. Italy's equity markets fell 8.5% in May and Spain's dropped by 6.1%. In stark contrast, the UK's FTSE 100 rose by 2.3% and France was little changed from the prior month.

Most Asian equity markets ended the month lower, with China the region's best performing markets, while Malaysia and Singapore lost value. Uncertainties over trade renegotiations, political developments in Italy, US dollar strength and a higher oil price weighed on sentiment across the region.

The Australian dollar rose by a marginal 0.2% against the US dollar in May, but was 3.8% stronger against the euro and British pound while being 0.5% weaker against the Japanese yen.

Australian bond yields rose early in May but ended the month lower as escalating geopolitical uncertainties sapped risk sentiment. This was predominantly centred on Italy and worries a new government could promote anti-euro policies. Meanwhile, developments on the Australian monetary policy front were relatively uneventful as the Reserve Bank left the cash rate on hold for the 19th consecutive month. The Board noted some progress on unemployment but reiterated further improvements were expected to be gradual. Economic data painted a mixed picture over the period. Wage growth was weak with a 0.5% increase for the first quarter and consumer confidence, retail sales and building approvals were also soft. The monthly labour market report revealed 23,000 jobs were added during the month; however an increase in the participation rate drove the unemployment rate higher to 5.6%. In contrast, business conditions strengthened to 21 – the previous high for the series. Finally, the Australian 10 year yield finish the month lower by 10bp to 2.67%, the 3-year yield dropped a more modest 7bp to 2.11% and 90 day BBSW fell 6bp to 1.98%. The BBSW-OIS spread narrowed over the period, but still ended relatively elevated.

Global bond yields rose early in May but ended the month lower as escalating geopolitical uncertainties sapped risk sentiment. This was driven by Italy and worries that a new government could promote anti-euro policies. Investors fled Italian government bonds and 2 year yields spiked from -0.33% to 2.67% in the final week of May. By the last day of the month, these fears were alleviated to a degree by the announcement of a finance minister who is less sceptical to remaining in the Eurozone. Elsewhere, the deteriorating situation in pockets of emerging markets as well as fears over the impact of a rising US dollar added to investor concerns. In terms of economic developments, the Fed left its target rate unchanged and suggested inflation was nearing its 2% objective. Finally, the US yield curve flattened over the month with the 10 year yield falling 10bp to 2.86% and the 2 year yield declining 6bp to 2.43%.

Portfolio performance

The Pendal Active Balanced Fund (formerly the BT Wholesale Active Balanced Fund) returned 0.55% (post-fee, pre-tax) for the month of May, underperforming its benchmark by 0.13%.

The Fund delivered a positive return in May, supported by exposure to Australian and offshore equity and listed property markets. Global and Australian fixed income markets also generated positive, albeit modest returns in May which contributed to performance. Partially offsetting the contribution within global equities was the Fund's exposure to emerging markets, as this segment experienced weakness during the month. Exposure to alternatives provided an overall positive return this month. At a Fund level, the contribution to performance was significantly higher from asset allocation, while manager contribution delivered was negative for a select number of strategies.

Tactical asset allocation contributions were driven by the Fund's exposure to Australian and global listed property as well as alternatives.

The key factors influencing our active management returns were stock selection outcomes within Australian equities. Within the Australian equity strategy, overweight positions in Qantas, BHP and Aristocrat together with exposure to small caps which outperformed the broader market contributed value. These contributions were mitigated by overweight positions in Metcash, JB Hifi, Telstra and CYBG.

Within the global equities portfolio, the Core portfolio outperformed while the Concentrated portfolio fell marginally short of the benchmark but positively contributed to overall returns. The European Value strategy was a notable detractor this month after the region underperformed.

Our Alternatives core portfolio detracted from returns this month, with four of the eight sub-strategies within the core portfolio delivering negative returns, which more than offset the positive impact of three sub-strategies. The Alternatives strategy delivered a total return (before fees) of -0.50% vs. a cash return of 0.17%.

The equity long-short, fixed income relative value and event driven strategies made positive contributions this month, with good performance from developed markets and completion of 13 deals within the event driven component. These were more than offset by detractions from the equity market neutral, dedicated short bias and managed futures strategies. Investor Sentiment themes were the primary source of losses within the dedicated short bias, while trends were weak within the managed futures strategy.

In relation to our tactical positioning within Alternatives, our long position in crude oil and volatility strategies contributed to returns, as we were able to profit from both the rise in oil prices and a decrease in volatility as market conditions settled. At the end of May we have maintained a long position in oil, copper and gold. We closed a spread position between Australian and US bond yields and have a long position in managed futures.

Strategy and outlook

Recent developments on the political arena highlight the risks of spill-over effects into asset markets. The degree of speculation typically associated within the realms of political brinkmanship, sensitivities to regulatory imposts and other localised factors warrant a degree of caution. Although there is considerably more clarity on the fundamental drivers of equity and bond markets, news on the macro front is likely to perpetuate bouts of heightened volatility. As active managers, we are conscious of this dichotomy and use a range of strategies at our disposal to take advantage of the opportunities that market dislocations can offer in the shorter term, while retaining the positioning within our asset allocation strategy which is guided by medium to longer term considerations.

The US economy is continuing to show signs of sustained recovery which bodes well for US equities. The Fed is also proceeding along its normalisation path and we expect this to continue but not indefinitely. Its growth drivers remain in force and labour markets are particularly strong, which suggests inflation will normalise over time. The Australian economy presents quite a contrast, with some challenges due to imbalances across industries and states, which suggests a degree of caution is warranted.

Pendal in continuing to apply its multi-faceted approach to generating additional returns on these investments and managing risks, with both short term and medium term considerations, and cognisant of structural and cyclical drivers. We have recently taken advantage of such moves which have been supported by our modelling. By further neutralising our relative exposures to growth and defensive assets and maintaining a material allocation to the diversifying properties of Alternatives, we have demonstrated that opportunities do exist to add value by employing a dynamic approach to allocating capital.

Investors can expect to see some refinements in asset allocation as we actively position the Fund to meet its longer term targeted outcomes, while retaining the ability to take advantage of active allocation opportunities as they arise.

Performance as at 31 May 2018

(%)	1 Month	3 Months	6 Months	FYTD	1 year (pa)	2 Years (pa)	3 Years (pa)	5 Years (pa)	Since Incp. (pa)
Australian Shares - All Cap									
Pendal Australian Share Fund									APIR - RFA0818AU
Total Return (post-fee, pre-tax)	0.81	0.94	5.07	12.49	14.32	11.95	6.63	9.80	10.04
Total Return (pre-fee, pre-tax)	0.88	1.14	5.48	13.32	15.24	12.84	7.48	10.68	11.04
Benchmark	1.19	1.10	2.93	9.74	9.99	10.39	6.06	8.78	9.92
Pendal Imputation Fund									APIR - RFA0103AU
Total Return (post-fee, pre-tax)	1.47	1.44	4.27	10.15	11.29	10.41	5.06	8.03	9.53
Total Return (pre-fee, pre-tax)	1.54	1.67	4.73	11.06	12.29	11.40	6.00	9.00	10.55
Benchmark	1.19	1.10	2.93	9.74	9.99	10.39	6.06	8.78	8.68
Pendal Focus Australian Share Fund									APIR - RFA0059AU
Total Return (post-fee, pre-tax)	0.62	1.13	6.21	13.57	16.16	13.99	8.48	11.86	9.45
Total Return (pre-fee, pre-tax)	0.49	1.27	7.09	14.95	18.11	15.50	9.73	13.02	10.59
Benchmark	1.19	1.10	2.93	9.74	9.99	10.39	6.06	8.78	7.47
Pendal Ethical Share Fund									APIR - RFA0025AU
Total Return (post-fee, pre-tax)	0.00	0.04	4.16	11.48	13.46	11.12	6.45	9.84	8.61
Total Return (pre-fee, pre-tax)	0.08	0.28	4.65	12.46	14.54	12.17	7.46	10.89	9.68
Benchmark	1.19	1.10	2.93	9.74	9.99	10.39	6.06	8.78	8.05
Australian Shares - Mid Cap									
Pendal MidCap Fund									APIR - BTA0313AU
Total Return (post-fee, pre-tax)	0.47	2.49	8.46	21.91	26.77	17.33	13.91	16.34	11.15
Total Return (pre-fee, pre-tax)	0.23	2.85	9.83	23.94	28.98	18.88	15.38	18.06	13.44
Benchmark	1.07	1.52	4.51	15.64	17.93	14.22	12.35	13.81	6.11
Australian Shares - Small Cap									
Pendal Smaller Companies Fund									APIR - RFA0819AU
Total Return (post-fee, pre-tax)	3.48	5.73	10.78	25.62	29.72	14.38	12.54	12.84	13.50
Total Return (pre-fee, pre-tax)	3.59	6.06	11.48	27.06	31.35	15.81	13.95	14.25	14.80
Benchmark	3.70	4.11	6.89	22.95	25.40	13.95	11.55	9.69	7.98
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund									APIR - RFA0061AU
Total Return (post-fee, pre-tax)	3.61	0.13	5.69	18.51	21.02	17.84	15.74	20.26	18.58
Total Return (pre-fee, pre-tax)	3.72	0.44	6.32	19.85	22.51	20.76	18.53	24.62	23.80
Benchmark	3.70	4.11	6.89	22.95	25.40	13.95	11.55	9.69	3.54
International Shares									
Pendal Core Global Share Fund									APIR - RFA0821AU
Total Return (post-fee, pre-tax)	0.52	1.78	1.94	12.95	9.87	11.43	7.42	14.64	5.90
Total Return (pre-fee, pre-tax)	0.61	2.03	2.44	13.96	10.92	12.49	8.44	15.74	7.07
Benchmark	0.37	2.58	2.17	12.77	9.80	11.55	8.13	14.90	7.34
Pendal Global Emerging Markets Opportunities Fund - WS									APIR - BTA0419AU
Total Return (post-fee, pre-tax)	-1.63	1.23	-0.02	12.66	11.43	17.54	5.69	11.05	11.58
Total Return (pre-fee, pre-tax)	-1.51	1.57	0.68	14.09	12.98	19.17	7.18	12.73	13.79
Benchmark	-3.77	-2.94	1.22	14.44	12.19	17.94	6.58	9.59	11.09
Pendal Concentrated Global Share Fund									APIR - BTA0503AU
Total Return (post-fee, pre-tax)	0.22	1.64	4.02	14.38	11.25	N/A	N/A	N/A	15.87
Total Return (pre-fee, pre-tax)	0.29	1.86	4.58	15.59	12.54	N/A	N/A	N/A	17.26
Benchmark	0.37	2.58	2.17	12.77	9.80	N/A	N/A	N/A	13.87
Property									
Pendal Property Securities Fund									APIR - BTA0061AU
Total Return (post-fee, pre-tax)	2.77	7.09	0.62	9.71	4.86	3.98	7.52	10.86	7.50
Total Return (pre-fee, pre-tax)	2.83	7.26	0.94	10.36	5.55	4.66	8.21	11.58	8.31
Benchmark	2.98	7.50	0.86	10.68	5.69	3.98	7.71	11.46	7.39
Pendal Global Property Securities Fund									APIR - RFA0051AU
Total Return (post-fee, pre-tax)	1.92	7.49	0.77	4.32	5.61	4.68	4.26	7.84	9.13
Total Return (pre-fee, pre-tax)	2.00	7.75	1.25	5.22	6.59	5.65	5.23	8.84	10.13
Benchmark	2.19	7.66	0.60	3.97	4.86	4.93	4.49	8.11	8.86
Fixed Interest									
Pendal Fixed Interest Fund									APIR - RFA0813AU
Total Return (post-fee, pre-tax)	1.08	1.33	0.85	2.59	1.55	1.62	2.07	3.69	6.40
Total Return (pre-fee, pre-tax)	1.13	1.46	1.10	3.06	2.06	2.13	2.58	4.21	6.95
Benchmark	0.69	1.18	0.68	2.60	1.67	2.09	2.93	4.07	6.61
Pendal Global Fixed Interest Fund									APIR - RFA0032AU
Total Return (post-fee, pre-tax)	0.50	1.03	0.09	1.12	0.67	0.71	2.05	3.89	5.96
Total Return (pre-fee, pre-tax)	0.54	1.17	0.36	1.62	1.21	1.24	2.59	4.44	6.55
Benchmark	0.30	1.12	0.41	1.79	1.48	1.50	3.32	4.70	6.87
Pendal Enhanced Credit Fund									APIR - RFA0100AU
Total Return (post-fee, pre-tax)	0.47	0.71	0.81	3.03	2.41	3.00	3.26	4.28	5.72
Total Return (pre-fee, pre-tax)	0.51	0.83	1.03	3.45	2.87	3.46	3.73	4.75	6.25
Benchmark	0.47	0.82	0.90	2.99	2.38	2.95	3.29	4.30	5.83
Cash & Income									
Pendal Enhanced Cash Fund									APIR - WFS0377AU
Total Return (post-fee, pre-tax)	0.17	0.46	1.19	2.53	2.82	2.90	2.65	2.84	4.93
Total Return (pre-fee, pre-tax)	0.19	0.53	1.32	2.76	3.08	3.16	2.91	3.10	5.27
Benchmark	0.17	0.48	0.91	1.63	1.78	1.81	1.96	2.24	4.87
Pendal Managed Cash Fund									APIR - WFS0245AU
Total Return (post-fee, pre-tax)	0.15	0.45	0.88	1.63	1.78	1.84	1.96	2.22	6.43
Total Return (pre-fee, pre-tax)	0.17	0.51	0.99	1.84	2.00	2.06	2.19	2.45	6.74
Benchmark	0.17	0.48	0.91	1.63	1.78	1.81	1.96	2.24	6.51
Pendal Monthly Income Plus Fund									APIR - BTA0318AU
Total Return (post-fee, pre-tax)	0.37	0.60	1.04	4.48	4.36	3.72	3.67	4.70	5.48
Total Return (pre-fee, pre-tax)	0.43	0.76	1.36	5.11	5.04	4.39	4.35	5.39	6.15
Benchmark	0.13	0.38	0.75	1.39	1.51	1.53	1.69	2.02	2.91
Diversified									
Pendal Active Balanced Fund									APIR - RFA0815AU
Total Return (post-fee, pre-tax)	0.55	1.46	2.19	9.11	8.85	8.38	5.41	8.54	7.70
Total Return (pre-fee, pre-tax)	0.63	1.70	2.67	10.07	9.89	9.41	6.42	9.57	8.78
Benchmark	0.68	1.50	1.95	7.90	7.12	7.75	5.84	8.23	7.50

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PENDAL

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Pendal is the issuer of the following products:

Pendal Australian Share Fund ARSN 089 935 964

Pendal Smaller Companies Fund ARSN 089 939 328

Pendal Concentrated Global Share Fund ARSN 613 608 085

Pendal Core Global Share Fund ARSN 089 938 492 #

Pendal Global Fixed Interest Fund ARSN 099 567 558

Pendal Enhanced Credit Fund ARSN 089 937 815

Pendal Fixed Interest Fund ARSN 089 939 542

Pendal Property Securities Fund ARSN 089 939 819

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Pendal Managed Cash Fund ARSN 088 832 491

Pendal Enhanced Cash Fund ARSN 088 863 469

Pendal Active Balanced Fund ARSN 088 251 496

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