PENDAL

Fund Manager Commentary

Month ended 31 July 2018

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Market Review

The S&P/ASX 300 Accumulation Index rose by 1.3% over the month of July, with the majority of the heavy lifting done by Industrials (+1.6%). The performance of Resources (+0.1%) was positive yet a laggard. The ongoing trade tensions between the US and China saw base metals sell off during the month, with the former now flagging the expansion of tariffs to US$200b worth of imports from the latter. The price of crude oil also eased over the period, despite a large drop in US oil inventories. Potential supply increases by OPEC nations as well as Russia weighed on investor sentiment. In addition, President Trump was reportedly considering selling oil from the country's strategic oil reserves to suppress any further price increases.

The majority of GICS sectors delivered positive returns over the period, with the exceptions being Utilities (-1.4%), Information Technology (-1.1%) and Consumer Staples (-0.9%). The Utilities sector's decline could be largely attributed to the release of an ACCC report that aims to rein in soaring electricity prices that have reached a decade high. While the recommendations from the report do not translate into legislation automatically, comments from the Government in regard to the report have been constructive and may see most recommendations being accepted. This weighed on investor sentiment and saw AGL (AGL, -2.2%) decline over the month.

Index heavyweight Materials (-0.3%) also recorded a small loss. BHP (BHP, +2.8%) saw its share price rise as news of the US on-shore shale assets sale came in sooner than expected and was at a reasonable price. In contrast, negative returns from the gold miners were more than offsetting as the gold price declined 2.6% over the month as short positions against the precious metal reached a record high. Against this backdrop, a disappointing quarterly production update on the cost side from Evolution Mining (EVN, -20.5%) made it the largest performance detractor within the sector.

Turning to the positive side of the spectrum, the recently beleaguered Telecommunication Services (+7.6%) sector recorded the best monthly sector return; while a rebound in index heavyweight Financials (+2.0%) contributed the most to the headline index performance. Within the former, the three major companies, Telstra (TLS, +8.4%), TPG (TPM, +11.4%) and Vocus (VOC, +4.3%) all finished the month higher. The recent sell-off within Telecoms, on the back of concerns around increasing competition in the mobile market have seen the sector de-rate to a level that is now looking relatively cheap compared to history. In addition, Telstra also announced a major restructure of its executive team to help the company-wide overhaul aimed at tackling the major headwinds it is encountering. Elsewhere, banks managed to take a breather from the Royal Commission as the focus shifted to the superannuation industry. All the 'big four' banks finished the month in positive territory, albeit the return from Westpac (WBC, +0.6%) was more muted compared to ANZ (ANZ, +3.8%), NAB (NAB, +3.4%) and CBA (CBA, +2.6%). Share prices of the regionals also moved higher, with Bendigo & Adelaide Bank (BEN) adding +8.0%, and Bank of Queensland (BOQ) adding +9.0% in July.

Portfolio performance

The Pendal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned 1.77% (post-fee, pre-tax) in July, outperforming its benchmark by 0.46%.

Contributors

Overweight Qantas Airways

The oil price slumped on concerns around potential increases in oil supply over the month, which supported the share price of national airliner, Qantas (QAN, +9.1%), in the absence of any additional company news. Continued strength in domestic travel demand also helped to support investor sentiment. Qantas will release its FY18 results later in August and we uphold our conviction in the company.

Overweight CYBG

UK retail bank CYBG (CYB, +7.6%) updated the market on its operational performance in late July. For the year to June, mortgage growth came in at +3.8% (for the 9-month period) to £24.2B, and third quarter mortgage drawdowns were reduced due to lower applications in the prior quarter. FY18 mortgage growth was expected to be at the lower end of its guidance range, as previously flagged by management. Lastly, the net interest margin (NIM) of 218 bps was in line with guidance and management reiterated its target of 220bps for FY18.

In terms of the Virgin Money (VM) deal, the company continues to expect its all-share offer for Virgin Money to complete in Q4, subject to shareholder and regulatory approvals. As previously mentioned, the VM acquisition will significantly improve scale, cost of funding and the ability to acquire customers for CYB. When added to the technological investment that CYB has made to date, it should provide substantial revenue and cost synergies. As such, we continue to hold CYB in our portfolio.

Underweight Insurance Australia Group

At the beginning of July, there was some negative media coverage on IAG (IAG, -5.7%) around potential malpractices being identified by company-led examinations. The company refuted these reports. Nevertheless, taking the lead from AMP's recent experience under the Royal Commission spotlight, the reports sustained some investor concerns which weighed on IAG's share price. Former Group Council and Company Secretary Chris Bertuch's departure following extended leave weighed further on investor sentiment. The company will release its full year results in mid-August.

Overweight Amcor

The share price of packaging company, Amcor (AMC, +4.6%), had been trading sideways since the company last reported in May. To recap, management revised down its outlook, while highlighting impacts from developments in the North American beverages market. The company noted that despite maintaining market share, beverage volumes remained lower compared to prior years. As such, the stock is trading at a significant discount on a historical relative price-earnings valuation basis. In our view, the current earnings headwinds are largely cyclical rather than structural and the market has been waiting for signals for the headwinds to turn. Our analysis suggests the main drivers, including input costs, the Asia and Latin America Flexi businesses are stabilising.

Detractors

Underweight Brambles

Brambles' (BXB, +11.3%) share price advanced in July after a number of brokers increased their target price for the company. Cost inflation in the US remains the most commonly quoted issue for the business and there are no signs of that subsiding. Business profitability for its European segment also leads us to hold back our conviction in the stock. Although Brambles remains one of the defensives names favoured by the market, we find its premium stock valuations hard to justify at this stage.

Overweight Nine Entertainment

Nine Entertainment (NEC, -9.7%) underperformed on the news of its effective takeover of Fairfax Media (FXJ) at a 20% premium in July. The move makes strategic sense and reflects NEC's view that, despite the recent resurgence in traditional media, ultimately the company needs to diversify into digital channels. The merger will result in significant cost saving synergies and provides NEC with exposure to attractive digital channels such as Domain (DHG). The merged ownership of Stan also leaves it better placed to potentially cut deals there. The market's negative reaction may be partly due to the fact that NEC had to purchase FXJ's regional newspapers as part of the deal, with the expectation that these would be sold at some point. There also seems to be a degree of arbitrage as some investors sold NEC and bought FXJ ahead of the deal. Our analysis suggests that the market has oversold the stock. Should the falls persist, it also raises the risk that the all-scrip deal may also fall through.

Overweight Origin Energy

The share price of gas explorer/energy retailer, Origin Energy (ORG, -2.6%), declined over the month of July, as the combined effect of lower oil prices and the release of the ACCC report weighed on the earnings outlook for the company. The oil price slumped on concerns around potential increase in oil supply over the month, while the ACCC report aims to rein in the decade-high power price domestically. That said, we continue to like ORG. Its recent contract changes are allowing the company to drive greater output from its coal-fired Eraring power station, taking advantage of elevated prices. Its gas business also continues to grow market share, while simultaneously reducing production costs at APLNG. The retail energy environment remains competitive; however, ORG's integrated nature and production capacity - across both traditional and renewable sources - provides it with an advantage and is supporting upgraded earnings guidance. Its financial leverage to the currently tight market makes it the most attractively valued stock among its peers.

Underweight National Australia Bank

The 'big four' banks, including National Australia Bank (NAB, +3.6%) rebounded in July, taking a breather from the close scrutiny of the Royal Commission as the focus has now shifted to the superannuation industry. Whilst sector valuations appear appealing compared to historic averages, cyclical earnings headwinds remains evident and have been keeping investor sentiment at bay. Among the majors, ANZ Bank (ANZ, +3.8%) remains our preferred bank, with a greater scope of cost reduction and capital management. ANZ recently doubled their share buy-back plan from $1.5b to $3b following the sale of its life insurance business.

Strategy and outlook

The portfolio outperformed in July, helped by strong performance from Qantas and CYBG, the UK-based banking group previously spun out of National Australia Bank. There was also a helpful bounce from some stocks including Amcor, Telstra, JB Hi-Fi and Metcash which have lagged in recent months.

Several of the market's favourite growth stocks such as Treasury Wine Estates and Sonic Healthcare continued to outperform in July. In aggregate, high growth stocks have eclipsed the previous highs of mid-2016 in terms of their valuation relative to the market. We have to go back prior to the GFC to find the last time that growth stocks were this expensive in relative terms. This is posing one of the key challenges to investors in today's market; just because these stocks are expensive, it doesn't mean they cannot become more expensive and continue to outperform.

The high point of mid-2016 was followed by a sharp sell-off in growth stocks. At the time there were several factors at play including a reversal in US bond yields and a couple of earnings disappointments in stocks such as Domino's Pizza. At the same time, earnings growth was surging in the resource sector in response to Chinese stimulus and higher commodity prices, providing an opportunity for investors to rotate away from expensive growth stocks. Today, it is harder to see the obvious areas for investors to switch into; financials remain under pressure on many fronts, many industrials are facing disruptive challenges, and resource earnings have moderated to far more sedate levels.

We are underweight the growth sector as a whole, but remain mindful that it can continue to do well in the absence of any obvious alternatives. As a result, and in keeping with our approach of driving performance through stock insights rather than thematic positions, we retain a growth exposure via stocks such as CSL, Resmed and Aristocrat. In each instance, we believe that the market's rating of these companies - while not 'cheap' - can be justified by the trajectory of underlying earnings, in contrast to some other growth stocks where hype and hope are perhaps playing a greater role.

The market is also questioning Chinese growth given the escalation of its trade issues with the US. However, we are more positive than many in this regard. China has already been slowing over the last 12-18 months as authorities have clamped down on shadow lending in order to curb the pace of debt accrual. However, China's authorities have recently reverted to gentle pressure on the accelerator in the form of lower banking reserve requirements, greater directed lending to small businesses and tax cuts in order to ensure that growth remains robust enough to help cope with the effects of trade sanctions. The implicit message to the US is that China has the ability to offset trade pressure. We think Chinese demand should remain reasonable and, in combination with continued supply-side rationalisation in industries such as steel and aluminium, should be enough to underpin commodity prices. As a result, we remain reasonably positive on the resource sector.

Pendal Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation Index finished July with a loss of 1.0%, underperforming its large cap counterpart by 2.3%. Small cap Resources (-2.6%) saw a larger pull back compared to small cap Industrials (-0.6%), as a number of miners experienced the consequences of the escalated trade tensions between the US and China. The gold price declined by 2.6% as short positions against the precious metal reached a record high. This in turn weighed on Materials (-6.5%). Gold miners including St. Barbara (SBM, -14.7%), Regis Resources (RRL, -12.9%) and Independence Group (IGO, -12.5%) all declined over the month. SBM's decline in particular was against the backdrop of a solid fourth quarter production report, where the All-In Sustaining Costs (AISC) stood at $812/oz at the group level. Copper miner Sandfire Resources (SFR, -19.4%) underperformed after the release of its latest production results which were strong, although the share price reacted to poor guidance for FY19 which was weaker than the market's expectations.

Outside Materials, Consumer Staples (-5.9%) also finished the month lower. The weakness reflected the impacts of share price declines for Bellamy's (BAL, -29.2%) and Asaleo Care (AHY, -49.8%). Bellamy's weakness was related to concerns around potential delays in gaining approvals from the China Food and Drug Administration (CFDA). BAL will not be able to sell its new higher-margin formula in its largest market until obtaining such approval. For AHY, the personal care products manufacturer/distributor revised down its FY18 earnings (EBITDA) guidance from $113-$119m to a lower range of $80-$85m. A number of earnings headwinds, including higher input costs, lower sales volume due to increasing competition, and protracted negotiations regarding price increases saw the company's first half EBITDA come in 24% lower than that of last year.

Performance of the other index heavyweight, Consumer Discretionary (-0.5%), was also weak although the loss was more contained. It was largely attributed to the loss incurred by Nine Entertainment (NEC, -9.7%), on the back of its effective takeover announcement of Fairfax Media

(FXJ, +8.0%) at a 20% premium. The move makes strategic sense and reflects NEC's view that, despite the recent resurgence in traditional media, ultimately the company needs to diversify into digital channels. The merger will result in significant cost saving synergies and provides NEC with exposure to attractive digital channels such as Domain (DHG). The merged ownership of Stan also leaves the company better placed to potentially negotiate deals there. The market's negative reaction may be partly due to the fact that NEC had to purchase FXJ's regional newspapers as part of the deal, with the expectation that these would be sold at some point. There also seems to be a degree of arbitrage as some investors sold NEC and bought FXJ ahead of the deal.

Energy (+7.8%) was the best performing sector for the month, as all the companies within the sector delivered positive returns. Beach Energy (BPT, +8.8%) was the largest contributor to sector performance. The company reported its FY18 results, which saw oil production for the year reach 26.7 MMboe, slightly higher than the guidance midpoint. Deleveraging also continued on the back of increased realised pricing and a better expenditure control. Net gearing has been reduced to 26% from the 33% reported in January and the company now looks to be tracking well on achieving its gearing target of less than 20% by FY19. Elsewhere, there were a couple of standouts from Information Technology (+1.0%). Afterpay Touch (APT, +51.7%) rallied after the company boosted their FY18 earnings outlook ahead of market expectations. FY18 group earnings (EBITDA) is now expected to reach $33-34m. Technology One (TNE, +16.2%) also announced the impact of new accounting changes for IFRS/AASB 15 which will start to apply in October 2018. The company expects a 10% headwind to FY19 revenue recognition, without any cash flow impact and minimal impact on profit.

Portfolio performance

The Pendal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned -1.04% (post-fee, pre-tax) in July, performing broadly in line with the S&P/ASX Small Ordinaries Accumulation Index.

Contributors

Overweight Cleanaway Waste Management

Cleanaway outperformed on the back of the news that it had increased its commercial and industrial waste processing capacity via the acquisition of a stake in a new plant in Western Sydney, which converts waste into fuel. Cleanaway is well positioned to benefit from the multi-year pipeline of east coast infrastructure projects.

Overweight Technology One

Technology One provides enterprise software to businesses and local government, among others. There had been some fears that their adoption of new accounting standards, which shifts the recognition of revenue to the point where services are provided, would negatively impact future profits. Management updated the market on this issue in July, reiterating its 10-15% target for annual profit growth and stating that underlying free cash flow would not be affected.

Detractors

Underweight Afterpay Touch

Afterpay Touch surged in response to an update which revealed a 287% increase in volumes in FY18 over FY17. We do not hold the stock, preferring other names in the software sector. This underweight position detracted from relative performance.

Overweight Independence Group

Independence Group's share price lagged this month as a 2.6% fall in the gold price weighed upon gold miners across the board. The portfolio is slightly underweight gold in aggregate, so the detraction from this position was ultimately offset by the underweights in other gold stocks such as St Barbara and Kidman Resources.

Strategy and outlook

The portfolio ended the month roughly in line with its benchmark. There were solid contributions from positions across the market, including industrials (Cleanaway Waste Management), retail (Bapcor), health care (Ryman Healthcare), and services (Corporate Travel Management). Technology One also enjoyed a bounce back from recent softness. They key drag in relative performance came from not owning Afterpay Touch - one of the small cap market's highest profile stocks which gained over 51% for the month.

The Small Resources sector was buffeted by concerns over escalating trade tensions between China and the US - and the ultimate implications for Chinese GDP growth and demand for resources. We are mindful of this risk, but probably a little more optimistic than many in the market on China's ability to manage the headwinds that may come with reduced US demand for its exports. Chinese GDP growth has already been slowing in recent months in response to its clamp down on shadow bank credit creation outside of the mainstream banking system, in order to maintain control debt within the economy. With the shadow banking sector now constrained, there have been signs that authorities are willing to release some pressure on the brake. We have recently seen an increase in directed lending to small-and-medium enterprises, reduced banking reserve ratios and tax cuts at both a household and corporate level. These serve to support growth, offsetting potential pressure from tariffs and serving as a signal to the US that the economy is able to absorb pressure on trade. Ultimately, while trade-based rhetoric may prompt bouts of volatility in Australia's resource sector, we do not see a sustained drop in commodity prices as an imminent risk, particularly while China maintains discipline on the supply side of its economy.

All that said, we are broadly neutral in our mining position. We do have a small allocation, notably to lithium (via Mineral Resources), rare earths (Lynas Corp) and copper (Sandfire Resources). However our natural bias against companies with a high degree of unforecastable 'event risk' means that we often regard a material portion of the small resource sector as un-investable. When we do see cyclical tailwinds in resources, we tend to focus our exposure on the 'picks and shovels' - the mining services companies whose contract-based order book provides leverage to cyclicality, but with a greater degree of clarity and certainty of earnings. In this vein, we have exposure via Seven Group and Ausdrill, among others. Several of our positions here have the twin tailwinds of exposure both to the uptick in spending by mining companies as well as the large emerging pipeline of east coast infrastructure projects.

International Shares

Pendal Concentrated Global Share Fund

Market review

The global equity market delivered positive returns again this month, reflecting a generally optimistic tone on continued growth momentum, particularly in the US. Recent trade tensions appeared to simmer as signs of further engagement between the US and major trading partners emerged. Investors took comfort here and sentiment was further supported by another strong series of corporate earnings results in the US and Europe. The gathering of G20 finance ministers and central bank governors in Buenos Aires in July formed agreement on the global economy being on a firm footing. The group noted in its post-forum communique that “global economic growth remains robust and unemployment is at a decade low. However, growth has been less synchronised recently, and downside risks over the short and medium term have increased”. The cautious tone highlighted concerns over growing imbalances and financial vulnerabilities, although these comments were kept in perspective and most markets ended the month higher.

US stocks continued to exhibit strong momentum, although some weakness emerged in the mega technology players following the latest round of earnings releases. Twitter (-27.0%), Netflix (-13.8%) and Facebook (-11.2%) experienced rapid sell-downs following their latest earnings releases. In contrast, Industrials was the best performing sector, supported by positive earnings releases and a sense of optimism towards developments on trade policies. The latest economic data confirmed the buoyant conditions in the economy, with GDP reaching an annual rate of 4.1% - the strongest pace of growth since 2014. The market closed July with the S&P500 delivering a total return of 3.7%, while the NASDAQ rallied with a return of 2.2%.

Most major markets in Europe also delivered substantial gains in July. All sectors rose to varying degrees, supported by some particularly strong corporate earnings results and positive signs of economic recovery taking hold. The ECB’s Bank Lending Survey found demand for loans strengthened during the second quarter, which indicated growing loan demand from households which is at the fastest pace in nearly two years. Demand for mortgage loans rose sharply and headline inflation for the region rose to an annual rate of 2.1%, while wages growth showed signs of improvement, particularly in Germany. Performance of the region’s markets was led by Switzerland (+6.1%), Germany (+4.2%) and France (+3.5%), while the UK’s FTSE 100 somewhat lagged with a gain of 1.4%.

Asian equity markets recorded a mixed set of results in July. Concerns over the impact of the recent imposition of tariffs on China’s exports to the US for the broader region weighed on some markets. This was compounded by concerns over China’s growth after the authorities shifted fiscal policy settings to an expansionary stance by cutting taxes for companies to offset some of the trade-induced impacts. China’s latest GDP growth eased to an annual rate of 6.7% after a series of tightening measures on credit earlier this year, although markets are predicting a degree of policy reversal in the period ahead. Japan did reasonably well this month despite concerns over the implications of the US-China trade issue, with positive news on corporate earnings and a weakening yen supporting valuations. The Southeast Asian markets of Thailand (+6.7%) and Malaysia (+5.5%) outperformed the weaker North Asia markets of Japan (+1.1%) and Hong Kong (-1.3%).

The Australian dollar experienced a consolidation in value this month and was little changed against the major currencies.

Portfolio performance

The Pendal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned 2.12% (post fee, pre-tax) in July, underperforming its benchmark by 0.40%.

The end of July marks the fund’s two year anniversary, and we are pleased with the 17.1%pa return of the fund over the period which is 1.75%pa ahead of the benchmark and has been driven by contributions from many stocks. While our investors have been rewarded, we remain focused on maintaining performance over the longer term in line with our approach on identifying leading businesses which are undervalued for their potential. We expect this approach to continue to reward investors over many more years.

The bulk of the S&P 500 companies reported second quarter earnings in July, with 86% of those reporting delivering a positive earnings surprise, and 85% delivering earnings growth averaging over 20%. Amid continuing trade war concerns, a rising interest rate environment and strong US equity market, what has been notable about the latest quarterly reporting season has been the increasing volatility in stock prices, particularly in the technology sector.

Whilst the technology sector broadly has suffered heightened volatility in the second quarter, the so-called ‘FAANG’ stocks (Facebook, Amazon, Apple, Netflix and Alphabet – Google’s parent company) in particular have attracted the headlines. Facebook registered the largest ever single-day market cap loss a US company has experienced, falling 19% on the day following their results release, while Apple became the first publicly listed company to achieve a US$1 trillion dollar market cap. While the media likes to characterise the FAANG companies as one and the same, we view them as five very different businesses, with membership of the technology sector and significant market caps the only common factors. Our only FAANG holding is Alphabet and we are pleased with the company’s 8.7% performance this month after reporting a solid second quarter earnings update. Alphabet delivered top line growth in their core search business of around 24% year on year (an annualised ~US$85b growth in earnings), and ahead of market expectations, whilst at the same time seeing a decline in traffic acquisition costs (TAC). We remain confident that under the watchful eye of CFO, Ruth Porat, Alphabet’s “other bets” are on the path to commercialisation and that capital expenditure is allocated in a way which paves the way for the future growth of the business, yet at the same time continues to deliver shareholders consistent earnings per share growth.

Last quarter we updated readers on a meeting with railway operator, Norfolk Southern, one of the US industrial holdings in our fund. We were pleased to see the company continue its outperformance in July (+12%) after a strong quarterly result. Second-quarter earnings per share of $2.50 beat market expectations of $2.32, with management indicating a stronger pricing environment in the second quarter which is expected to continue into the third quarter. However, what impresses us most is a management team that understands the cyclicality of their business. While management acknowledge that conditions are likely to remain strong until at least the end of the year, they remain focused on improving their operating ratio to below 65% by 2020. We believe this target will prove to be conservative and look forward to management updating the market on their long term operating targets towards the end of the year.

Our holding in Seven & I was down 5.7% this month, despite delivering a first quarter result in line within market expectations. Seven & I is a Japan-listed company that owns the 7-Eleven convenience stores in both Japan and the US. In Japan, they command a number one market share in a concentrated market, and in the US they are a number two market share behind Couche-Tard. The market’s reaction to the result stems from disappointment with a perceived lack of progress on cost reductions in the Japanese business. However, we believe the company’s capacity to invest will allow them to maintain a dominant market share, while still maintaining operating profit growth. Coupled with investments in new store lay-outs and new product lines, management has also embraced technology with the launch of ‘Seven App’. These strategies are still being rolled out; however, we would expect further sales traction over the coming months. We view consensus estimates for convenience store sales growth of 2% as conservative and believe the current valuation does not give credit for either the success of a number of restructuring efforts in Japan or the opportunity available to them in the US, courtesy of their dominant position in a fragmented market.

Our 8.8% cash position was a drag on the performance of the fund this month. We are confident that if we remain patient, the increasing volatility in markets will allow us the opportunity to initiate positons in companies that are on our watch-list.

Strategy and outlook

Our view two years ago at the Fund’s inception was the tailwinds that equity investors had benefited from in the previous five years; compelling valuations post the global financial crisis, quantitative easing and lower interest rates would become headwinds over next five years. In the last two years we have seen the US Federal Reserve lift rates from 0.25% to 2%, Central Banks around the world have signalled, if not the unwind, the end of quantitative easing and the MSCI All Country World Index has returned 15.3%. We remain of the view that these market conditions will lead to greater volatility and greater dispersion. We look forward to the opportunities that arise and are confident that owning a select portfolio of companies is the best way to optimise equity market returns. We take a long term approach to our investments and have a deep understanding of the companies we invest in. This provides us with the confidence to buy businesses when they appear out of favour, yet in our view offer significant long term rewards.

Pendal Core Global Share Fund

Market review

The global equity market delivered positive returns again this month, reflecting a generally optimistic tone on continued growth momentum, particularly in the US. Recent trade tensions appeared to simmer as signs of further engagement between the US and major trading partners emerged. Investors took comfort here and sentiment was further supported by another strong series of corporate earnings results in the US and Europe. The gathering of G20 finance ministers and central bank governors in Buenos Aires in July formed agreement on the global economy being on a firm footing. The group noted in its post-forum communique that “global economic growth remains robust and unemployment is at a decade low. However, growth has been less synchronised recently, and downside risks over the short and medium term have increased”. The cautious tone highlighted concerns over growing imbalances and financial vulnerabilities, although these comments were kept in perspective and most markets ended the month higher.

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The Australian dollar experienced a consolidation in value this month and was little changed against the major currencies.

Portfolio performance

The Pendal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned 2.29% (post-fee, pre-tax) in July, underperforming its benchmark by 0.23%.

The Fund underperformed the benchmark over July 2018 due to negative performance in Northern America which was only partially offset by positive performance in Europe. Asia ended the month broadly in line with its regional benchmark.

Thematically, underperformance in North America was due to negative performance in our momentum and quality measures, which outweighed positive performance from our valuation and management signalling factors. The outperformance in Europe was driven by positive performance in our earnings quality signal, outweighing negative performance in our momentum and management signalling factors. Flat performance in Japan was driven by positive performance in our valuation and investor sentiment signals which were offset by negative performance in our momentum and stability factors.

From a stock and industry attribution perspective, active industry tilts detracted from active returns, whereas within-industry stock selection contributed positively to performance over the month. At a sector level, an overweight to Information Technology and underweight to Financials were the largest detractors from active returns. Stock selection was most rewarded within the Energy and Consumer Discretionary sectors, offset somewhat by underperformance of stock positioning within the Information Technology and Financials sectors.

At a stock level, the largest contributors to active returns came from overweight positions in Peugeot SA, a French multi-national automotive manufacturer; Covestro AG, a German adhesive manufacturing company; Southwest Airlines Co., a major US discount airline; Deutsche Lufthansa AG, a major German Airline; and Valero Energy Corporation, a US headquartered international manufacturer and marketer of transportation fuels. The largest detractors over the month were overweight positions in Facebook Inc., an American online social media and social networking service company; Synchrony Financial, a US-headquartered consumer financial services company; Abiomed, a manufacturer of medical implant devices headquartered in the US; Las Vegas Sands Corp, a US-based casino and resort company; and an underweight position in Bank of America Merrill Lynch, an US multi-national investment bank

Strategy and outlook

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

Australian Fixed Income

Pendal Fixed Interest Fund

Market review

Australian bond yields experienced a marginal increase with further flattening of the curve in July. During the month, the Reserve Bank of Australia left rates unchanged as widely expected and issued a relatively unchanged post-meeting statement. Second quarter inflation data was closely-watched during the period. The central bank's preferred gauge, the trimmed mean, rose 0.5% for the quarter and 1.9% year-on-year. Labour market figures were more constructive, with a stronger-than-expected 50,900 increase in employment, driven by full time positions. Consumer confidence data was also encouraging, with a 3.9% increase to 106, the highest level in more than four years. Retail sales rose a modest 0.4%. Meanwhile, business conditions increased a marginal 1 point to +15 and confidence slipped 1 point to +6. A narrowing of the BBSW-OIS spread from worrying highs was also noteworthy. Finally on market movements, the Australian 3-year and 10-year yields rose a marginal 3bp and 2bp to 2.10% and 2.65%, respectively. In contrast, the 90-day BBSW rate fell 15bp to 1.96%. Despite the increasingly negative Australia-US yield spread, the Australian dollar was relatively well supported against the US dollar and finished 0.2% higher.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned -0.12% in July (post-fees, pre-tax), underperforming its benchmark by 0.28%.

During July, the alpha overlay and the Duration strategy added value and the Yield Curve strategy was essentially flat, while the FX, Macro and Relative Value strategies detracted. The government bond component performed in line with its benchmark. The credit component was also in line with its benchmark, with an outperformance from overweight positions in Utilities offset by an underperformance from an underweight allocation to Supranationals.

Strategy and outlook

The RBA left the cash rate unchanged at its July meeting and maintained this position at the August meeting, marking two years since the last rate change. The market expects they may well reach three years with this stance. Whilst GDP and employment numbers show an economy close to capacity, inflation numbers remain at the bottom of the central bank's 2-3% band. Second-quarter CPI numbers released in late July did at least see headline inflation creep above 2% (actual rate was 2.1%) on the back of higher oil prices. However, underlying inflation came in at 0.5% again and leaves the annual numbers at 1.9%. Improving wage outcomes over the medium term will lift inflation slightly but slowing growth in the big four inflation contributors of the last decade (tobacco, utilities, education and health) will likely see 2% become the new norm. In turn it will be difficult to reach the midpoint of the RBA's target range (2.5%) with the central bank's own forecasts suggesting it will not be reached over the next few years.

We are less concerned than many around recent house price falls. Housing approvals are falling but outright levels remain healthy and built up demand from owner occupiers - particularly first home buyers - should see an orderly decline in prices continue over the next year. Indeed for the right buyers (owner occupiers, less than 80% loan to value ratio) mortgage rates are falling in some cases.

Our focus for any potential change in outlook for the RBA is from China. Our outlook for China during the first half of the year was more pessimistic than the market, but recent Chinese government stimulus does alleviate some concerns over a more sizeable slowdown. China should continue to underpin commodities and governments in Australia will continue to spend the windfall. We are not yet ready to call an RBA hike in the first half of 2019 but with market odds of a hike so low we are positioned with short duration.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bond yields increased and curves flattened further in July as investors looked past another month of escalating trade war developments. Instead, investors took cues from strong fundamentals. On the former, the 25% tariff on US$34b of imports from China to the US took effect in July, with a further US$16b still under consideration. At the same time, the US and European Union (EU) worked towards an agreement of no tariffs outside of the auto sector. On the data-front, US second quarter GDP figures revealed the strongest increase in four years at an annualised pace of 4.1%. Solid corporate earnings seasons in the US and Europe also bolstered risk sentiment. Regarding monetary policy news, China's central bank made headlines with the announcement of new stimulus designed to support China's economy after previous tightening efforts crimped borrowing. In neighbouring Japan, after much speculation the Bank of Japan announced minor changes to its policy settings, including a marginally wider tolerance band for its 10-year yield target. Meanwhile in Europe, the European Central Bank (ECB) did not change their forward guidance and in the US there was no scheduled Federal Reserve meeting. Finally on market movements, the US 2-year yield added 14bp to 2.67% and the 10-year yield rose 10bp to 2.96%.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned -0.66% in July (post-fees, pre-tax), underperforming its benchmark by 0.38%.

Over the month, all strategies detracted value, with the majority of the losses coming from the Macro and FX strategies. The portfolio risk level was maintained at four risk units throughout the month.

The Duration strategy detracted from returns over the month. Losses were split between long duration positions in the Swedish front-end and the Japanese long-end, both of which were stopped out. Losses were somewhat mitigated by gains from short duration positions in US Treasuries and the Australian curve front-end.

The FX strategy was one of the largest detractors over the month. The losses were from two main positions; firstly a short EUR against US$ position which was expressed in options, and secondly a short NZ$ positions against A$ and JPY. Gains were made from a USD-MXN put spread which performed strongly and we took profit early in the month. Ahead of the BoJ meeting we added a USD-JPY put spread position which ended the month with a minor loss. Over the month, we closed long volatility positions in US$-EUR and US$-NZ$ and opened a new volatility position in US$-JPY.

The Yield Curve strategy experienced minor losses for the month. We added to our long-end curve flattening position in Europe during the month, which posted small negative returns. We continue to hold the steepening position in the long-end of the Japanese curve which delivered a small gain for the month.

The Macro strategy was the largest detractor over the month. The bulk of losses were from buy protection (short credit) positions in European investment grade and the emerging market space, both of which tightened materially as risk-assets rallied. We brought Macro positioning down over the month by closing positions in the US high yield CDS and Mexico sovereign CDS and reducing positions in the iTraxx Europe main CDS and Turkey sovereign CDS. This month we also added a front end buy protection position in the CDX investment grade index CDS.

The Relative Value strategy detracted from performance over the month. The majority of the losses were from the 5-year invoice spread widener in the US, while the Australian 3-year EFP spread ended the month with a flat performance. There were no trades in the Cross-Market strategy for the month.

Strategy and outlook

Over the month of July, trade tension fears have continued to grow in markets and Trump's rhetoric will likely remain hawkish as the administration starts building towards the November Mid-terms. The policy developments from China this month show a distinct shift in stance towards easing and stimulus, and warrant a change in global growth expectations for the rest of 2018. With monetary easing well under way in China, and soon to be boosted by regulatory easing and fiscal stimulus, it is reasonable to assume a boost through trade and commodities for European and emerging economies. However, the global liquidity backdrop is still deteriorating, with an inwardly focused US Federal Reserve (Fed) driving the continued drain in offshore US dollars. Signals from the Bank of Japan this month also point to their desire to rein in their extraordinary monetary policy, which further reinforces our core investment theme of global central bank liquidity withdrawal. In light of this liquidity withdrawal we continue to expect the markets to become even more discerning between the 'haves' and 'have-nots' in the second half of 2018.

Credit

Pendal Enhanced Credit Fund

Market review

Australian credit posted another positive return for the month. This was driven by a tightening in credit spreads and reasonable accruals, which more than offset a small rise in underlying yields. Spreads fell as investors looked past trade war concerns to focus on strong fundamentals, including solid corporate earnings seasons in the US and Europe. Domestic concerns surrounding the widening in BBSW-OIS spreads were also eased to some extent as the 3-month BBSW rate fell 15bp.

Turning to local credit market activity, issuance in July totaled A$5.3b, an increase from just A$1.8b in June, but still light compared with previous years. The largest issue was conducted by ANZ at A$2b of 3-year paper at 75bp over swap. Foreign banks - RBC, Mizuho and UOB - also tapped the market for debt capital. However, there was no issuance from corporates as they held back ahead of the full year reporting season in August.

The Australian iTraxx index (Series 29 contract) traded in a wide 13bp range, finishing the month 6bp tighter to +74.5bp. On average, physical credit spreads finished the month unchanged. However, real estate, resources and telecommunications underperformed, widening by 3, 2 and 1bp respectively. Semi-government bonds performed in line with government bonds over the month.

Portfolio performance

The Pendal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 0.19% in July (post-fees, pre-tax), underperforming the benchmark by 0.04%.

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 in June. 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 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 few years. The major Australian banks have stronger capital ratios than previous years which 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 the housing market 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 marginal increase, with further flattening of the curve in July. During the month, the Reserve Bank of Australia left rates unchanged as widely expected and issued a relatively unchanged post-meeting statement. Second quarter inflation data was closely-watched during the period. The central bank's preferred gauge, the trimmed mean, rose 0.5% for the quarter and 1.9% year-on-year. Labour market figures were more constructive with a stronger-than-expected 50,900 increase in employment, driven by full time positions. Consumer confidence data was also encouraging with a 3.9% increase to 106 - the highest in more than four years. Retail sales rose by a modest 0.4%. Meanwhile, business conditions increased a marginal 1 point to +15 and confidence slipped 1 point to +6. A narrowing of the BBSW-OIS spread from worrying highs was also noteworthy, with the 3-month rate dropping 15bp.

Turning to offshore developments, investors looked past another month of escalating trade war developments and instead took cues from strong fundamentals. On the former, the 25% tariff on US$34b of Chinese imports to the US took effect in July, with a further US$16b still under consideration. The Trump administration also flagged another US$200b in exports that could face a 10% tariff. At the same time, the US and European Union (EU) worked towards an agreement of no tariffs outside of the auto sector. On the data-front, US second quarter GDP figures revealed the strongest increase in four years at an annualised pace of 4.1%. Solid corporate earnings seasons in the US and Europe also bolstered risk sentiment.

Regarding monetary policy news, China's central bank made headlines with the announcement of new stimulus designed to support China's economy after previous tightening efforts crimped borrowing. Additional fiscal measures were also announced including tax reductions and targeted tax rebates. In neighbouring Japan, after much speculation the Bank of Japan (BoJ) announced minor changes to its policy settings, including a marginally wider tolerance band for its 10-year yield target. Meanwhile in Europe, the ECB did not change their forward guidance and in the US there was no scheduled Federal Reserve meeting.

Finally on market movements, the Australian 3-year and 10-year yields rose by a marginal 3bp and 2bp to 2.10% and 2.65%, respectively. In contrast, the 90-day BBSW rate fell 15bp to 1.96%. Movements were more pronounced in the US with the 2-year yield adding 14bp to 2.67% and the 10-year yield rising 10bp to 2.96%. Despite the increasingly negative Australia-US yield spread, the Australian dollar was relatively well supported against the US dollar and finished 0.2% higher.

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 0.16% in July (post-fees, pre-tax), underperforming the benchmark by 0.03%.

The Fund performed well for the month and remains well positioned to outperform, with a higher running yield than the index. 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 along the curve continue to offer better relative value and the weighted average maturity has consistently been longer than benchmark for this reason. The RBA is unlikely to tighten monetary policy in the near term. The Fund remains well positioned to continue to outperform its benchmark.

Enhanced Cash

The Pendal Enhanced Cash Fund (formerly the BT Wholesale Enhanced Cash Fund) returned 0.22% in July (post-fees, pre-tax) outperforming the benchmark by 0.03%.

Positive performance came from financials and industrials sectors. The portfolio has outperformed its benchmark by around 1% (before fees) over the past 12 months.

Portfolio activity during the month included reducing exposure to the resources sector. As at the end of the month, the portfolio had a credit spread of 63bp over bank bills, interest rate duration of 0.08 years and credit spread duration of 1.53 years.

Strategy and outlook

The RBA left the cash rate unchanged at its July meeting and will do so again at the August meeting, marking 2 years since the last rate change. The market expects they may well reach 3 years. Whilst GDP and employment numbers show an economy close to capacity, inflation numbers remain at the bottom of the central bank's 2-3% band. Q2 CPI numbers released in late July did at least see headline inflation creep above 2% (actual 2.1%) on the back of higher oil prices. However underlying inflation came in at 0.5% again and leaves the annual numbers at 1.9%. Medium term improving wage outcomes will lift inflation slightly but slowing growth in the big four inflation contributors of the last decade (tobacco, utilities, education and health) will likely see 2% become the new norm. In turn it will be difficult to reach the midpoint of the RBA's target range (2.5%) with the central bank's own forecasts suggesting it will not be reached over the next few years.

We are less concerned than many around recent house price falls. Housing approvals are falling but outright levels remain healthy and built up demand from owner occupiers, particularly first home buyers, should see the orderly fall in prices continue over the next year. Indeed for the right buyers (owner occupiers, less than 80% LVR) mortgage rates are in some cases falling.

Our focus for any potential change in outlook for the RBA is from China. Our outlook for China during the first half of the year was more pessimistic than the market, but recent Chinese government stimulus does alleviate some concerns over a more sizeable slowdown. China should continue to underpin commodities and governments in Australia will continue to spend the windfall. We are not yet ready to call an RBA hike in the first half of 2019 but with market odds of a hike so low we are positioned short duration.

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

2018 has witnessed a shift in the credit market backdrop from previous years with an increase in volatility as global monetary stimulus is withdrawn. This is a marked change from 2017 and most of 2016, where accommodative policy had supported risk sentiment and the resilience of credit. During that period the Australian iTraxx fell from a high of +173 in February 2016 to +58 by the end of 2017. This tightening has reversed to some degree in 2018 with a high of +85 reached during July. The global factors driving this reversal include the Fed and ECB progressing with policy normalisation, a slowing Chinese economy and rising geopolitical risks including trade wars. With these risks in mind as well as increased market volatility we are cautiously positioned until further clarity is gained.

However, we do acknowledge strong corporate fundamentals remain with healthy balance sheets, positive earnings growth and low high yield default rates. This was evident during the month with solid second quarter earnings results abroad.

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 ASX A-REIT index rose by 1% in July, underperforming the broader equity market (+1.4%) by 40bp. However, for the 12-month period, the market has returned +14.2%, only slightly below that of equities (+14.6%). Globally, REITs rose by +1% for the month and have returned 4.3% for the year (on an A$ hedged basis). Over the past year, Australian REITs has been the best performer (+14.2%), followed by Europe (+10%). Conversely, emerging market REITs were the worst performers (-5%).

During the month, Scentre Group announced the acquisition of a 50% stake in Westfield Eastgardens for $720m on a 4.25% cap rate. While the centre has modest sales ($9,800/sqm) there are a number of mixed use opportunities in the medium to longer term. Meanwhile, Stockland (+6.5%) tightened its FY18 earnings guidance to the top end of the range and as a result, Stockland and Mirvac were the best performing REITs over the month. Unibail-Rodamco Westfield also announced that it had sold the Capital 8 office building in Paris for €789m (A$1.2b) as part of its €3b asset divestment program. Elsewhere, independent experts assessed the $5.15 cash offer for Investa Office Fund as “not fair, but reasonable”.

The MSCI World global equity index rose by 2.9% for the month, with all major indices delivering positive returns. US equities continued to perform well, supported by favourable corporate earnings and economic data. The latest reading on US GDP growth was an annual growth rate of 4.1%, with strong contributions from consumer spending and business fixed investment spending. US inflation (CPI) came in at +0.2%, with year over year growth of +2.3%. US Treasury yields rose 10bp to 2.96%. Housing starts in the US fell by 12% to 1.17m, while new single family home sales fell 5.3% and existing home sales were also down 1%.

In Australia, the RBA left interest rates on hold. Second quarter CPI came is at +0.4% (a +2.1% annual rate), with petrol lifting the rate by +7% over the prior quarter. Australian retail sales were +0.4%, with strong sales in clothing/footwear (+2.2%) offset by lacklustre café/restaurant sales (-1%). Private sector credit was very soft, +0.3%, with investor housing credit (-0.1%) down marginally for the month (only the fourth time in the history of the series) and 1.6% higher for the 12-month period - the weakest growth on record. Employment growth was solid (+50,900), however the unemployment rate remained steady at 5.4% as the participation rate inched up 20bp to 65.7%.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned 1.13% in July (post-fee, pre-tax), outperforming its benchmark by 0.18%.

The portfolio outperformed over the month, with positive attribution from overweight positions in Mirvac Group, Arena REIT and Dexus Property Group and underweight positions in Scentre Group and Shopping Centres Australia. Overweight positions in Investa Office, Charter Hall Long WALE and Rural Funds Group and underweight positions in Vicinity and Stockland Group detracted from performance.

Over the month we reduced our overweight positions in Investa Office Fund and Iron Mountain (it will delist in August 2018) and increased our overweight positions in Charter Hall Group, Unibail-Rodamco Westfield and Rural Funds Group.

Strategy and outlook

The A-REIT sector is now priced on an FY19 dividend yield of 5.1%, a price-earnings ratio of 16.9 times and a 23% premium to net tangible assets, above its long-term average of 16%. Cap rates will likely compress further in the current reporting period (on the back of recent transaction evidence), but asset valuation uplift thereafter will depend on income growth and tenancy retention. Balance sheets are stable, with sector gearing at 28%.

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 continued to move higher in July, posting a total return of 0.9%. Europe (+1.4%) was the strongest performing region, followed by Asia Pacific (+0.8%) and North America (+0.7%). In Asia Pacific, results were largely positive across the region. Hong Kong (+2.8%) was the strongest performer, followed by Singapore (+2.4%) and New Zealand (+1.3%), while Japan (-1.1%) was the only negative performer. In Europe, results were mixed. Sweden (+12.8%) posted the largest increase, followed by Norway (+7.1%) and Austria (+4.4%). Notable negative performers included Israel (-3.5%), the United Kingdom (-1.3%), and Finland (-1.2%) In North America, the US and Canada returned 0.6% and 2.1%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund (formerly the BT Wholesale Global Property Securities Fund) returned 0.86% in July (post-fee, pre-tax), underperforming the benchmark by 0.07%.

North America

The North America portfolio returned 0.48% in July (before fees and withholding taxes), lagging the FTSE EPRA/NAREIT North America Index by 21 basis points. Underperformance relative to the benchmark was attributable to negative stock selection results, which were partially offset by positive sector allocation results. In terms of stock selection, results were weakest in the triple net lease, shopping centre, and regional mall sectors and were strongest in the diversified, health care, and other residential sectors. Regarding sector allocation, positive results were driven by the portfolio's overweight to the outperforming data centre and regional mall sectors. Among the portfolio's holdings, top individual contributors to relative performance included holding no exposure to the underperforming Extra Space Storage (EXR) and overweight positions in the outperforming CyrusOne (CONE) and Simon Property Group (SPG). Detractors most notably included overweight positions in the underperforming CubeSmart (CUBE), American Campus Communities (ACC), and Rexford Industrial Realty (REXR).

Europe

The Europe portfolio returned 2.17% in July (before fees and withholding taxes), outperforming the regional EPRA benchmark by 70 basis points. Outperformance relative to the benchmark was driven by both positive stock selection and positive country allocation results. Regarding country allocation, positive results were attributable to the portfolio's overweight to the outperforming markets of Sweden and Norway. Conversely, the portfolio's lack of exposure to the outperforming Belgium was a notable detractor from relative performance. In terms of stock selection, results were strongest in the United Kingdom, Spain and France and were weakest in the Netherlands, Sweden and Norway. Among the portfolio's holdings, top contributors to relative performance included overweight positions in outperforming Fabege AB (Sweden), Entra ASA (Norway) and Kungsleden AB (Sweden). Detractors most notably included overweight positions in the underperforming Segro PLC (United Kingdom) and NSI NV (Netherlands), and a lack of exposure to the outperforming Hemfosa Fastigheter AB (Sweden).

Asia

The Asia portfolio returned 0.64% in July (before fees and withholding taxes), lagging the regional EPRA benchmark by 13 basis points. Underperformance relative to the benchmark was driven by negative stock selection results, while country allocation results were largely neutral. In terms of stock selection, negative results in Hong Kong were partially offset by positive results in Japan and Singapore. Among the portfolio's holdings, top contributors to relative performance included an overweight position in the outperforming Link REIT (Hong Kong) and holding no exposure to the underperforming Hulic Co. (Japan) and City Developments (Singapore). Detractors most notably included overweight positions in the underperforming UOL Group (Singapore) and Nippon Building Fund (Japan), and a lack of exposure to the outperforming Sino Land (Hong Kong).

Active Balanced

Pendal Active Balanced Fund

Markets review

The S&P/ASX 300 Accumulation Index rose by 1.3% over the month of July, with the majority of the heavy lifting done by Industrials (+1.6%). The performance of Resources (+0.1%) was positive yet a laggard. The ongoing trade tensions between the US and China saw base metals sell off during the month, with the former now flagging the expansion of tariffs to US$200b worth of imports from the latter. The price of crude oil also eased over the period, despite a large drop in US oil inventories. Potential supply increases by OPEC nations as well as Russia weighed on investor sentiment. In addition, President Trump was reportedly considering selling oil from the country's strategic oil reserves to suppress any further price increases.

The majority of GICS sectors delivered positive returns over the period, with the exceptions being Utilities (-1.4%), Information Technology (-1.1%) and Consumer Staples (-0.9%). The Utilities sector's decline could be largely attributed to the release of an ACCC report that aims to rein in soaring electricity prices that have reached a decade high. While the recommendations from the report do not translate into legislation automatically, comments from the Government in regard to the report have been constructive and may see most recommendations being accepted. This weighed on investor sentiment and saw AGL (AGL, -2.2%) decline over the month.

Index heavyweight Materials (-0.3%) also recorded a small loss. BHP (BHP, +2.8%) saw its share price rise as news of the US on-shore shale assets sale came in sooner than expected and was at a reasonable price. In contrast, negative returns from the gold miners were more than offsetting as the gold price declined 2.6% over the month as short positions against the precious metal reached a record high. Against this backdrop, a disappointing quarterly production update on the cost side from Evolution Mining (EVN, -20.5%) made it the largest performance detractor within the sector.

Turning to the positive side of the spectrum, the recently beleaguered Telecommunication Services sector recorded the best monthly sector return (+7.6%); while a rebound in index heavyweight Financials (+2.0%) contributed the most to the headline index performance. 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.

The global equity market delivered positive returns again this month, reflecting a generally optimistic tone on continued growth momentum, particularly in the US. Recent trade tensions appeared to simmer as signs of further engagement between the US and major trading partners emerged. Investors took comfort here and sentiment was further supported by another strong series of corporate earnings results in the US and Europe. The gathering of G20 finance ministers and central bank governors in Buenos Aires in July formed agreement on the global economy being on a firm footing. The group noted in its post-forum communique that “global economic growth remains robust and unemployment is at a decade low. However, growth has been less synchronised recently, and downside risks over the short and medium term have increased”. The cautious tone highlighted concerns over growing imbalances and financial vulnerabilities, although these comments were kept in perspective and most markets ended the month higher.

US stocks continued to exhibit strong momentum, although some weakness emerged in the mega technology players following the latest round of earnings releases. Twitter (-27.0%), Netflix (-13.8%) and Facebook (-11.2%) experienced rapid sell-downs following their latest earnings releases. In contrast, Industrials was the best performing sector, supported by positive earnings releases and a sense of optimism towards developments on trade policies.

Most major markets in Europe also delivered substantial gains in July. All sectors rose to varying degrees, supported by some particularly strong corporate earnings results and positive signs of economic recovery taking hold. Performance of the region’s markets was led by Switzerland (+6.1%), Germany (+4.2%) and France (+3.5%), while the UK’s FTSE 100 somewhat lagged with a gain of 1.4%.

Asian equity markets recorded a mixed set of results in July. Concerns over the impact of the recent imposition of tariffs on China’s exports to the US for the broader region weighed on some markets. This was compounded by concerns over China’s growth after the authorities shifted fiscal policy settings to an expansionary stance by cutting taxes for companies to offset some of the trade-induced impacts. The Southeast Asian markets of Thailand (+6.7%) and Malaysia (+5.5%) outperformed the weaker North Asia markets of Japan (+1.1%) and Hong Kong (-1.3%).

The Australian dollar experienced a consolidation in value this month and was little changed against the major currencies.

Australian bond yields experienced a marginal increase with further flattening of the curve in July. During the month, the Reserve Bank of Australia left rates unchanged as widely expected and issued a relatively unchanged post-meeting statement. Second quarter inflation data was closely-watched during the period. The central bank’s preferred gauge, the trimmed mean, rose 0.5% for the quarter and 1.9% year-on-year. Labour market figures were more constructive, with a stronger-than-expected 50,900 increase in employment, driven by full time positions. Consumer confidence data was also encouraging, with a 3.9% increase to 106 - the highest level in more than four years. Retail sales rose a modest 0.4%. Meanwhile, business conditions increased a marginal 1 point to +15 and confidence slipped 1 point to +6. A narrowing of the BBSW-OIS spread from worrying highs was also noteworthy. Finally on market movements, the Australian 3-year and 10-year yields rose a marginal 3bp and 2bp to 2.10% and 2.65%, respectively. In contrast, the 90-day BBSW rate fell 15bp to 1.96%. Despite the increasingly negative Australia-US yield spread, the Australian dollar was relatively well supported against the US dollar and finished 0.2% higher.

Global bond yields increased and curves flattened further in July as investors looked past another month of escalating trade war developments. Instead, investors took cues from strong fundamentals. On the former, the 25% tariff on US$34b of imports from China to the US took effect in July, with a further US$16b still under consideration. At the same time, the US and European Union (EU) worked towards an agreement of no tariffs outside of the auto sector. The European Central Bank (ECB) did not change their forward guidance and in the US there was no scheduled Federal Reserve meeting. On market movements, the US 2-year yield added 14bp to 2.67% and the 10-year yield rose 10bp to 2.96%.

Portfolio performance

The Pendal Active Balanced Fund (formerly the BT Wholesale Active Balanced Fund) returned 1.09% (post-fee, pre-tax) for the month of July, marginally underperforming its benchmark by 0.08%.

The Fund delivered a positive return in July, albeit slightly below the benchmark return. Positive performance was supported by exposure to Australian and offshore equity and listed property markets. Australian fixed income markets also generated a positive, albeit modest return in July while global fixed income experienced a negative return as bond yields moved higher. Exposure to alternatives delivered a negative return this month, reflective of the strategy's diversifying characteristics. At a Fund level, the asset allocation settings across the traditional asset classes made a positive contribution to performance, although some detractions came from manager contribution from a select number of strategies.

Tactical asset allocation contributions were driven by the Fund's exposure to Australian and global shares, together with an underweight to fixed income.

The key factors influencing our active management returns were stock selection outcomes within Australian equities. Within the Australian equity strategy, overweight positions in Qantas, CYBG and Amcor, together with an underweight to Insurance Australia Group contributed value. These contributions were partially offset by overweight positions in Nine Entertainment and Origin Energy and underweight positions in Brambles and National Australia Bank.

Within the global equities portfolio, the Core and Concentrated portfolios fell marginally short of the benchmark but positively contributed to overall returns.

Our Alternatives core portfolio detracted from returns this month, which is to be expected for strategies incorporating short positions in a rising market. The Alternatives strategy delivered a total return (before fees) of -0.07% versus a cash return of 0.19%.

The global macro, long-short equity, managed futures and event driven strategies made accounted for most of the declines this month. Relative value signals within the global macro strategy were weak over the month, while the loss from Event Driven strategies was largely due to the cancellation of the Qualcomm takeover proposal for Netherlands-based NXP Semiconductor which overshadowed a month where 14 deals were completed and 63% of these generated gains. The equity market neutral and dedicated short bias strategies also generated small profits this month.

In relation to our tactical positioning within Alternatives, our long position in equity market futures contributed to returns as markets were strong in July. This was somewhat offset by long positions in Gold, Copper and Crude Oil which detracted from performance. At the end of July we have moved to a short position in gold and closed a short position in US bond yields.

Strategy and outlook

The recent settling of volatility in markets highlights the importance of actively focusing on the underlying fundamental factors to assess the prospects of markets. Through much of this year markets have been driven by themes and geopolitical factors which have historically shown to be temporary adjustments to the otherwise normal functioning of markets. The recent US and European corporate reporting season has evidenced the dichotomy between market themes and fundamentals, where many corporates have been enjoying a profitable operating environment. However, the valuation support that corporations have received by virtue of ultra-low interest rates is now moving to the past tense. Looking forward, it is more likely that market volatility will expand and there will be greater dispersion in the performance across companies and sectors. This environment is particularly favourable for fundamental research-driven active management. The Fund will continue to maintain exposure to a range of diversifying strategies with the aim of reducing volatility and generating outperformance.

We have recently implemented 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 July 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)	1.77	4.73	6.37	1.77	16.18	13.52	7.78	9.85	10.13
Total Return (pre-fee, pre-tax)	1.84	4.94	6.79	1.84	17.12	14.42	8.64	10.72	11.13
Benchmark	1.31	5.78	6.05	1.31	14.70	10.80	8.09	9.15	10.05
Pendal Imputation Fund									APIR - RFA0103AU
Total Return (post-fee, pre-tax)	1.73	6.36	7.21	1.73	15.24	12.35	6.70	8.35	9.72
Total Return (pre-fee, pre-tax)	1.81	6.60	7.68	1.81	16.28	13.36	7.66	9.32	10.74
Benchmark	1.31	5.78	6.05	1.31	14.70	10.80	8.09	9.15	8.86
Pendal Focus Australian Share Fund									APIR - RFA0059AU
Total Return (post-fee, pre-tax)	1.91	4.65	7.04	1.91	17.49	15.52	9.73	11.97	9.65
Total Return (pre-fee, pre-tax)	2.06	4.57	7.51	2.06	18.84	17.02	10.85	13.12	10.78
Benchmark	1.31	5.78	6.05	1.31	14.70	10.80	8.09	9.15	7.73
Pendal Ethical Share Fund									APIR - RFA0025AU
Total Return (post-fee, pre-tax)	1.81	4.03	5.40	1.81	15.16	13.09	7.50	9.99	8.78
Total Return (pre-fee, pre-tax)	1.90	4.28	5.90	1.90	16.26	14.17	8.52	11.04	9.84
Benchmark	1.31	5.78	6.05	1.31	14.70	10.80	8.09	9.15	8.25
Australian Shares - Mid Cap									
Pendal MidCap Fund									APIR - BTA0313AU
Total Return (post-fee, pre-tax)	0.45	1.98	5.91	0.45	23.32	15.14	15.54	16.45	11.12
Total Return (pre-fee, pre-tax)	0.52	1.81	6.65	0.52	25.38	16.62	16.85	18.06	13.38
Benchmark	1.16	4.06	5.41	1.16	20.37	12.32	15.12	14.68	6.31
Australian Shares - Small Cap									
Pendal Smaller Companies Fund									APIR - RFA0819AU
Total Return (post-fee, pre-tax)	-1.04	2.03	7.65	-1.04	22.27	10.58	13.04	11.68	13.35
Total Return (pre-fee, pre-tax)	-0.93	2.35	8.32	-0.93	23.81	11.96	14.45	13.08	14.64
Benchmark	-1.01	3.74	4.19	-1.01	22.58	10.11	14.03	9.27	7.92
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund									APIR - RFA0061AU
Total Return (post-fee, pre-tax)	0.69	5.42	1.10	0.69	18.55	13.54	17.59	19.86	18.48
Total Return (pre-fee, pre-tax)	0.79	5.74	1.43	0.79	19.55	15.97	20.07	24.01	23.64
Benchmark	-1.01	3.74	4.19	-1.01	22.58	10.11	14.03	9.27	3.49
International Shares									
Pendal Core Global Share Fund									APIR - RFA0821AU
Total Return (post-fee, pre-tax)	2.29	3.74	4.95	2.29	17.85	14.78	7.12	13.00	5.99
Total Return (pre-fee, pre-tax)	2.38	3.98	5.44	2.38	18.98	15.87	8.14	14.08	7.16
Benchmark	2.52	5.29	7.16	2.52	20.31	15.35	8.53	13.83	7.49
Pendal Global Emerging Markets Opportunities Fund - WS									APIR - BTA0419AU
Total Return (post-fee, pre-tax)	0.45	-1.55	-0.24	0.45	11.90	14.89	8.52	11.03	11.24
Total Return (pre-fee, pre-tax)	0.57	-1.20	0.45	0.57	13.46	16.49	10.05	12.70	13.44
Benchmark	1.57	-4.06	-4.09	1.57	12.07	15.41	8.50	9.29	10.71
Pendal Concentrated Global Share Fund									APIR - BTA0503AU
Total Return (post-fee, pre-tax)	2.12	4.94	6.76	2.12	21.14	17.10	N/A	N/A	17.13
Total Return (pre-fee, pre-tax)	2.20	5.17	7.26	2.20	22.48	18.48	N/A	N/A	18.50
Benchmark	2.52	5.29	7.16	2.52	20.31	15.35	N/A	N/A	15.37
Property									
Pendal Property Securities Fund									APIR - BTA0061AU
Total Return (post-fee, pre-tax)	1.13	6.20	7.11	1.13	14.04	1.29	8.21	12.24	7.60
Total Return (pre-fee, pre-tax)	1.18	6.37	7.45	1.18	14.77	1.95	8.91	12.97	8.42
Benchmark	0.95	6.32	7.49	0.95	14.45	1.16	8.33	12.56	7.49
Pendal Global Property Securities Fund									APIR - RFA0051AU
Total Return (post-fee, pre-tax)	0.86	5.19	3.94	0.86	6.54	2.76	5.38	8.93	9.26
Total Return (pre-fee, pre-tax)	0.94	5.41	4.40	0.94	7.52	3.71	6.35	9.94	10.26
Benchmark	0.93	5.24	3.74	0.93	6.09	2.48	5.56	9.10	8.98
Fixed Interest									
Pendal Fixed Interest Fund									APIR - RFA0813AU
Total Return (post-fee, pre-tax)	-0.12	1.75	2.32	-0.12	3.01	0.89	2.29	3.93	6.38
Total Return (pre-fee, pre-tax)	-0.08	1.88	2.57	-0.08	3.53	1.39	2.81	4.45	6.94
Benchmark	0.16	1.33	2.13	0.16	2.99	1.37	3.02	4.24	6.59
Pendal Global Fixed Interest Fund									APIR - RFA0032AU
Total Return (post-fee, pre-tax)	-0.66	0.55	0.83	-0.66	0.91	-0.77	2.09	4.14	5.90
Total Return (pre-fee, pre-tax)	-0.61	0.69	1.10	-0.61	1.45	-0.24	2.63	4.69	6.49
Benchmark	-0.28	0.34	1.11	-0.28	1.60	0.02	3.21	4.80	6.80
Pendal Enhanced Credit Fund									APIR - RFA0100AU
Total Return (post-fee, pre-tax)	0.19	0.96	1.57	0.19	3.02	2.58	3.33	4.35	5.70
Total Return (pre-fee, pre-tax)	0.22	1.07	1.80	0.22	3.49	3.04	3.80	4.82	6.22
Benchmark	0.23	1.06	1.76	0.23	3.10	2.57	3.41	4.37	5.81
Cash & Income									
Pendal Enhanced Cash Fund									APIR - WFS0377AU
Total Return (post-fee, pre-tax)	0.22	0.56	1.02	0.22	2.59	2.88	2.67	2.87	4.91
Total Return (pre-fee, pre-tax)	0.24	0.62	1.14	0.24	2.85	3.14	2.92	3.13	5.25
Benchmark	0.19	0.52	0.95	0.19	1.83	1.81	1.95	2.21	4.85
Pendal Managed Cash Fund									APIR - WFS0245AU
Total Return (post-fee, pre-tax)	0.16	0.47	0.90	0.16	1.80	1.82	1.95	2.19	6.41
Total Return (pre-fee, pre-tax)	0.18	0.52	1.01	0.18	2.02	2.04	2.17	2.41	6.71
Benchmark	0.19	0.52	0.95	0.19	1.83	1.81	1.95	2.21	6.48
Pendal Monthly Income Plus Fund									APIR - BTA0318AU
Total Return (post-fee, pre-tax)	0.42	1.32	1.48	0.42	4.87	3.60	3.90	4.74	5.49
Total Return (pre-fee, pre-tax)	0.47	1.49	1.80	0.47	5.56	4.27	4.58	5.42	6.16
Benchmark	0.13	0.38	0.75	0.13	1.51	1.51	1.66	1.97	2.88
Diversified									
Pendal Active Balanced Fund									APIR - RFA0815AU
Total Return (post-fee, pre-tax)	1.09	2.33	2.52	1.09	10.81	8.70	5.93	8.35	7.72
Total Return (pre-fee, pre-tax)	1.17	2.58	3.00	1.17	11.88	9.73	6.94	9.38	8.80
Benchmark	1.17	3.54	4.16	1.17	11.09	8.07	6.74	8.34	7.56

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PENDAL

Performance figures are calculated in accordance with the Financial Services Council (FSC) standards. Performance data (post-fee) assumes reinvestment of distributions and is calculated using exit prices, net of management costs. Performance data (pre-fee) is calculated by adding back management costs to the (post-fee) performance. Past performance is not a reliable indicator of future performance. The term 'benchmark' refers to the index or measurements used by an investment manager to assess the relative risk and the performance of an investment portfolio.

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

Pendal Global Property Securities Fund ARSN 108 227 005

Pendal Managed Cash Fund ARSN 088 832 491

Pendal Enhanced Cash Fund ARSN 088 863 469

Pendal Active Balanced Fund ARSN 088 251 496

A product disclosure statement (PDS) is available for each of the above products and can be obtained by contacting Pendal on 1800 813 886, or by visiting www.pendalgroup.com. You should consider the relevant PDS in deciding whether to acquire, or to continue to hold, the product.

AQR began managing international equity for BT Financial Group in July 2006.