Fund Manager Commentary

Month ended 30 June 2018

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Market Review

The S&P/ASX 200 Accumulation Index rose 3.2% in June to end the financial year with an +8.5% gain for the full year, or +13.2% once dividends are included. Earnings growth has powered these gains, as the Royal Commission and a challenging environment has seen the banks de-rate, keeping the market's aggregate valuation rating steady. This is important, as ultimately we see earnings-driven market growth as more sustainable than valuation-driven returns. The market's return was broadly in-line with the +8.8% 12-month gain from the MSCI World Index (in local currency terms). In the US, the S&P 500 gained +12.2% and the NASDAQ +22.3%, while Japan's Nikkei was up +11.3%. European returns were muted, with the UK's FTSE 100 up +4.4% over 12 months, while Germany's DAX was down -0.2%

Uncertainties around the potential trade war between the US and China weighed on market sentiment over the month, but haven't fully deterred investors from risky assets. That said, the impending implementation of the 25% tariff on US$50b worth of goods on July 6 is going to be closely watched by the market, as China is expected to retaliate in kind. Any further escalation in trade tensions could see the global equity market react poorly. Nevertheless, market valuations remain supportive in Australia, largely attributable to a weak currency against the greenback, as well as patience displayed by the RBA in prolonging its first interest rate hike.

Most of the industry sectors managed to record gains in June, with the exception of Industrials (-0.3%) and Telecommunication Services (-5.5%). The latter was the largest performance detractor for the headline index over the month. Whilst both TPG (TPM, -7.2%) and Vocus (VOC, -4.2%) finished the month lower, sector heavyweight Telstra (TLS, -6.4%) detracted the most. The national carrier's long-awaited investor day emphasised the challenges facing the mobile phone market in Australia, with competition intensifying as the largest player attempts to shift tack from being the disrupted to becoming the disruptor. Management flagged an additional A$1b of costs that the company expects to cut over the next three years, on top of the existing A$1.5b program, driven by job cuts and rationalisation of its phone plans from 1800 to 20 to simplify the business. However, dampening investor sentiment was management's guidance to a -17% fall in core underlying earnings for FY19. Following a -9% fall in the first half of FY18 and an expected -13% fall in the second half, this accelerating trend in earnings declines is the key challenge facing the business, and saw the stock sell off as a result.

On the positive side, Energy advanced the most in absolute return terms, finishing the month 7.7% higher; followed by Consumer Staples (+5.9%), Information Technology (5.9%) and Utilities (5.0%). Similarly, heavyweight Financials was the largest contributor to headline index performance, with a gain of 4.0%. While the Royal Commission remains an overhang for the banking sector, the 'Big Four' banks all bounced back somewhat from their recent lows, ranging from 2.3% (ANZ) to 5.2% (WBC). Macquarie (MQG, +8.2%) also contributed after investor sentiment for the bank/asset manager remained buoyant from the upbeat trade results released in May. Offsetting these gains though was AMP (AMP, -8.7%) which retreated further and was removed from the top 20 index. Outside Financials, some noteworthy outperformers include energy infrastructure owner/operator, APA Group (APA, +13.4%). It received a non-binding all cash takeover offer from Hong Kong-based consortium, CK Infrastructure. The announced price represented a 33% premium to APA's closing price at the time. Convenience store operator/oil refiner Caltex (CTX, +10.6%) also benefited from a deal update - BP was walking away from its offer to acquire Woolworths' petrol station business following prolonged negotiations with the ACCC. The volume that the market expected CTX to lose as WOW's petrol supplier, should the deal pass through, is likely to remain with CTX, at least for now.

Portfolio performance

The Pendal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned 2.08% (post-fee, pre-tax) in June, underperforming its benchmark by 1.11%.

Contributors

Overweight Caltex

Convenient store operator/oil refiner Caltex (CTX, +10.6%) provided guidance for its first-half results over the month. Management now expects net profit (on a replacement cost of sales basis) to be in the range of A$295m-315m, or a 4% growth rate compared to the previous corresponding period. While guidance was not too overwhelming to the upside, the company subsequently saw some broker upgrades. CTX's share price has fallen around 17% since it last updated the market in February, making stock valuations more appealing. Also propelling investor sentiment was BP's announcement that it was walking away from the deal to acquire Woolworths' petrol station business following prolonged negotiations with the ACCC.

Overweight CYBG

CYBG (CYB, +10.2%) announced its recommended offer for Virgin Money (VM), in which shareholders will receive 1.2125 CYBG shares in exchange for each VM share. CYBG will keep using VM's national brand, having agreed a fixed yearly minimum royalty payable by CYBG. Whilst some are doubtful over prospects considering the price paid, as previously communicated, we believe the market will ultimately focus on the emergence of CYBG as a stronger competitor within the UK market.

Overweight Santos

Santos' (STO, +7.0%) share price bounced back in June, recouping some of the losses it made in May when the company walked away from the takeover offer from Harbour Energy. The natural gas explorer announced further progress on the front end engineering and design (FEED) phase of the Barossa offshore project, with the award of three major engineering contracts during the month. In addition, the oil price was once again on the rise over the month, with the West Texas Intermediate crude oil fetching US$74/bbl at month end, or a +10.6% gain for the month, which was partially attributable to the US' upcoming ban of oil exports from Iran, which could take place as soon as November. The elevated oil price provides the backbone for STO's free cash flow generation. Santos is now targeting a payout of free cash flow as shareholder dividends in the range of 10% to 30%.

Not holding South 32

Stock performance of South 32 (S32, -3.0%) turned negative in June, as performance of base metals in general suffered. The escalation in the trade war tensions between the US and China has caused concerns over the impact on economic growth, and many have become doubtful regarding the near future demand for industrial metals. The greenback also advanced on the back of the trade war jitters, which further weighed on commodity prices. The prices for aluminium (-6.3%), zinc (-6.7%), copper (-3.9%) and nickel (-2.3%) all declined over the month, which weighed on S32.

Detractors

Overweight Metcash

Food/Grocery/Hardware wholesaler, Metcash (MTS, -10.0%) reported its full year result over the month. In our view, the result was reasonable given the competitive challenges in the supermarket sector. The stock initially rallied post-result, but then gave back the gains as the market latched onto two specific items. The first was the material decline in sales in some parts of Western Australia in response to new Aldi stores, with the market concerned that IGA's large share of the market may be under sustained threat. We see some parallels here with South Australia, where new Aldi stores initially dented IGA sales before management were able to respond with promotional programmes which ultimately arrested the decline. Sales growth has turned positive in South Australia during the most recent quarter and we expect management to replicate this approach in Western Australia. The second issue was the planned one-off $10m investment into the food and grocery business, which management have indicated will be put towards staffing and marketing, although the market appears to have assumed this will translate directly to price discounts and the bottom line.

We maintain our conviction in MTS despite the market's concerns; in our view it is only half-way, at best, through the transition programme implemented to turn the company around. One key positive area is the removal of 6,000 low value, low turnover items and their replacement with 3,000 higher turnover units in their food and grocery business. This is in the early days of roll-out through IGA stores and there is evidence emerging of sales growth in those stores where it has taken place. Elsewhere, there are further gains to be made in hardware as the integration continues. MTS trades at a multiple of 12.15x consensus next 12 months earnings and a dividend yield of 5.7% and the company has no debt. At this point, the implied valuation for food and groceries is only 2x earnings (EBIT), once hardware and liquor are backed out, which we believe is far too low for a division where several positive programmes are in place to regain sales growth.

Overweight Qantas

The share price of national airliner, Qantas (QAN, -3.0%) pulled back moderately despite the lack of any additional news. Against this backdrop, we suspect that some investors turned their focus towards the continuous rise of the global oil price which could see operating costs move higher for Qantas. As previously stated, whilst it is something that we keep an eye on, we do not believe it compromises our investment thesis on QAN for now, which is predicated on continuous growth of demand in excess of capacity growth within the domestic market; alongside an improving international market.

Overweight Ramsay Health care

Private hospital operator, Ramsay Healthcare (RHC, -12.0%), downgraded FY18 earnings growth expectations from 8-10% to 7%, citing flagging volumes in the UK as well as a subdued environment in Australia. While weaker demand for procedures in Australia is one issue, the key challenge on RHC's horizon is the upcoming contract negotiations between private insurers and hospitals. The risk from a possible Labor federal government looms large here, with Bill Shorten stating that private insurance premium growth would be capped at 2% per annum, putting pressure on their business models and, in turn, on what they are willing to pay hospitals.

Overweight AMP

AMP retreated by another 8.7%, as it was removed from the top 20 index. David Murray has now commenced as the new Chairman of the Board. To reiterate our views on AMP, while we acknowledge it will take time for it to rebuild trust with the market, regulators and the public, we also think the circa 35% fall in the share price (from its March peak) is out of proportion to the likely earnings and valuation impacts. Errors in the business were compounded with misrepresentations to the regulators. There is no doubt that senior management and the board must be held accountable, and the likely outcomes we see from here are management and board changes in conjunction with fines and higher regulatory costs. Nevertheless, we expect the franchise risks around adviser and customer departures to likely recede as negative publicity subsides. Given where stock valuations are at the moment, we continue to hold AMP in the Fund.

Strategy and outlook

Australian equities rose into the end of the financial year, with large caps generally outperforming their smaller peers. The portfolio made absolute gains, helped by strong performance from some of its mid-cap stocks such as Caltex Australia, CYBG, and Whitehaven Coal. However, the overweights in Metcash and Qantas saw the Fund lag the index over the month.

The Index returned 13.2% for the financial year, including dividends. At just under 16x the next-12-month price/earnings for the S&P/ASX 300, the market's valuation remains above its long term average, however not egregiously so given the low target interest rate of the Reserve Bank of Australia (RBA). While rates remain low we believe the market can maintain its current valuation - and we do not expect imminent rate rises given the lack of inflation in the economy. This leaves earnings to drive stock markets. We think there is enough capacity in the economy to support mid-single digit earnings growth, helped by the pipeline of infrastructure spending and a pick-up in capital expenditure in corporate Australia. As a result we continue to expect Australian equities to return somewhere near high single-digit returns for the next year, once dividends are factored in.

The market's key feature remains the increase in stock dispersion in recent times. This is driven partly by the decline in previous thematic drivers, but the scale of disruptive challenges facing a large swathe of corporate Australia is paramount. This provides a fertile ground for active managers to add value.

Our key positions in the current environment include BHP in resources. Chinese supply-side policy settings continue to support commodity prices and earnings growth, while the company's strategy of divesting its poorly-performing assets should lead to improved capital allocation and return on equity. We also maintain conviction in Metcash. We believe the market's reaction to the loss of the Drake contract in South Australia has been disproportionate, while we also believe the improving trends in supermarket sales are underestimated. At this point, the implied valuation for the IGA business is little more than two times EBITDA, which we believe is far too low given the programmes in place to drive revenue growth.

Qantas lagged slightly over the quarter; however, it also remains among our highest conviction positions. Disciplined pricing and capacity in the domestic market underpin continued earnings and cash flow. A pick up in corporate capital investment - not least by the West Australian miners - is helping domestic demand growth while trends in its international market have also turned positive for the first time in a while. At 9.9x next-12-month price/earnings, we think QAN continues to offer a compelling opportunity, despite its strong gains over the last five years.

Pendal Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation Index finished June in positive territory with a gain of 1.1%, despite underperforming its large cap counterpart by 2.1%. However, over the financial year the Small Cap index returned 24.2% with the help of small cap Resources (+49.0%).

Over the month, sector performance was divergent, with six of the GICS sectors finishing June higher and the other five recorded losses. In total return terms, Energy (+7.3%) delivered the largest gains whilst Utilities (-9.2%) suffered the most. Within the Energy sector, Liquefied Natural Gas (LNG, +31.8%) was the standout performer. As the global oil price remains elevated, LNG's share price rallied during the month. In addition, LNG issued 56.4m ordinary shares at A$0.50/share, raising $28.2m via a share placement with IDG Energy Investment Group, a HK-listed entity that engages in the exploration, development and production of crude oil in China. Net proceeds will be used in support of ongoing LNG offtake marketing efforts, focused on Magnolia LNG; whereas strategically, IDG's investment is likely to increase LNG's credibility in China, a key growing market for liquefied natural gas. Within the Utilities sector, both of the only two companies in the sector, ERM Power (EPW, -3.9%) and Infigen Energy (IFN, -11.4%), finished the month lower. The latter reported its May monthly production report, with FYTD volumes 1.7% higher than the previous corresponding period.

Consumer Discretionary (+2.8%), the second largest sector in the Index, was driven by strong performances from Corporate Travel Management (CTD, +10.9%), Webjet (WEB, +7.8%) and IDP Education (IEL, +8.6%). WEB received a sell-side upgrade in June on the back of strong demand and increased hotel booking rates in its key destination markets such as the US and Western Europe. Similarly, IDP continued to strengthen following 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, as well as the limited and fragmented nature of its direct competition. Offsetting some of these gains was Retail Food Group (RFG). The company experienced a significant 34.2% share price fall during June. The company has been on a downward spiral since the release of a report in December last year that revealed the struggling circumstances for many of RFG's franchisees. The company received a number of broker downgrades over the month, despite providing earnings guidance and announcing that lenders agreed to waive testing of financial covenants under RFG's senior debt facilities for FY18. Outside of Consumer Discretionary, Real Estate (+4.1%), Information Technology (+5.0%) and Health Care (+4.6%) all experienced a positive month.

On the other side of the spectrum, index heavyweight Materials (-2.9%) declined over the month and was the largest performance detractor in June. It was partially attributable to negative performance from Mineral Resources (MIN, -13.4%) and Ausdrill (ASL, -27.5%). Ausdrill provides exploration and drilling services to the mining and energy sectors, and it provided a project update in June, which advised that reduced scope at the Mineral Resources' Wodgina project will see the contract value halve to $90m over the next three years. This dampened investor sentiment for both MIN and ASL. ASL also advised that a wall failure at the Kalgoorlie Super Pit gold mine has reduced their contract scope by 35%. Offsetting some of the losses, Regis Resources (RRL, +8.0%), Independence Group (IGO, +6.2%) and Sandfire Resources (SFR, +5.4%) all managed to record gains over the month.

Portfolio performance

The Pendal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned -0.36% (post-fee, pre-tax) in June, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 1.42%.

Contributors

Overweight IDP Education

IDP Education (IEL, +8.8%) provides university placement and English language testing services in Australia, New Zealand, Canada and the US. The stock price continued to strengthen following 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 both language testing and university placement, as well as the limited and fragmented nature of its direct competition. We like the company based on a combination of structural tailwinds, conservative management and the steps they are taking to drive greater efficiency through digital solutions.

Overweight Webjet

Webjet (WEB,+7.8%) is an online travel agent and has grown to become Australia’s largest online flight booking site. It has also expanded into the US, Singapore and Hong Kong in recent years.

The company saw a sell-side upgrade in June on the back of strong demand and increased hotel rates in its key destination markets such as the US and Western Europe. We like the company for its structural tailwinds from the move to online booking and the growth in tourism in-and-out of Australia, as well as the potential opportunities from its move into the business-to-business sector.

Detractors:

Overweight Ausdrill

Ausdrill (ASL, -27.3%) provides exploration and drilling services to the mining and energy sectors. The stock fell in June following a project update which advised that reduced scope at the Wodgina project will see the contract value halve to $90m over the next three years. It also advised that a wall failure at the Kalgoorlie Super Pit gold mine has reduced their contract scope by 35%. While this does present a near-term setback, we believe the company will continue to benefit from further cyclical tailwinds as mining companies begin to spend on expansions and replacement projects.

Overweight RCR Tomlinson

RCR Tomlinson (RCR, -13.1%) is a diversified infrastructure and engineering company, with a particular focus on renewable energy projects. It fell following some market concerns that there may be a shortfall in near-term earnings versus expectations due to a lack of recent contract wins. We believe RCR will continue to benefit from a strong pipeline of infrastructure and mining projects and it is particularly well placed to benefit from a structural shift to more renewable energy sources. We have been adding to our position on this recent share price weakness.

Strategy and outlook

The S&P/ASX Small Ordinaries made positive gains in June, but underperformed its large cap peers as the major banks experienced a partial rebound. The portfolio fell slightly for the month, despite strong gains from IDP Education and Corporate Travel Management. Several of the Fund's mining stocks underperformed, as did the position in infrastructure and mining services, which contributed to the portfolio finishing behind the index for the month.

The small cap sector gained +24.3% for the financial year. Strength in commodity and oil prices saw the S&P/ASX Small Resources gain +49.0%, a surge which saw portfolio holdings - Pilbarra Minerals and Whitehaven Coal - finish among the best performers in the Index. Strong cash flows are allowing mining companies to begin spending on development again, following several years of drawn purse-strings. This is seeing life return to the mining services sector in the form of new contracts. We do have some positions in mining and energy companies; however, our preferred exposure is via services to the resource sector, given that small cap resource companies can often be dependent on one asset. As a result, we retain exposure to companies such as Seven Group and Ausdrill. Technology also did well in aggregate for the year. Altium - another portfolio holding - was also among the sector's best performers. In aggregate, the Fund managed to add value through what has been particularly strong market return for FY18.

Looking forward, we continue to see attractive opportunities in the sector. The key challenge remains finding the pockets of growth but avoiding over-hyped themes where companies have been priced for perfection. In addition to mining services, we have identified opportunities aligned with structural tailwinds such as IDP Education (overseas education), Ryman Healthcare (aged care), and RCR Tomlinson (renewable energy). The Australian retail sector continues to face an unprecedented level of disruptive challenge. Here, we are positioned in companies such as Bapcor which we believe have some level of protection from new competition, or which are acting as disrupters themselves, such as Webjet. A recent research trip to China emphasised the opportunities in those companies that can successfully capture some niche of consumption there, although it is crucial to retain valuation discipline given the cycles of euphoria and despair that often accompany such opportunities. With A2 Milk having risen out of the small cap index, our exposure to this segment includes New Zealand-listed Synlait Milk, a dairy company with exposure across several different products, including a supply contract to A2 Milk.

International Shares

Pendal Concentrated Global Share Fund

Market review

The global equity market experienced another month of heavy geopolitical influences on sentiment, obscuring the more fundamental drivers of performance. At its core were concerns of an intensifying trade war between the US and China, together with the potential implications for other countries, particularly in Europe and emerging markets. During the month, President Trump announced the imposition of a 25% tariff on US$50b worth of imports from China, which accompanied a further threat of tariffs on another US$200b in goods from China should retaliatory measures be announced. The trade war fears, combined with consternation over central bank policy direction acted to limit gains on share markets, although a weaker Australian dollar translated to a gain in the MSCI World (A$) Index.

US stocks advanced during the month, despite the market's preoccupation with trade tensions. However, there was considerable dispersion across industry sectors, with Industrials and Financials faring the worst, evidenced by weakness in heavyweights like Boeing and Caterpillar. Both companies are heavy importers of goods from China. Meanwhile, consumer-oriented sectors were among the strongest performers, buoyed by continuation of strong economic data. The latest figures on the labour market saw the national unemployment rate fall to an 18-year low of 3.8%, while headline inflation crept up to annual rate of 2%. As expected, the US Federal Reserve raised the cash rate by 0.25%, but what was less expected was the signalling of two more rises this year, with previous indications pointing to only one more hike. The market closed June with the S&P500 delivering a total return of 0.6%, while the NASDAQ rallied with a return of 0.9%.

The performance of European equity markets saw considerable dispersion, with the larger markets of Germany and France declining while Spain and Switzerland were the standout performers. Trade rhetoric dominated the concerns, while a softening of policy tones from the central bank kept economic growth projections in check. Economic data also pointed to a mixed outlook. Headline inflation for the region edged up to 2%, driven by higher food and energy prices, although core inflation was subdued at 1%. A rise in the eurozone Purchasing Managers' Index (PMI) from 54.1 to 54.8 was above expectations; however, consumer sentiment and retail sales indicators in some key markets were somewhat disappointing. The performance of Germany's DAX (-2.4%) and France's CAC (-1.4%) was in contrast to the strength of Spain (+2.6%), Switzerland (+2.0%) and Sweden (+0.8%), which helped to neutralise returns at a regional level. The UK's FTSE 100 declined by 0.5%, driven by both domestic and offshore concerns.

Most Asian equity markets ended the month lower, given the expectation that emerging markets are net losers in a trade war between the US and China. Concerns over China's growth more generally, acted to weaken regional markets. During the month, the People's Bank of China announced a reserve ratio cut of 0.50% (the reserve ratio is the portion of depositors' balances that banks must have on hand as cash) to generate liquidity and support growth, which reflected some concerns over the growth trajectory. The region's weakness was reflected in the returns for Thailand (-7.6%), Hong Kong (-5.0%) and Singapore (-4.6%), while Japan (+0.5%) traded into positive territory after assistance from a weaker yen.

The Australian dollar declined in June by 2.2% against the US dollar, 2.1% against the euro, 1.4% against the British pound and 0.4% against the yen.

Portfolio performance

The Pendal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned 2.53% (post fee, pre-tax) in June, outperforming its benchmark by 0.20%.

Whilst the North Korean/US summit in Singapore has come and gone, and relations between the two countries at face value have appeared to thaw, the market remains on heightened alert to the threats posed to future economic growth by a global trade war. The rhetoric from the US in particular has become increasingly assertive regarding what the US administration believes needs to be done to rectify perceived trade imbalances. However, the concerns are not yet reflected in global GDP growth or second quarter earnings forecasts. Global GDP growth was 3.9% for the quarter whilst consensus second quarter earnings forecasts in the US imply 20% earnings growth. We remain aware that a number of holdings within our portfolio have re-rated significantly post the Fund's inception, and we have taken the opportunity to dilute some of our positions through inflows and raise our cash levels to around 11%.

Regular readers of our monthly would be aware of our positive view on US media companies, or more specifically the content providers (refer to https://www.pendalgroup.com/education-and-resources/making-money-media/ for a detailed discussion on our positioning in the sector). Our position in Time Warner and 21st Century Fox were bid for at a 40% and 30% premium, respectively, and we opted to roll the funds into Discovery Communications. Discovery was up 35% this month with management giving a confident update at a media conference in the US on the synergies they expect to derive from the acquisition of Scripps Network. Management are guiding to US$600m of net cost synergies after year two of the deal closing. We remain confident that the acquisition provides an opportunity for management to reset the cost structure of both companies, and guidance may prove to be conservative. The company also announced a US$2b, 12-year PGA deal which gives them the international multi-media platform rights for 2000+ hours of golf content. A significant portion of the cost will be offset by sub-licencing deals, through which the company will be able to further monetise through advertising and affiliate fees. The combined Discovery/Scripps Networks business has the highest share (approximately 20%) of basic cable viewers in the industry. We expect this to lead to increased bargaining power with the virtual multi-channel video programming distributors, as well as the traditional TV channels. Consensus estimates assume no earnings (EBITDA) growth through 2019 aside from merger synergies, we believe the combined company will be able leverage their increased viewer share to negotiate better terms with advertisers. We also believe the 8x enterprise value (EV/EBITA) multiple that the stock currently trades on does not reflect the true value of the company.

Pharmaceuticals producer, Sanofi, performed well this month, with a 4.3% return. Following a meeting with Sanofi management, we remain confident in the longer term earnings trajectory of the company and management's ability to improve margins. We welcome the appointment of the new CFO, Jean-Baptiste Chasseloup, effective in October 2018. Chasseloup was formerly CFO of the French automotive group, Peugeot Citroen, where he was credited with steering an improvement in margins. With two new acquisitions to integrate, recent major product launches and a diversified product suite, we expect management's efforts in the next 12 months to focus on improving margins and earnings in their five speciality areas: multiple sclerosis, oncology, immunology, rare diseases and rare blood disorders. As shareholders, we are receiving a 5% dividend yield, and believe that the current strategy will over time deliver earnings and margin growth over what is being currently being implied by current share prices.

Our holding in Oracle was down 6% this month after the company reported fourth quarter results. Revenues for the quarter and the full year were marginally better than consensus estimates. Earnings (EBIT) margins improved from the 46% last year to 47%, whilst earnings per share for the full year increased by 11%. The negative stock price reaction appeared to stem from a reclassification of reporting segments which will result in less transparency on Cloud revenues and growth. The new segments now combine On Premise and Cloud License revenue. While separating the Cloud results would make it easier for analysts to determine whether Oracle is successfully transitioning their business from a On Premise business to a Cloud centric business, the reality is that both businesses will exist in tandem for some time. Oracle's BYOL (Bring your own licence) product initiative allows existing On Premise customers to move all or part of their data to the Cloud. Hence, it becomes difficult to classify a customer as being purely a Cloud or an On Premise customer. We remain comfortable with the full year guidance provided by management for double digit EPS growth and a further expansion in Cloud margins.

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

The global equity market experienced another month of heavy geopolitical influences on sentiment, obscuring the more fundamental drivers of performance. At its core were concerns of an intensifying trade war between the US and China, together with the potential implications for other countries, particularly in Europe and emerging markets. During the month, President Trump announced the imposition of a 25% tariff on US$50b worth of imports from China, which accompanied a further threat of tariffs on another US$200b in goods from China should retaliatory measures be announced. The trade war fears, combined with consternation over central bank policy direction acted to limit gains on share markets, although a weaker Australian dollar translated to a gain in the MSCI World (A$) Index.

US stocks advanced during the month, despite the market's preoccupation with trade tensions. However, there was considerable dispersion across industry sectors, with Industrials and Financials faring the worst, evidenced by weakness in heavyweights like Boeing and Caterpillar. Both companies are heavy importers of goods from China. Meanwhile, consumer-oriented sectors were among the strongest performers, buoyed by continuation of strong economic data. The latest figures on the labour market saw the national unemployment rate fall to an 18-year low of 3.8%, while headline inflation crept up to annual rate of 2%. As expected, the US Federal Reserve raised the cash rate by 0.25%, but what was less expected was the signalling of two more rises this year, with previous indications pointing to only one more hike. The market closed June with the S&P500 delivering a total return of 0.6%, while the NASDAQ rallied with a return of 0.9%.

The performance of European equity markets saw considerable dispersion, with the larger markets of Germany and France declining while Spain and Switzerland were the standout performers. Trade rhetoric dominated the concerns, while a softening of policy tones from the central bank kept economic growth projections in check. Economic data also pointed to a mixed outlook. Headline inflation for the region edged up to 2%, driven by higher food and energy prices, although core inflation was subdued at 1%. A rise in the eurozone Purchasing Managers' Index (PMI) from 54.1 to 54.8 was above expectations; however, consumer sentiment and retail sales indicators in some key markets were somewhat disappointing. The performance of Germany's DAX (-2.4%) and France's CAC (-1.4%) was in contrast to the strength of Spain (+2.6%), Switzerland (+2.0%) and

Sweden (+0.8%), which helped to neutralise returns at a regional level. The UK's FTSE 100 declined by 0.5%, driven by both domestic and offshore concerns.

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The Australian dollar declined in June by 2.2% against the US dollar, 2.1% against the euro, 1.4% against the British pound and 0.4% against the yen.

Portfolio performance

The Pendal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned 0.88% (post-fee, pre-tax) in June, underperforming its benchmark by 1.45%.

The Fund's underperformance during June 2018 reflected the impact of negative performance in all core regions. Thematically, underperformance in the US was due to negative performance in our industry momentum and momentum signals, while underperformance in Europe was due to negative performance in our valuation and industry momentum signals, partially offset by the positive performance of our momentum factor. The underperformance in Japan was due to negative performance in our investor sentiment and stability signals.

From a stock and industry attribution perspective, both active industry tilts and intra-industry stock selection detracted from performance over the month. At a sector level, an overweight to Consumer Staples was the largest detractor from active returns, while an overweight to Materials was the largest contributor. Within sectors, stock selection in Information Technology and Industrials drove underperformance and was only marginally offset by positive performance from stock selection in Health Care and Consumer Staples.

At a stock level, the largest contributors to active returns came from overweight positions in Darden Restaurants Inc., an American multi-brand restaurant operator; Michael Kors Holdings Ltd., an American fashion company; and Facebook Inc., an American online social media and social networking service company. The largest detractors over the month were an overweight position in Micron Technology Inc., a US-headquartered manufacturer of semi-conductors and data storage devices; an underweight position in Netflix Inc., a US-headquartered global entertainment company; and an underweight to the Volkswagen Group, a German multi-national automotive manufacturing company.

Strategy and outlook

Moving into July, Entering July, the largest sector tilts are an overweight in Information Technology and underweights in Financials and Consumer Staples.

Australian Fixed Income

Pendal Fixed Interest Fund

Market review

Australian bond yields experienced a small fall and a flattening of the curve over June. During the month, the Reserve Bank of Australia (RBA) left rates unchanged at 1.50% for the 20th month in a row. In its statement, the Board noted it continues to expect gradual progress on inflation and unemployment. It also highlighted recent global developments like political uncertainty in Italy and US trade policy changes. The latter continued to weigh on broader risk sentiment over June. The local market also endured concerns over another expansion in the BBSW-OIS spread. The spread on the three-month maturity widened 13bp to 61bp and the grind higher appeared independent of its US equivalent.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned 0.78% in June (post-fees, pre-tax), outperforming its benchmark by 0.30%.

Within the alpha overlay, all strategies added to performance, with the Macro and FX strategies being the strongest performers. The government bond component marginally underperformed its benchmark, with the Relative Value strategy being the main detractor. Finally, the Credit component underperformed its benchmark, which was partly attributable to an underweight supranationals and overweight Infrastructure position.

Strategy and outlook

The RBA left the cash rate unchanged at its July meeting and indicated no near term change to monetary policy. Economic growth released early in June was in line with their forecasts and forecasts from the Statement on Monetary Policy (SoMP), particularly around inflation and the labour market, indicate that they will likely remain on hold for at least the next 12 months. Higher funding costs for banks are translating into rising mortgage rates more recently for some households, although this needs to be kept in context against longer term moves which have resulted in lower mortgage rates, despite no change in the cash rate. It is unlikely that the RBA will be changing their view or stance on monetary policy in response to the more recent increases in funding costs. The key economic data due for release in July includes second quarter inflation. With inflation below target and no change expected from the RBA, the larger market reaction would come from a higher than expected release. In the near term the market will be focused on what happens with the BBSW-OIS spread and repo rates. Previous moves wider have usually mirrored offshore markets, although the widening in June was specific to the Australian market. The lack of liquidity was concerning. With three major banks having a September year end (CBA is the exception with a June year end) we may not have long to wait to witness similar volatility in short end money markets.

Turning to credit markets, we maintain our recently adopted neutral view on investment grade credit.

Credit markets have lost the teflon coating they had during most of 2016 and all of 2017. For those two years, credit spreads were much more appealing, with the Australian iTraxx reaching a high of +173 in Feb 2016. The market's concern around a slowdown in China and a hawkish US Federal Reserve had started to recede, we also had the European Central Bank buying corporate bonds.

These factors drove down equity volatility with the VIX Index falling from 28 to 9 by the end of 2017, this also saw credit spreads stage a strong rally with the iTraxx closing out 2017 at +58.

However, 2018 has seen a reversal of these factors. We are starting to see signs of a slowdown in growth in China, the Fed is raising rates due to signs of US inflation, and the ECB is planning the tapering of its corporate bond buying program. Additionally, concerns around potential global trade wars and European politics are dragging down risk sentiment. This has seen equity volatility pick up and credit spreads widen with the iTraxx closing out June at +80.5.

Reduced market liquidity, in part due to a withdrawal of central bank stimulus will see increased volatility in markets. All of these factors leave us cautiously positioned until we have further clarity on these developments.

However, we do acknowledge strong corporate fundamentals remain, with healthy balance sheets, positive earnings growth and low high yield default rates.

On balance, the uncertainty and less attractive risk-return trade-off warrants a neutral stance for now. We believe investment grade securities should outperform high yield issuers in this environment.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bond curves flattened over June. Escalating trade tensions captured investors' focus during the period as President Trump announced new tariffs and China retaliated with its own levies. Meanwhile, fears over the potential for extreme anti-euro policies in Italy faded. On the monetary policy front, the US Federal Reserve hiked rates by 0.25% as widely expected. The FOMC also raised its rate outlook to include a total of two more hikes by the end of the year and as such, was perceived as more hawkish. US data remained relatively strong, including the monthly jobs report and ISM manufacturing figures. Meanwhile in Europe, the ECB announced it would begin tapering its quantitative easing program in September this year, with purchases to stop by December. However, its guidance for rates to remain at current levels at least until the European summer of 2019 suggested a dovish message overall.

Data in the region was reasonable, with the composite PMI increasing 0.7 to 54.8 and strong IFO business climate figures. Escalating trade tensions continued to make headlines and concerned investors. Finally in terms of market movements, the US 2-year yield rose 10bps to 2.53% while the 10-year yield finished unchanged at 2.86%.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned 0.72% in June (post-fees, pre-tax), outperforming its benchmark by 0.41%.

Over the month, all strategies contributed positively to performance. The portfolio started the month at eight risk units and decreased to three risk units before finishing the month at four risk units.

The Duration strategy was slightly positive over the month. Gains came from long duration positions in Germany and Japan, although the gains were offset by losses from a new long duration position in the Swedish front end and a short duration positions in the US long end. During the month we also took profits on a long duration position in Korea.

The FX strategy was one of the largest contributors over the month. Gains in the month were mainly from long USD against short CNH and KRW, due to the concerns around the escalation of trade war between the US and China. After taking profit on some long USD positions last month, we reopened long USD positions against short PHP which contributed positively to the portfolio. We closed all long volatility positions early in the month but reinitiated long volatility positions in EUR/AUD, EUR/USD and NZD/USD with a slight positive contribution to performance.

The Yield Curve strategy contributed positively for the month. Most of the gains were from flattening positions in Europe, which were initiated toward the end of the month. As of month end we continue to hold a steepening position in the Japanese long end. There were no trades in the Cross-Market strategy for the month.

The Macro strategy was the largest contributor over the month. The majority of gains were from the continued widening of the CDX EM spread, where we took partial profit on our buy protection positions. During the month, we used the opportunity of slight tightening in EM spreads to re-enter buy protection positions on the more concerning countries of Turkey, Brazil, South Africa and Mexico. We maintained our buy protection positions in Europe Main and added a position in short-dated CDX IG as a tail event protection.

The Relative Value strategy added to performance over the month. Gains were mainly from the 5-year invoice spread widener in the US. We continue to hold the Australian 3-year EFP spread widening positions with a flat performance.

Strategy and outlook

Since the GFC, market and trading liquidity has changed structurally and for the worse. The lack of that liquidity when markets are at their maximum pain point can create significant overshoots. This was witnessed in May through the market's reactions on Italy and Turkey. While it may have been a short-lived reaction, it does not mean that the worst is behind us for European and emerging markets.

In June, the larger risk-off driver was the resurfacing of Sino-US trade tensions. This escalation differed from previous episodes because it has highlighted the extent of China's own cyclical weaknesses. It also highlights further cyclical vulnerabilities in Europe and emerging markets and has the potential to snuff out the growth momentum in the US if China's policy makers fail to contain a hard landing. Whilst a return to a 2015 scenario is not our base case, we continue to expect further slowing of the Chinese economy later this year. More broadly, we believe the withdrawal of global liquidity will continue to create vulnerabilities in certain markets that benefited from monetary excess in previous years.

Credit

Pendal Enhanced Credit Fund

Market review

Australian credit posted a positive return for the month. This was driven by accruals and a small fall in underlying yields, which more than offset a widening in credit spreads. The increase in spreads was tied to broad investor concerns regarding trade tensions. This was in addition to lingering worries over anti-euro policies in Italy, although these faded to some degree in June. Sentiment in the domestic market was also hurt by a widening in the BBSW-OIS spread and reduced liquidity.

Turning to local credit market activity, issuance in June totaled only $1.75b, a significant reduction versus the $8b issuance in May. Financials were the only issuers, with no deals from corporates over the month. Barclays tapped the market for $600m in debt capital and Westpac issued $750m. The light issuance likely helped suppress a larger rise in spreads.

The Australian iTraxx index (Series 29 contract) traded in a 12bp range, finishing the month 11bps wider to +80.5bps. Physical credit spreads widened 1bp on average across the sectors. The worst performing sectors were telecoms, resources and real estate, which widened by 6, 4 and 4bps, respectively, whilst supranationals and offshore banks outperformed with both narrowing 1bp. Semi-government bond spreads outperformed after tightening 2bps to government bonds over the month.

Portfolio performance

The Pendal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 0.30% in June (post-fees, pre-tax), underperforming the benchmark by 0.06%.

Accruals and a fall in the underlying swap rate both made positive contributions and 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, fund activity was light, with issuance from GPT the only purchase.

Strategy and outlook

Our macro credit view is neutral. Whilst 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 in part 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 in May and Sino-US trade tensions in June.

Over the remainder of the year, it is expected there will be further cash rate increases in the US, as reinforced by the Fed this month. Additionally, the ECB has announced its intention to end quantitative easing by the end of this year. Market price dislocations will occur, should expectations of central bank actions and emerging economic growth, inflation and labour data not align with 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. The domestic market is also enduring an elevated BBSW-OIS spread, that has created concern among investors. 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 experienced a small fall and a flattening of the curve over June. During the month, the RBA left rates unchanged at 1.50% for the 20th month in a row. In its statement, the Board noted it continues to expect gradual progress on inflation and unemployment. Support for the local economy from public infrastructure, stronger exports and non-mining business investment was also discussed. It also highlighted recent global developments like political uncertainty in Italy and US trade policy changes. The latter continued to weigh on broader risk sentiment over June. The local market also endured concerns over another leg higher in the BBSW-OIS spread. The spread on the three-month maturity widened 13bp to 61bp and the grind higher appeared independent of its US equivalent.

Domestic data was relatively mixed over the period. First quarter GDP growth at 1.0% beat expectations and brought the year-on-year rate to 3.1%. This was attributed to strength in net exports, while in contrast consumption was subdued. Also during the month, employment data revealed a soft 12,000 increase in jobs, which was skewed to part-time positions. Leading indicators were more constructive with retail sales growth of 0.4% and in increase in consumer confidence to 102.1. At the same time business conditions and confidence measures fell to +15 and +6 respectively.

Looking abroad, the US Federal Reserve hiked rates by 0.25% as widely-expected. The FOMC also raised its rate outlook to include a total of two more hikes by the end of the year and as such was perceived as more hawkish. Also in the US, the monthly non-farm payrolls report revealed 223,000 jobs were added during the month and the unemployment rate fell to 3.8%, the lowest since December 1969. ISM Manufacturing data was also strong with an increase from 57.3 to 60.2.

Turning to Europe, the ECB announced it would begin tapering its quantitative easing program in September this year, with purchases to stop by December. However, its guidance for rates to remain at current levels at least until the European summer 2019 suggested a dovish message overall. Data in the region was reasonable with the composite PMI increasing 0.7 to 54.8 and strong IFO business climate figures.

Meanwhile, escalating trade tensions continued to make headlines and concerned investors. President Trump announced during June that US$50b of Chinese imports will face a 25 percent tariff that will be introduced in two stages with a further US$200b threatened. Chinese policymakers responded in kind with a 25% tariff on $US50b worth of imported US goods. US auto imports from Europe were also flagged as a potential tariff target, which prompted tit-for-tat talk from policymakers in Europe.

Beyond trade-related geopolitics, President Trump's meeting with his North Korean counterpart, Kim Jong Un, had little impact on markets, with a full resolution and denuclearisation on the Korean peninsula yet to be achieved. Italian political developments were perceived as more noteworthy as fears surrounding the more extreme anti-euro policies faded further.

Finally in terms of market movements, Australian 3 and 10 year yields fell 3bps and 4bps to 2.07% and 2.64% respectively. In contrast, 3 month BBSW rose 13bp to 2.11%. In the US, the 2 year yield rose 10bps to 2.53% while the 10 year finished flat at 2.86%. This brought the 2 year spread between Australia and the US to -23bp. In combination with broad US Dollar strength AUD/USD fell 2.2% over the month.

Portfolio performance

Managed Cash

The Pendal Managed Cash Fund (formerly the BT Wholesale Managed Cash Fund) returned 0.15% in June (post-fees, pre-tax), matching the benchmark performance.

With a higher running yield than the index remains well positioned to continue to perform well. 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 61 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. The RBA is unlikely to tighten monetary policy in the near term. 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 June (post-fees, pre-tax) outperforming the benchmark by 0.02%.

Positive performance came from financials and industrial sectors. The portfolio has outperformed its benchmark by over 100 bp (before fees) over the past 12 months.

As at the end of the month, the portfolio had a credit spread of 61bps over bank bills, interest rate duration of 0.09 years and credit spread duration of 1.62 years.

Strategy and outlook

Australian bond yields experienced a small fall and a flattening of the curve over June. During the month, the RBA left rates unchanged at 1.50% for the 20th month in a row. In its statement, the Board noted it continues to expect gradual progress on inflation and unemployment. Support for the local economy from public infrastructure, stronger exports and non-mining business investment was also discussed. It also highlighted recent global developments like political uncertainty in Italy and US trade policy changes. The latter continued to weigh on broader risk sentiment over June. The local market also endured concerns over another leg higher in the BBSW-OIS spread. The spread on the three-month maturity widened 13bp to 61bp and the grind higher appeared independent of its US equivalent.

Domestic data was relatively mixed over the period. First quarter GDP growth at 1.0% beat expectations and brought the year-on-year rate to 3.1%. This was attributed to strength in net exports, while in contrast consumption was subdued. Also during the month, employment data revealed a soft 12,000 increase in jobs, which was skewed to part-time positions. Leading indicators were more constructive with retail sales growth of 0.4% and in increase in consumer confidence to 102.1. At the same time business conditions and confidence measures fell to +15 and +6 respectively.

Turning to credit markets, we maintain our recently adopted neutral view on investment grade credit.

Credit markets have lost the teflon coating they had during most of 2016 and all of 2017. For those two years, credit spreads were much more appealing, with the Australian iTraxx reaching a high of +173 in Feb 2016. The market's concern around a slowdown in China and a hawkish US Federal Reserve had started to recede, we also had the European Central Bank buying corporate bonds. These factors drove down equity volatility with the VIX Index falling from 28 to 9 by the end of 2017, this also saw credit spreads stage a strong rally with the iTraxx closing out 2017 at +58.

However, 2018 has seen a reversal of these factors. We are starting to see signs of a slowdown in growth in China, the Fed is raising rates due to signs of US inflation, and the ECB is planning the tapering of its corporate bond buying program. Additionally, concerns around potential global trade wars and European politics are dragging down risk sentiment. This has seen equity volatility pick up and credit spreads widen with the iTraxx closing out June at +80.5.

Reduced market liquidity, in part due to a withdrawal of central bank stimulus will see increased volatility in markets. All of these factors leave us cautiously positioned until we have further clarity on these developments.

However, we do acknowledge strong corporate fundamentals remain, with healthy balance sheets, positive earnings growth and low high yield default rates.

On balance, the uncertainty and less attractive risk-return trade-off warrants a neutral stance for now. We believe investment grade securities should outperform high yield issuers in this environment.

Australian Property

Pendal Property Securities Fund

Market review

The S&P/ASX AREIT Index returned 2.2% in June, underperforming the broader market (+3.3%) by 110 basis points (bp). However, AREITs performed in line with the broader market over the financial year, with both sectors returning 13%. Outperformance was driven by merger and acquisition activity (Westfield, Investa Office and more recently Gateway) and strong increases in office and industrial values. During FY18, Australia was the world's best performing REIT market outperforming the Global Index by 690bp.

Conversely, the US was the worst performing developed REIT market (+5.1%). The US market was flat over the month and the US Federal Reserve (Fed) lifted the official cash rate by 25bp to 1.75-2.00%. The Fed is expecting to lift rates twice more in 2018. The US yield curve flattened (-10bp) with the short end up 10bp to 2.53% and long end (10-year bond) flat at 2.86%. Non-farm payrolls were strong at +223,000 and the unemployment rate fell to 3.8%, the lowest level since December 1969. Average hourly earnings were +2.7% higher over the year.

In Australia, the Reserve Bank of Australia (RBA) left interest rates on hold. GDP was +1% in the March quarter and +3.1% over the year. The ABS National House Price Index fell by -0.8% for the first quarter of 2018, falling across Australia for the first time since September 2012. A combination of tighter credit with banks enforcing current guidelines and muted sentiment is likely to see further falls in 2018. Total private sector credit growth was just 0.2% in May, with investor credit growth at 2%, a fresh low for this series. Employment increased by 12,000 jobs; however, the composition was skewed towards part-time (+33,000) and away from full time (-21,000) employment. The unemployment rate dropped 0.2% to 5.4%.

During the month Investa Office Fund revalued its portfolio, resulting in an average uplift of 7.9%, with its weighted average cap rate firming 17bp to 5.48%. The new NTA at $5.48 is well above Blackstone's takeover offer of $5.15/unit. During the month, Vicinity Centres also placed assets on the market, with $1b of secondary, smaller retail assets up for sale with the average asset value of $68m (vs VCX average of $220m) and average specialty sales of $7,700/sqm, 25% lower than VCX portfolio average. Goodman Group also held its investor day, at which time the management team highlighting that the Group continues to recycle assets into urban renewal projects and is working on increased density (building second levels) at its well-located Sydney assets. During the month, manufactured housing group, Gateway Lifestyle, received takeover offers from both Brookfield and Hometown America.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned 2.18% in June (post-fee, pre-tax), underperforming its benchmark by 0.09%.

The portfolio marginally underperformed over the month, with positive attribution from overweight positions in Investa Office Fund, Lifestyle Communities, Iron Mountain and Charter Hall Group and an underweight position in Vicinity Centres. Overweight positions in Mirvac Group and underweight positions in Scentre Group, Viva Energy and Ingenia Communities detracted from performance.

Over the month we increased our overweight positions in Investa Office Fund, Charter Hall Group, Unibail-Rodamco Westfield, Dexus Property Group and Goodman Group and reduced our underweight in GPT Group. This was facilitated by the cash we received in the Unibail/Westfield takeover as well as increasing our underweights in Scentre Group, Stockland Group and exiting our positions in Folkestone Education Trust and Vital Health Care REIT.

Strategy and outlook

The AREIT sector is now priced on an FY19 dividend yield of 5.2%, a PE ratio of 17.0 times, well ahead of its 27 year average of 13.4x, but in line with its long term average relative to Industrials (0.97x). 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, especially lower quality malls in the next 6-12 months. Balance sheets are stable with sector gearing at 27%.

International Property

Pendal Global Property Securities Fund

Market review (in US$)

Performance of the global property securities market (on an ex-Australia basis) as measured by the FTSE EPRA/NAREIT Developed Index rose in June, posting a total return of 1.7%. North America (+3.9%) and Europe (+0.4%) were positive performers, while Asia Pacific (-2.9%) was a negative performer. Within Asia Pacific, results were negative across the region. Singapore (-5.4%) posted the largest decline, followed by New Zealand (-5.3%), Hong Kong (-4.2%) and Japan (-1.3%). In Europe, results were mixed. Spain (+5.6%) posted the largest gain, followed by Germany (+2.3%) and Israel (+1.7%). Notable negative performers within the region included Norway (-3.9%), Austria (-3.5%), and France (-1.5%). Within North America, the U.S. and Canada returned 4.1% and 0.2%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund (formerly the BT Wholesale Global Property Securities Fund) returned 2.32% in June (post-fee, pre-tax), outperforming the benchmark by 0.28%.

North America

The North America portfolio returned 4.43% in June (before fees and taxes), outperforming the FTSE EPRA/NAREIT North America Index by 48 basis points. Benchmark outperformance was driven by positive stock selection results, while sector allocation results were largely neutral. In terms of stock selection, results were strongest in the diversified, health care and other residential sectors and were weakest in the shopping centre, triple net lease, and industrial sectors. The portfolio’s small cash position was a modest detractor to relative performance in light of the regional benchmark’s positive absolute performance for the month. Among the portfolio’s holdings, top individual contributors to relative performance include overweight positions in the outperforming American Homes 4 Rent Class A (AMH), Welltower (WELL), and Forest City Realty Trust Class A (FCE.A). Notable detractors include overweight positions in the underperforming Host Hotels & Resorts (HST), RLJ Lodging Trust (RLJ), and Rexford Industrial Realty (REXR).

Europe

The European portfolio returned 0.57% in June (before fees and taxes), outperforming the regional EPRA benchmark by 19 basis points. Outperformance relative to the benchmark was driven by positive stock selection results, while country allocation results were largely neutral. In terms of stock selection, results were strongest in Sweden, Netherlands, and Switzerland and were weakest in the United Kingdom, Spain, and Austria. Regarding country allocation, positive results attributable to the portfolio’s overweight to the outperforming Spain was offset by an overweight to the underperforming Norway, which was a negative. Among the portfolio’s holdings, top contributors to relative performance included overweight positions in the outperforming Wihlborgs Fastigheter AB (Sweden) and Merlin Properties Socimi SA (Spain), and an underweight position in the underperforming Unibail-Rodamco Westfield (Netherlands). Detractors most notably included overweight positions in the underperforming Workspace Group PLC (United Kingdom) and Entra ASA (Norway), and a lack of exposure to the outperforming Grand City Properties SA (Germany).

Asia

The Asia portfolio returned -2.62% in June (before fees and taxes), beating the regional EPRA benchmark by 26 basis points. Outperformance relative to the benchmark was attributable to positive stock selection results in Hong Kong, which were partially offset by negative results in Japan and Singapore. Country allocation results were largely neutral. Among the portfolio’s holdings, top contributors to relative performance include overweight positions in outperforming Link REIT (Hong Kong) and Nippon Building Fund (Japan) and an underweight position in the underperforming Henderson Land Development (Hong Kong). Detractors included a lack of exposure to the outperforming Hulic Co. Ltd. (Japan) and United Urban Investment (Japan), and an underweight position in the outperforming Activia Properties (Japan).

Active Balanced

Pendal Active Balanced Fund

Markets review

The S&P/ASX 200 Accumulation Index rose 3.2% in June to end the financial year with an +8.5% gain for the full year, or +13.2% once dividends are included. Earnings growth has powered these gains, as the Royal Commission and a challenging environment has seen the banks de-rate, keeping the market's aggregate valuation rating steady. This is important, as ultimately we see earnings-driven market growth as more sustainable than valuation-driven returns.

Uncertainties around the potential trade war between the US and China weighed on market sentiment over the month, but haven't fully deterred investors from risky assets. That said, the impending implementation of the 25% tariff on US$50b worth of goods on July 6 is going to be closely watched by the market, as China is expected to retaliate in kind. Any further escalation in trade tensions could see the global equity market react poorly. Nevertheless, market valuations remain supportive in Australia, largely attributable to a weak currency against the greenback, as well as patience displayed by the RBA in prolonging its first interest rate hike.

Most of the industry sectors managed to record gains in June, with the exception of Industrials (-0.3%) and Telecommunication Services (-5.5%). The latter was the largest performance detractor for the headline index over the month.

On the positive side, Energy advanced the most in absolute return terms, finishing the month 7.7% higher; followed by Consumer Staples (+5.9%), Information Technology (5.9%) and Utilities (5.0%). Similarly, heavyweight Financials was the largest contributor to headline index performance, with a gain of 4.0%. While the Royal Commission remains an overhang for the banking sector, the 'Big Four' banks all bounced back somewhat from their recent lows, ranging from 2.3% (ANZ) to 5.2% (WBC). Outside Financials, some noteworthy outperformers include energy infrastructure owner/operator, APA Group (APA, +13.4%). It received a non-binding all cash takeover offer from Hong Kong-based consortium, CK Infrastructure. The announced price represented a 33% premium to APA's closing price at the time.

The global equity market experienced another month of heavy geopolitical influences on sentiment, obscuring the more fundamental drivers of performance. At its core were concerns of an intensifying trade war between the US and China, together with the potential implications for other countries, particularly in Europe and emerging markets. During the month, President Trump announced the imposition of a 25% tariff on US$50b worth of imports from China, which accompanied a further threat of tariffs on another US$200b in goods from China should retaliatory measures be announced. The trade war fears, combined with consternation over central bank policy direction acted to limit gains on share markets, although a weaker Australian dollar translated to a gain in the MSCI World (A$) Index.

US stocks advanced during the month, despite the market's preoccupation with trade tensions. However, there was considerable dispersion across industry sectors, with Industrials and Financials faring the worst, evidenced by weakness in heavyweights like Boeing and Caterpillar. Both companies are heavy importers of goods from China. Meanwhile, consumer-oriented sectors were among the strongest performers, buoyed by continuation of strong economic data. The latest figures on the labour market saw the national unemployment rate fall to an 18-year low of 3.8%, while headline inflation crept up to annual rate of 2%. As expected, the US Federal Reserve raised the cash rate by 0.25%, but what was less expected was the signalling of two more rises this year, with previous indications pointing to only one more hike. The market closed June with the S&P500 delivering a total return of 0.6%, while the NASDAQ rallied with a return of 0.9%.

The performance of European equity markets saw considerable dispersion, with the larger markets of Germany and France declining while Spain and Switzerland were the standout performers. Trade rhetoric dominated the concerns, while a softening of policy tones from the central bank kept economic growth projections in check. Economic data also pointed to a mixed outlook. Headline inflation for the region edged up to 2%, driven by higher food and energy prices, although core inflation was subdued at 1%. A rise in the eurozone Purchasing Managers' Index (PMI) from 54.1 to 54.8 was above expectations; however, consumer sentiment and retail sales indicators in some key markets were somewhat disappointing. The performance of Germany's DAX (-2.4%) and France's CAC (-1.4%) was in contrast to the strength of Spain (+2.6%), Switzerland (+2.0%) and Sweden (+0.8%), which helped to neutralise returns at a regional level. The UK's FTSE 100 declined by 0.5%, driven by both domestic and offshore concerns.

Most Asian equity markets ended the month lower, given the expectation that emerging markets are net losers in a trade war between the US and China. Concerns over China's growth more generally, acted to weaken regional markets. During the month, the People's Bank of China announced a reserve ratio cut of 0.50% (the reserve ratio is the portion of depositors' balances that banks must have on hand as cash) to generate liquidity and support growth, which reflected some concerns over the growth trajectory. The region's weakness was reflected in the returns for Thailand (-7.6%), Hong Kong (-5.0%) and Singapore (-4.6%), while Japan (+0.5%) traded into positive territory after assistance from a weaker yen.

The Australian dollar declined in June by 2.2% against the US dollar, 2.1% against the euro, 1.4% against the British pound and 0.4% against the yen.

Australian bond yields experienced a small fall and a flattening of the curve over June. During the month, the Reserve Bank of Australia (RBA) left rates unchanged at 1.50% for the 20th month in a row. In its statement, the Board noted it continues to expect gradual progress on inflation and unemployment. It also highlighted recent global developments like political uncertainty in Italy and US trade policy changes. The latter continued to weigh on broader risk sentiment over June. The local market also endured concerns over another expansion in the BBSW-OIS spread. The spread on the three-month maturity widened 13bp to 61bp and the grind higher appeared independent of its US equivalent.

Global bond curves flattened over June. Escalating trade tensions captured investors' focus during the period as President Trump announced new tariffs and China retaliated with its own levies. Meanwhile, fears over the potential for extreme anti-euro policies in Italy faded. On the monetary policy front, the US Federal Reserve hiked rates by 0.25% as widely expected. The FOMC also raised its rate outlook to include a total of two more hikes by the end of the year and as such, was perceived as more hawkish. US data remained relatively strong, including the monthly jobs report and ISM manufacturing figures. Meanwhile in Europe, the ECB announced it would begin tapering its quantitative easing program in September this year, with purchases to stop by December. However, its guidance for rates to remain at current levels at least until the European summer of 2019 suggested a dovish message overall.

Data in the region was reasonable, with the composite PMI increasing 0.7 to 54.8 and strong IFO business climate figures. Escalating trade tensions continued to make headlines and concerned investors. Finally in terms of market movements, the US 2-year yield rose 10bps to 2.53% while the 10-year yield finished unchanged at 2.86%.

Portfolio performance

The Pendal Active Balanced Fund (formerly the BT Wholesale Active Balanced Fund) returned 0.68% (post-fee, pre-tax) for the month of June, underperforming its benchmark by 0.97%.

The Fund delivered a positive return in June, 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 June which contributed to performance. Exposure to alternatives detracted from returns this month. At a Fund level, the contribution to performance was primarily driven by manager contribution across a number of strategies.

The contribution from tactical asset allocation was largely driven by the Fund's overweight exposure to Australian equities and listed property as well as underweight positioning in fixed income.

The key factors influencing the alpha generated through active management returns related to stock selection outcomes within Australian equities. Within the Australian equity strategy, overweight positions in CYBG, Caltex and Santos together with exposure to small caps which outperformed the broader market contributed value. These contributions were mitigated by overweight positions in Metcash, Metcash, Ramsay Health Care and AMP.

Within the global equities portfolio, the Concentrated portfolio outperformed while the Core portfolio fell short of the benchmark but positively contributed to overall returns.

Our Alternatives core portfolio detracted from returns this month, with three of the eight sub-strategies within the core portfolio delivering negative returns, which more than offset the positive impact of five sub-strategies. The Alternatives strategy delivered a total return (before fees) of -2.47% verus a cash return of 0.15%.

The event driven, global macro and managed futures strategies made positive contributions this month. These were more than offset by detractions from the equity market neutral, dedicated short bias and long-short equity strategies which were hampered by weak equity market trends.

In relation to our tactical positioning within the Alternatives component of the Fund, our long position in equity market futures added value, as did the positioning in Australian and US bonds. Long positions in gold and copper detracted from returns, as did our short volatility position. At the end of the month we added long positions in German equities and Australian bonds, and moved to a short on US bonds.

Strategy and outlook

Asset market valuations are not a material source of concern, however the degree to which these are being complicated by more esoteric forces like global trade and political brinkmanship give rise to factors which can distort underlying fundamentals. At the same time, uncertainties such as these can lead to temporary bouts of volatility and greater dispersion between the performance of different asset classes, sectors, industries and companies. This is a very fertile ground for investors to take active, research based decisions on where and how to allocate capital.

While some challenges may persist due to imbalances across markets to warrant a degree of caution, 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 being cognisant of structural and cyclical drivers. We have recently taken advantage of such moves which have been supported by our modelling. By managing our relative exposures to growth and defensive assets and maintaining a material allocation to the diversifying properties of Alternatives, we can demonstrate that opportunities do exist when 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 30 June 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)	2.08	6.99	4.81	14.83	14.83	15.30	9.16	10.67	10.09
Total Return (pre-fee, pre-tax)	2.15	7.20	5.22	15.76	15.76	16.22	10.02	11.55	11.09
Benchmark	3.19	8.36	4.27	13.24	13.24	13.53	9.14	9.99	10.02
Pendal Imputation Fund								APIR -	RFA0103AU
Total Return (post-fee, pre-tax)	3.04	8.53	5.61	13.50	13.50	14.30	7.88	9.13	9.66
Total Return (pre-fee, pre-tax)	3.12	8.77	6.08	14.52	14.52	15.32	8.85	10.11	10.68
Benchmark	3.19	8.36	4.27	13.24	13.24	13.53	9.14	9.99	8.82
Pendal Focus Australian Share Fund								APIR -	RFA0059AU
Total Return (post-fee, pre-tax)	2.06	7.01	5.96	15.91	15.91	17.67	11.18	12.74	9.56
Total Return (pre-fee, pre-tax)	1.97	6.96	6.62	17.22	17.22	19.14	12.39	13.88	10.68
Benchmark	3.19	8.36	4.27	13.24	13.24	13.53	9.14	9.99	7.68
Pendal Ethical Share Fund								APIR -	RFA0025AU
Total Return (post-fee, pre-tax)	2.18	6.32	3.93	13.92	13.92	14.89	8.97	10.80	8.71
Total Return (pre-fee, pre-tax)	2.26	6.57	4.42	15.00	15.00	15.98	10.01	11.85	9.77
Benchmark	3.19	8.36	4.27	13.24	13.24	13.53	9.14	9.99	8.21
Australian Shares - Mid Cap									
Pendal MidCap Fund								APIR -	BTA0313AU
Total Return (post-fee, pre-tax)	1.05	5.59	6.13	23.19	23.19	19.66	17.32	17.62	11.17
Total Return (pre-fee, pre-tax)	1.05	5.62	7.25	25.25	25.25	21.20	18.70	19.30	13.43
Benchmark	1.78	6.34	3.48	17.70	17.70	16.35	16.35	15.36	6.24
Australian Shares - Small Cap									
Pendal Smaller Companies Fund								APIR -	RFA0819AU
Total Return (post-fee, pre-tax)	-0.36	6.00	7.79	25.16	25.16	14.93	14.94	13.41	13.44
Total Return (pre-fee, pre-tax)	-0.26	6.34	8.46	26.73	26.73	16.36	16.38	14.83	14.74
Benchmark	1.06	7.67	4.67	24.25	24.25	15.31	15.01	11.56	7.99
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund								APIR -	RFA0061AU
Total Return (post-fee, pre-tax)	1.05	3.15	0.84	19.76	19.76	17.56	18.44	21.50	18.55
Total Return (pre-fee, pre-tax)	1.15	3.46	1.44	21.22	21.22	20.07	21.01	25.71	23.74
Benchmark	1.06	7.67	4.67	24.25	24.25	15.31	15.01	11.56	3.60
International Shares									
Pendal Core Global Share Fund								APIR -	RFA0821AU
Total Return (post-fee, pre-tax)	0.88	3.40	4.42	13.95	13.95	14.93	8.67	14.20	5.92
Total Return (pre-fee, pre-tax)	0.95	3.64	4.91	15.04	15.04	16.02	9.70	15.29	7.08
Benchmark	2.33	5.53	6.37	15.39	15.39	15.06	9.95	14.91	7.41
Pendal Global Emerging Markets Opportunities Fund - WS								APIR -	BTA0419AU
Total Return (post-fee, pre-tax)	-0.36	0.73	-0.12	12.25	12.25	16.59	7.12	11.68	11.33
Total Return (pre-fee, pre-tax)	-0.25	1.09	0.59	13.81	13.81	18.21	8.62	13.37	13.54
Benchmark	-1.85	-4.45	-1.19	12.33	12.33	16.16	7.00	9.61	10.57
Pendal Concentrated Global Share Fund								APIR -	BTA0503AU
Total Return (post-fee, pre-tax)	2.53	4.66	7.21	17.27	17.27	N/A	N/A	N/A	16.65
Total Return (pre-fee, pre-tax)	2.61	4.89	7.75	18.60	18.60	N/A	N/A	N/A	18.03
Benchmark	2.33	5.53	6.37	15.39	15.39	N/A	N/A	N/A	14.60
Property									
Pendal Property Securities Fund								APIR -	BTA0061AU
Total Return (post-fee, pre-tax)	2.18	9.58	2.39	12.11	12.11	3.33	9.75	11.73	7.58
Total Return (pre-fee, pre-tax)	2.24	9.75	2.71	12.84	12.84	4.01	10.46	12.46	8.39
Benchmark	2.27	9.82	3.02	13.20	13.20	3.35	9.99	12.18	7.47
Pendal Global Property Securities Fund								APIR -	RFA0051AU
Total Return (post-fee, pre-tax)	2.32	7.42	1.84	6.74	6.74	4.63	6.65	8.92	9.26
Total Return (pre-fee, pre-tax)	2.38	7.65	2.30	7.72	7.72	5.59	7.63	9.93	10.25
Benchmark	2.04	7.16	1.55	6.09	6.09	4.45	6.78	9.15	8.97
Fixed Interest									
Pendal Fixed Interest Fund								APIR -	RFA0813AU
Total Return (post-fee, pre-tax)	0.78	1.45	2.44	3.39	3.39	1.24	2.90	4.12	6.41
Total Return (pre-fee, pre-tax)	0.83	1.58	2.69	3.91	3.91	1.74	3.42	4.64	6.96
Benchmark	0.48	0.82	1.69	3.09	3.09	1.66	3.41	4.38	6.61
Pendal Global Fixed Interest Fund								APIR -	RFA0032AU
Total Return (post-fee, pre-tax)	0.72	0.60	0.91	1.85	1.85	-0.28	2.92	4.36	5.98
Total Return (pre-fee, pre-tax)	0.76	0.73	1.18	2.39	2.39	0.25	3.46	4.91	6.56
Benchmark	0.31	0.17	0.60	2.11	2.11	0.39	3.83	4.97	6.86
Pendal Enhanced Credit Fund								APIR -	RFA0100AU
Total Return (post-fee, pre-tax)	0.30	0.62	1.41	3.34	3.34	2.77	3.60	4.54	5.71
Total Return (pre-fee, pre-tax)	0.34	0.73	1.64	3.80	3.80	3.24	4.06	5.01	6.24
Benchmark	0.36	0.77	1.50	3.36	3.36	2.76	3.66	4.54	5.82
Cash & Income									
Pendal Enhanced Cash Fund								APIR -	WFS0377AU
Total Return (post-fee, pre-tax)	0.17	0.53	1.10	2.70	2.70	2.88	2.67	2.88	4.92
Total Return (pre-fee, pre-tax)	0.19	0.59	1.23	2.96	2.96	3.13	2.92	3.14	5.26
Benchmark	0.15	0.49	0.92	1.78	1.78	1.80	1.95	2.22	4.86
Pendal Managed Cash Fund								APIR -	WFS0245AU
Total Return (post-fee, pre-tax)	0.15	0.45	0.89	1.79	1.79	1.83	1.96	2.20	6.42
Total Return (pre-fee, pre-tax)	0.17	0.51	1.00	2.01	2.01	2.05	2.18	2.43	6.72
Benchmark	0.15	0.49	0.92	1.78	1.78	1.80	1.95	2.22	6.50
Pendal Monthly Income Plus Fund								APIR -	BTA0318AU
Total Return (post-fee, pre-tax)	0.52	1.14	1.19	5.03	5.03	4.09	4.25	4.91	5.49
Total Return (pre-fee, pre-tax)	0.58	1.31	1.52	5.72	5.72	4.77	4.93	5.59	6.16
Benchmark	0.12	0.37	0.75	1.51	1.51	1.52	1.68	1.99	2.90
Diversified									
Pendal Active Balanced Fund								APIR -	RFA0815AU
Total Return (post-fee, pre-tax)	0.68	3.70	2.07	9.85	9.85	9.62	6.91	8.86	7.70
Total Return (pre-fee, pre-tax)	0.75	3.95	2.55	10.90	10.90	10.66	7.92	9.89	8.78
Benchmark	1.65	4.54	3.23	9.68	9.68	9.19	7.45	8.79	7.54

For more information contact your
key account manager or visit **pendalgroup.com**.