Fund Manager Commentary

Month ended 31 August 2018

Table of Contents

Australian Shares

Pendal Australian Share Fund

Market Review

The S&P/ASX 300 Price Index rose by 0.6% in August despite the political turmoil in Canberra. Adding dividends to the price return, the Accumulation Index was 1.4% higher. Industrials (+2.9%) led the gains of the headline index, whereas Resources (-4.5%) weighed on returns. Commodity prices fell across most segments over the month, due to the confluence of President Donald Trump flagging a potential tariff increase in imports from China to 25% from 10%, along with new tariffs put in place on imports of steel and aluminium from Turkey. Somewhat offsetting this impact on the Resources sector was the rise in the crude oil price after export volume expectations from both Iran and Venezuela continued to remain low.

Reporting season results drove stock performance over the month, as we saw some unusually high price reaction on both the positive and negative sides. Biotechnology company CSL (CSL, +15.6%) reported both strong headline growth as well as margin expansion which was received favourably by the market. Management also expects the strong momentum to continue, guiding towards 10-14% growth on underlying net profit for FY19 as well as further margin expansion on the back of the continuous growth in the group's higher-margin therapies. The company is now the third largest stock within the index. Similarly, results from respiratory products manufacturer, Resmed (RMD, +10.2%), were also upbeat. Mask sales grew 15% as the F20 full-face masks and the N20 nasal mask continued to perform. Sales for devices were also strong over the period, as RMD continued to gain market share in the US. As a result, the Health Care sector recorded a 10.4% return over the month.

The recently beleaguered Telecommunication Services sector also fared well in August (+13.0%) and recorded the highest sector return. Investor sentiment was bolstered by the announcement of TPG (TPM, +50.0%) merging with key competitor Vodafone Hutchinson Australia (VHA). The competitive landscape within the Mobile segment has intensified lately and seen the whole sector de-rate. Once approved and settled, the merger is likely to see the industry dynamic improve from here, benefiting companies like Telstra (TLS, +13.0%).

Also recording a double-digit gain was Information Technology (+12.2%), which rose on the back of an already lofty valuation. The sector now trades on a 30x one-year forward price-earnings multiple, compared to the market's long term average of 16x. While some of the sector heavyweights such as Computershare (CPU, +6.8%), Xero (XRO, +19.3%) and REA Group (REA, +5.7%) generated good gains, a number of the smaller companies also drove performance. Altium (ALU, +37.4%) Wisetech (WTC, +40.1%), and Afterpay Touch (+27.9%) were all in that cohort. In particular, WTC reported a FY18 result that was ahead of market expectations. Revenue rose by 44%, primarily led by organic growth. Revenue guidance also points to another 42% to 47% growth in FY19.

On the other end of the spectrum, index heavyweight Materials (-4.9%) was the largest detractor from index performance. Share prices of the major miner duo - BHP (BHP, -4.7%) and Rio Tinto (RIO, -8.4%) - pulled back from their recent highs despite reporting satisfactory results. Capital management also remains on the agenda, albeit with increased capital investment and operating costs. The latest developments in US-China trade tensions weighed on the global growth outlook, and consequently on near-term demand for base metals. Copper was 6.4% weaker over the month, whereas iron ore also dropped by 2.4%. The ongoing strength of the US dollar also saw the gold price decline (-2.2%), which weighed on the fortunes of gold miner, Newcrest Mining (NCM, -9.7%). NCM reported FY18 results in August, with underlying profit 16% higher than the prior period. There was no surprise in production guidance for FY19, although costs were higher. On the contrary, Alumina (AWC, +6.0%) finished the month higher on the back of support from higher prices for aluminium. The supply side of the market continues to be impacted by isolated events, including a strike by employees at Alcoa and China's decrease in production due to environmental concerns.

Portfolio performance

The Pendal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned 0.79% (post-fee, pre-tax) in August, underperforming its benchmark by 0.61%.

Contributors

Overweight CSL

Biotechnology company CSL (CSL, +15.6%) is one of our preferred growth stocks. Its relatively high valuation is justified by the strong underlying growth being achieved. The company reported FY18 results in August, where revenue was up by 11% (in constant currency terms) which exceeded consensus estimates by 2.7%. The company also benefited from operating leverage, with net profit (NPAT) rising by 28%, slightly ahead of consensus and at the top end of the company's most recent guidance upgrade in May.

Management has issued NPAT guidance of $1,880 - $1,950m for next year, which is equivalent to 8.7% - 12.7% growth - a level that we believe is conservative. We continue to uphold our conviction in the business as we do not believe its potential for headline growth and margin expansion has been fully appreciated by the market.

Underweight Woolworths

Woolworths (WOW, -6.0%) reported results in August that were in line with expectations; however, like-for-like sales for food had slowed and its cost of doing business has been on the rise which is constraining earnings margins on the food category for FY19. While the turnaround story at WOW's Australian food segment has been strong, the company is now trading at a 20x one-year forward price-earnings multiple, which is much higher than our preferred exposure to the sector through Metcash (MTS).

Overweight JB Hi-Fi

JB Hi-Fi's (JBH, +12.7%) share price bounced back strongly in August following the release of its FY18 results, after trading sideways since its May update. It was a good example of companies that defy expectations of bad news and continue to deliver sales growth. The company reported an improvement in earnings after larger than expected costs were incurred in the first half. The result was in line with guidance and there were some signs of improvement in the Good Guys franchise, where margin weakness has weighed in recent times. We continue to uphold our conviction in the company.

Overweight Santos

Santos (STO, +7.2%) reported its second-half earnings (EBITDA) results during the month, which exceeded market consensus. The gas explorer continued to impress the market with its cost control and the dividend has been restated as net debt continued to decline. In addition, its proposed takeover bid for privately-held Quadrant Energy was well received by investors. Quadrant supplies almost a quarter of Western Australia’s gas, as well as a significant portion of oil volumes, with some of Quadrant's assets co-owned by STO. The all-cash deal represents over 20% of STO’s market cap and will be funded by debt. However, its gas supply to Western Australia is under long-term contracts, providing clear visibility into the underlying future cash flows and reducing leverage to the oil price.

Detractors

Overweight Origin Energy

Power company Origin Energy (ORG, -18.6%) reported in August. Its liquefied natural gas (LNG) division continues to do well; however, the power generation/retailing business was impacted by a change to the accounting treatment of its hedging, which effectively detracted 6% from profits. ORG has also had to accept a reduction to margins as the government has effectively blocked the company from passing on increased power costs to consumers. Political division and uncertainty over the Government's energy policy is a significant headwind for the power sector and represents another example of regulatory and political intervention disrupting several sectors in the domestic economy.

Overweight BHP

The mining sector has de-rated on fears surrounding US trade sanctions and the possible effect on demand from China and commodity prices. The sector has underperformed as rhetoric ratcheted up in recent weeks, with sentiment towards resources companies including BHP (BHP, -4.7%) falling in spite of delivering a good set of results. We believe that sentiment is overly negative here, given that further sanctions are likely to prompt a stimulatory response from China's Government which, in conjunction with continued supply side constraints, should broadly underpin key commodity prices. At this point in the cycle, some companies such as BHP are handling cost pressures better than others and any further weakness in the sector could provide a buying opportunity for these particular companies.

Overweight Qantas

Qantas (QAN, -4.3%) - a key position in our portfolios - delivered a strong result in August. Revenue was better than expected as demand remains robust in both its domestic and international segments. However, this was offset by an increase in fuel costs as the oil price rose through the period. The market has reacted negatively to this headwind; however, we maintain conviction that QAN, having delivered $1.6b in pre-tax profit in FY18, will be able to achieve similar results next year despite having to absorb an additional $600m in fuel costs. The industry structure remains supportive and demand trends continue to look constructive, supporting revenue growth. Meanwhile, the buyback program continues to support earnings-per-share growth even as profit growth remains muted. By the end of this year QAN will have bought back over 26% of its shares over the past four years. It is currently valued at only 9.6x next-12 month consensus earnings and we still see material upside from here.

Overweight Caltex

Caltex (CTX, -7.2%) sold off following its trading update in August. The earnings results came in at the bottom end of guidance due to lower refining margins, which are inherently difficult to predict. The rest of the result was broadly in line with expectations. What has dampened investor sentiment was the strategic review of the company's asset base. The market was expecting some capital release from either restructuring CTX's petrol stations into some form of A-REIT, or asset sales from its infrastructure businesses. However, management concluded that there would be limited value creation for the business from both strategies and has opted to pursue a sale and lease-back of up to a quarter of its $2b in petrol station real estate via a long-term partnership. There would be limited capital release from this announced strategy. This disappointed those who had seen CTX as a potential capital-return stock rather than a long-dated reinvestment story.

Strategy and outlook

Strong performance from some of the portfolio's more non-consensus positions such as JB Hi-Fi, Telstra and Metcash made a positive contribution to returns in August, as did the position in CSL.

However, the overall Fund lagged the index during a period which was characterised by some remarkable price reaction to the reporting season.

One key and challenging feature of today's environment is the continued outperformance of Australia's relatively small cohort of high growth stocks in the technology, health care, and China consumer space. These companies have outperformed the market significantly since 2012; however, the surge in 2018 has propelled them to historical highs in terms of valuation relative to the market. This leaves them vulnerable to sharp corrections on even a minor disappointment, yet this did not daunt investors during reporting season as the cohort continued to outperform. A2 Milk's (A2M) near 20% gain in August provides a case in point.

While growth stocks look very expensive, it does not necessarily follow that they are obliged to correct any time soon. The last time the sector saw a material sell-off was in 2016 when investors could rotate into the resource sector which was gaining earnings momentum on the back of stimulus in China. Today, with earnings pressure on resources and extreme negative sentiment towards financials, there are few obvious places for investors to switch into. The challenge is therefore to find growth opportunities where valuations have not entirely disconnected from fundamentals. We see CSL as one example where the valuation can be justified, given the momentum in the underlying business. This position helped in August, although our underweight in the sector as a whole, in particular not owning companies such as A2M and Treasury Wine Estates (TWE) dragged on relative performance.

Our position in resources also dragged. The sector has de-rated on the fears surrounding US trade sanctions and the possible effect on Chinese demand and commodity prices. We believe that sentiment is overly negative towards the sector and any further weakness could provide a buying opportunity in select companies.

Overall, results from the reporting season underpinned our view that the domestic economy remains in reasonable shape. We did see an unusually high price reaction - both on the positive and negative side - to a relatively unsurprising set of results. It did not take much in terms of an earnings change to prompt a more than commensurate price change which we believe demonstrates the effect of quant fund and momentum trading strategies active in the market. Growth stocks were among the better performers, as were unloved stocks which defied the market's negative expectations, such as JB Hi-Fi and Telstra. From this point forward, we believe the market's valuation remains unchallenging, considering the opportunities for earnings growth and sentiment-driven factors that can prove to be sources of temporary weakness.

Pendal Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation Index returned 2.5% over August, outperforming its large-cap counterpart by 1.1%. Similarly, small Industrials (+4.4%) was the positive performer whereas small Resources (-4.1%) detracted from Index performance. Commodity prices fell across the board over the month, due to the confluence of President Donald Trump flagging a potential tariff increase on imports from China to 25% from 10%, along with new tariffs put in place on imports of steel and aluminium from Turkey.

As a result, Materials (-8.1%) fared the worst over the month in absolute return terms and was the largest drag on performance of the headline index. Sims Metal (SGM, -26.8%) experienced a significant share price decline as geopolitical risks weighed on sentiment. Increasing tension between the US and Turkey, alongside challenges within Turkey's domestic economy over the month, dampened investor sentiment for the steel scrap market. SGM also reported FY18 results which were in line with expectations, whereby underlying earnings (EBIT) and an underlying return on capital reached 10% for the first time in a decade. However, guidance and outlook comments from management were somewhat downbeat. Post-results comments acknowledged potential negative consequences from the increasing escalation of trade wars and the company accordingly expects first quarter earnings to be consistent with that of the last quarter for FY18. Mineral Resources (MIN, -5.9%) also retreated somewhat in August after reporting in-line results; whilst failing to provide any guidance on EBITDA or capital expenditure for FY19.

On the other end of the spectrum, we saw a number of technology companies retain their recent momentum and record double-digit total returns in August, lifting the Information Technology sector by 17.1%. Altium (ALU, +37.4%), Wisetech Global (WTC, +40.1%), Afterpay Touch (APT, +27.9%) and Appen (APX, +41.2%) were all amongst this cohort. Appen released its first-half result, where underlying earnings (EBITDA) more than doubled following last year's acquisition of Leapforce, a leading provider of search relevance services with a highly automated and proprietary end-to-end technology platform. Management has provided guidance for underlying earnings (EBITDA) for the full year to be in the range of $54 - $59m, which was ahead of market consensus and well received. Similarly, WTC also reported a FY18 result that was ahead of market expectations. Revenue rose by 44%, primarily led by organic growth, while revenue guidance also points to another 42% to 47% growth in FY19.

Outside of the two extremes of the market, other sectors that delivered gains over the month include Consumer Discretionary (+6.2%), Financials (+6.0%), Energy (+6.0%), Health Care (+3.4%), Industrials (+1.2%) and Consumer Staples (+1.3%). Online travel agent, Webjet (WEB, +27.3%), was the largest contributor to returns within the Consumer Discretionary sector. The company announced a 71% increase in earnings for the financial year, which drove a 63% gain in net profit after tax. While its recent acquisition of JacTravel in the UK made a material contribution to growth, there was positive momentum across the board, flowing through both its existing segments as well as recent acquisitions. The company continues to gain market share, growing bookings at three times the market rate and now has 5% of the domestic online travel market in Australia – and 3% worldwide. Conversely, childcare centre operator, G8 education (GEM, -17.3%), was the largest detractor from returns within the sector, after the company reported disappointing first half results. Weak occupancy remains a key dampener on investor sentiment, as supply continues to outpace demand in the industry.

Portfolio performance

The Pendal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned 3.30% (post-fee, pre-tax) in August, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.81%.

Contributors

Overweight Webjet

Online travel agent, Webjet (WEB, +27.3%), announced a 71% increase in earnings for the financial year, which drove a 63% gain in net profit after tax. While its recent acquisition of JacTravel in the UK made a material contribution to growth, there was positive momentum across the board, flowing through both its existing segments as well as recent acquisitions. The company continues to gain market share, growing bookings at three times the market rate and now has 5% of the domestic online travel market in Australia – and 3% worldwide.

Overweight Ryman Healthcare (RYM)

New Zealand listed Ryman Health care (RYM-NZ, +16.0%), which operates retirement villages across Australia and New Zealand, outperformed following its AGM in late July. The company announced it had received development approval for its fourth village in Melbourne, a 400-resident site in Burwood East. Meanwhile, construction has begun on its 34th village in New Zealand. The company continues to deliver strong growth, with underlying profit 14.2% higher for the year ending 31 March.

Detractors

Overweight RCR Thomlinson

RCR (RCR, -47.2%) was impacted by an isolated problem contract, which resulted in the company undertaking a discounted capital raising to repair its balance sheet. Investor sentiment towards the stock is very low as a result, and the business is trading at a fraction of what we consider to be its intrinsic value. We expect confidence to be restored as the company continues to execute on its order book and secure new contracts, which should result in a material re-rating of the stock. In the interim, the stock screens favourably as a potential takeover target by one of its larger peers.

Underweight Wisetech Global (WTC)

Wisetech Global (WTC, +40.1%) was among the group of software stocks which continued their recent surge through reporting season. While these are generally good businesses, the weight of money chasing them has pushed valuations to the point where there is little room for valuation correction in the case of disappointment, while at the same time they continue to face material risks and uncertainties. We maintain exposure to the software sector, but via stocks which we believe offer better justification for their valuation. Nevertheless, the underweight in WTC impacted relative returns in August.

Strategy and outlook

The small cap sector outperformed the broader index in August, helped by a remarkable surge by software companies (eg. Appen, Wisetech Global, Altium and Afterpay Touch) from already lofty valuations. The portfolio has a position in Altium, but is underweight this particular cohort of stocks in aggregate. Despite this, it outperformed the benchmark with strong contributions from other technology stocks such as Technology One as well as positions in tourism (Webjet), health care (Ryman Healthcare) and industrial services companies such as Bingo Industries and Seven Group.

Overall, results underpinned our view that the domestic economy remains in reasonable shape, with modest organic growth. There are pockets of growth in areas such as tourism, technology, education, and the infrastructure and mining services sector whereby the opportunity to invest in these pockets often lies within smaller companies. We have exposure to the tourism and agriculture sectors; however, the key challenge is to avoid overpaying for stocks in these pockets and valuation discipline remains critical. As always, we focus on earnings visibility and try to avoid over-hyped stocks and those with binary outcomes.

At the same time, there is considerable uncertainty in the market as new technology and competition disrupts long-standing industry structures and business models. Politics is also playing its part via both increased intervention in areas such as energy, finance and health care as well as the looming spectre of a change in government following the Liberal party's change in leadership. All this is providing a challenge for investors although this also presents opportunities as uncertainty often leads to mis-pricing.

In recent times we have been adding to our position in mining services as the mines increase spending to develop and expand production following a multi-year hiatus. Companies such as Seven Group are well placed to benefit from a pipeline of new work.

Outside of Seven Group, other key positions include Bapcor, which owns an auto parts distribution network and offers relatively resilient exposure to the Australian consumer, given the degree of disruption facing other parts of the consumer sector. We also like IDP Education, whose student placement and English testing services are well placed to benefit from the growth in demand for overseas education from countries such as India and China.

International Shares

Pendal Concentrated Global Share Fund

Market review

Returns from global equities kept investors placated with another positive performance this month. Although the benchmark index posted a return of 1.3%, there was considerable dispersion in performance across regions. European markets were generally weaker, whereby the UK fell on concerns of continuing trade tensions and the potential flow-on effects on commodity prices, while European markets were dented by the prospect of contagion from the deteriorating economic conditions in Turkey and Italy. However, weakness in these markets was more than offset by another strong performance by US stocks to lead the global index higher.

The US stock market reached twin milestones in August by marking the longest ever bull run in its history and reaching another all-time high. Supporting the market was another strong quarterly reporting season, led by cyclical sectors. Concerns over trade tensions simmered from the US perspective and the market distanced itself from the political arena to support businesses delivering strong earnings. The 'FAANG' stocks (Facebook, Amazon, Apple, Netflix and Google's parent company Alphabet) again dominated market performance, with Apple reaching US$1 trillion in market capitalisation and Amazon touched the same level early in September. Indications from the US consumer provided further reasons for optimism, with the latest reading on consumer sentiment reaching an 18-year high. The market finished August with the S&P500 delivering a total return of 3.0%, while the NASDAQ rallied with a return of 5.7%.

Most major markets in Europe were weak during August, reflecting broader regional concerns. The latest trade sanctions from the US announced on steel and aluminium imports from Turkey had a ripple effect across the region. Turkey responded with a hefty tariff on US cars, alcohol and other products, sparking contemplation of a broadening of trade sanctions for the region. Budget woes for Italy's Government and concern over its ability to meet fiscal pledges to the European Union left market sentiment weaker. The region's markets were led lower by Italy (-8.8%), followed by Germany (-3.5%) and France (-0.5%), while the UK (-1.9%) was also weaker.

Asian equity markets were also weaker, principally reflecting concerns over the US-China trade tensions. The US followed up this month with a tariff increase from 10% to 25% on an additional US$200b worth of imports from China. Weaker economic data from China added to the concerns over its future growth trajectory, while Japan's market also weakened on similar trade concerns before recovering on strong corporate earnings results and news that the economy grew 0.5% over the quarter. Japan (+1.4%) and the Southeast Asian markets of Thailand (+1.2%) and Malaysia (+2.0%) performed well, while Hong Kong (-2.4%) and Singapore (-1.0%) declined.

The Australian dollar continued its recent trend of weakening against the majors this month, principally related to the prospects for China and the associated flow through to commodity prices. The local unit declined against the US dollar (-1.9%), Japanese yen (-2.1%), the euro (-1.7%) and British pound (-2.7%).

Portfolio performance

The Pendal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned 1.25% (post fee, pre-tax) in August, underperforming its benchmark by 2.89%.

It was a tough month for the Fund, with the S&P500 eclipsing the record set in January and trading at the highest levels in history. A number of factors contributed to the underperformance of the Fund in August, including our high cash weighting, our underweight position in the US market, and overweight position in European banks. Our underweight in ‘FAANG’ stocks was also a material detractor this month. Apple in particular rose by 23% and made history by being the first US company to reach a market capitalisation of over US$1 trillion. Amazon (+16%) also reached all-time highs and the fact that we do not own these stocks impacted relative performance. At these heightened valuation levels we believe the risks to these stocks are increasing and are not being appreciated by the market. We will discuss these issues in a forthcoming note on the FAANG stocks.

The four European banks held by the Fund were dragged lower by the Turkish currency crisis in August. Whilst we acknowledge the ‘contagion’ effect these events can have on markets, which was reflected in the 11% fall in the Eurostoxx Bank Index, it is worth noting that the four banks held by the Fund have negligible exposure to Turkey and the Turkish Lira. In fact all four banks reported solid second-quarter earnings. Caixa Bank beat net profit expectations by 14%, with their capital position continuing to improve and fee income stronger. Lloyds Bank continues to post cost to income ratio declines, coupled with strong capital generation. KBC increased net interest income guidance, credit costs remain low and their return on equity remains at best in class at around 16%. Bank of Ireland’s cost reduction strategy remains on track and net interest income is poised to improve. We remain of the view that these banks, which trade at or below price to book and on average deliver a yield of over 5%, offer compelling value.

Our holding in MGM Resorts International declined by 5% in value this month after the company reported second quarter earnings at the beginning of August. Earnings were around 3% below consensus forecasts for the quarter, with guidance for the third quarter also below consensus expectations. MGM’s Las Vegas operations were the key area of concern for the market. The tragic shooting at their Mandalay Bay property in Vegas at the end of 2017 has had a more significant impact on sales in 2018 than expected, and the refurbishment of another property in Vegas - the MGM Park - has also taken longer than expected. Management have done a poor job in managing market expectations in relation to these delays as well as the seasonality of their conference business. In spite of these deficiencies, our view remains that the current share price represents an attractive long term investment opportunity. MGM are the largest casino operator in the Las Vegas Strip, and underlying fundamentals of the Las Vegas market remain strong. The completion of MGM Park in Vegas, along with the opening of a new casino in Springfield Massachusetts, and the launch of the new casino in Macau planned during the second half of 2018 is set to unlock significant free cash flow. This will allow management to pay down debt and increase returns to shareholders. We added to our positon in the company this month.

Whilst the FAANGs captured the headlines in the technology sector this month, we were pleased with the performance of semi-conductor stock, Analog Devices, which delivered second-quarter results ahead of guidance for the 11th consecutive quarter. After acquiring Linear Technology in 2017 the company have reached their 2x leverage target, nine months ahead of guidance. As a result the buyback has been reinstated and increased to US$8.2b, equating to approximately 22% of market capitalisation. The company have a diverse product suite with long lead times which is exposed to strategically important industries. With gross margins above 70% and operating margins above 40%, a strengthened balance sheet and impressive free cash flow, we believe the company will continue to benefit from their exposure to industrial markets and in the longer term, their strategic positioning to the development of the 5G industry.

Strategy and outlook

Geopolitics continues to attract the headlines and while tensions escalate globally, we come back to our view at Fund inception. Our view at the time was as interest rates increase, as quantitative easing is unwound and as populist Governments wind back regulations, market volatility would increase. Hence, investing in a select portfolio of companies rather than having indiscriminate broader market exposure would be the best way to maximise returns in the period ahead and we remain of that view. An increase in the Fund's cash levels is not a reflection of concerns regarding geopolitical events, but rather an acknowledgement of the fact that many of the names we owned or currently own have approached or are approaching what we would consider to be their intrinsic value. We are also cognisant that companies in many cases are reporting record margins, but costs are starting to creep higher. As long term investors, we want to buy companies when we consider they are trading at a significant discount to their intrinsic value. Patience will deliver us those opportunities.

Pendal Core Global Share Fund

Market review

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The US stock market reached twin milestones in August by marking the longest ever bull run in its history and reaching another all-time high. Supporting the market was another strong quarterly reporting season, led by cyclical sectors. Concerns over trade tensions simmered from the US perspective and the market distanced itself from the political arena to support businesses delivering strong earnings. The 'FAANG' stocks (Facebook, Amazon, Apple, Netflix and Google's parent company Alphabet) again dominated market performance, with Apple reaching US$1 trillion in market capitalisation and Amazon touched the same level early in September. Indications from the US consumer provided further reasons for optimism, with the latest reading on consumer sentiment reaching an 18-year high. The market finished August with the S&P500 delivering a total return of 3.0%, while the NASDAQ rallied with a return of 5.7%.

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Portfolio performance

The Pendal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned 3.92% (post-fee, pre-tax) in August, underperforming its benchmark by 0.22%.

The Fund underperformed the benchmark over August 2018 due to underperformance in both European and Asian regions, which was only partially offset by outperformance in North America.

Outperformance in the US was driven by the positive performance of our momentum and stability signals outweighing negative performance in our valuation and management signalling factors. The underperformance in Europe was due to the negative performance of our valuation signal which outweighed positive performance of our momentum factor. The underperformance in Japan was due to negative performance of our valuation and stability signals which outweighed the positive performance of our momentum and investor sentiment factors.

From a stock and industry attribution perspective, active industry tilts were a source of outperformance while intra-industry stock selection detracted from performance over the month. At a sector level, the overweight in Materials and Energy were the largest detractors from active returns, although these were more than offset by positive active contributions from an overweight to Information Technology and an underweight to Financials. Within sectors, stock selection in Information Technology drove underperformance which was only partially offset by positive performance from stock selection within Health Care and Energy.

At a stock level, the largest contributors to active returns came from overweight positions in: Lululemon Athletica Inc., a Canadian athletic apparel retailer; Abiomed, a manufacturer of medical implant devices headquartered in the US; Walmart Inc., an American multi-national retail corporation; BHP Limited, the UK and Australian-listed multi-national mining, metals and petroleum company; and TJX Companies, Inc., an American multinational and leading off-price department store corporation. The largest detractors over the month were overweight positions in Covestro AG, a German adhesive manufacturing company; Applied Materials, Inc., a US corporation that supplies equipment, services and software to enable the manufacture of technology; UniCredit S.p.A, an Italian global banking and financial services company; Taisei Corporation, a Japanese corporation conducting business in building construction, civil engineering and real estate development; and Rio Tinto Group, a metals and mining multi-national corporation headquartered in the UK.

Strategy and outlook

Moving into September, the largest sector tilts are overweights in Information Technology and Health Care and underweights in Financials and Consumer Staples.

Australian Fixed Income

Pendal Fixed Interest Fund

Market review

Australian bond yields fell with another flattening of the curve in August. During the month, the Reserve Bank left rates on hold once again, with little changes in their communication. This reaffirmed an outlook for no policy changes in the near-term and the market-implied probability of a hike in late 2019 decreased. This was reinforced by second quarter wage growth figures that revealed a 0.6% increase over the period, taking the year-on-year rate to a still subdued 2.1%. Employment figures were also discouraging with 3.9K jobs lost for the month and although the unemployment rate dropped to 5.3%, it was driven by a fall in the participation rate. Other economic data was mixed with better-than-expected retail sales growth of 0.4%, but falls in business conditions and consumer confidence. Turning to market movements, the Australian 3 year and 10 year yields dropped 10 basis points (bp) and 13bp to 2.00% and 2.53% respectively. At the very short end, the 3 month bank bill rate fell marginally by 2bp to 1.95%. While this contributed to a small tightening in the BBSW-OIS spread, it remains elevated compared to historical levels.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned 0.72% in August (post-fees, pre-tax), underperforming its benchmark by 0.09%.

In the alpha overlay, the Macro strategy was the largest contributor. The FX, Duration and Yield Curve strategies detracted while Relative Value and Cross-market strategies were largely flat. The government bond component underperformed its benchmark. Majority of the losses were from short duration positions in the Australian front end. The credit component outperformed its benchmark, which was attributable to overweight positions in Infrastructure and Utilities and an underweight allocation to Supranationals.

Strategy and outlook

The RBA left the cash rate unchanged at its August 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 August 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 fell and curves flattened further in August, driven in part by concerns over trade wars and emerging markets contagion. The US proceeded with tariffs on an additional US$16b of Chinese imports, while raising the proposed tariff on a flagged US$200b from 10% to 25%. Policymakers in China responded in kind with a 25% tariff on US$16b of imports from the US. In contrast, positive progress was made on trade negotiations between the US and Mexico, while there no constructive steps on a deal with Canada. Meanwhile, concerns in emerging markets and of broader contagion were stoked as the US doubled its tariffs on Turkey. This fuelled a further sell-off in the Lira which lost roughly half its value versus the US Dollar over the month.

Broad US dollar strength was supported by firmer expectations for at least one additional rate increase by the Federal Reserve before year-end. This was reaffirmed by Jerome Powell's Jackson Hole address where the chairman offered a positive outlook for the US economy. Separately, his counterparts at the Bank of England appeared optimistic on the UK labour market and local inflation with a 25bp hike in August. Meanwhile, the ECB and BOJ did not meet during the month. Finally in terms of Treasury movements, the 2 year yield fell 4p to 2.63% and the 10 year declined 10bp to 2.86%.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned 0.15% in August (post-fees, pre-tax), underperforming its benchmark by 0.01%.

Over the month, the Macro strategy was the largest contributor. The FX, Duration and Yield Curve strategies detracted while Relative Value and Cross-market strategies were largely flat. The portfolio risk level started at 4 risk units and increased to 6 risk units before finishing the month at 5 risk units.

The Duration strategy detracted over the month. Most of the losses were from short duration positions in the Australian front-end as the market kept pushing out the prospect for the Reserve Bank to hike. Short duration position in the South Korean long-end contributed to losses as well. In the middle of the month we added long duration positions along the US yield curve with minor losses, which were mitigated by the gains in our tactical short duration positions in JGBs and BTPs.

The FX strategy was the largest detractor over the month. Losses were mainly contributed by long USD against the MXN and KRW; these were closed during the month. The other material loss was from short EUR against long JPY as the EUR reversed mid-month and almost fully retraced the fall of the first half of the month. In long volatility positions, we closed USD/JPY early in the month and initiated new positions in NZD/JPY, NZD/USD, GBP/JPY and EUR/AUD. We held the long volatility position in AUD/USD through the month, and ended with small gains.

The Yield Curve strategy detracted from performance over the month. The majority of the losses were from the curve flattening position in the long-end of Europe. During the month we added a steepening position in the Japanese long-end and a steepening position along the Australian government curve. Performance of both of these positions was flat over the month.

The Macro strategy was the largest contributor over the month. Most of the gains were from buy protection positions in CDX EM and the underperforming single country CDS of Turkey and Brazil. We increased our buy protection position in Brazil and also opened a buy protection position in

South Africa, and both trades added to performance. We continued to hold buy protection positions in iTraxx Europe Main, CDX IG and Korea sovereign, which were largely flat over the month.

The Relative Value strategy was flat over the month. We continued to hold US 5-year invoice spread and Australian 3-year EFP spread positions.

In the Cross-Market strategy we opened a long Australia short US trade in the long end of the curve, which finished the month roughly flat.

Strategy and outlook

EM-contagion has become the main fear in markets. Political uncertainty in Brazil as well as stubbornly high inflation in Argentina added fuel to the fire. It also seems that for as long as volatility persists everywhere else in the world, US assets continue to benefit from the safety bid, be that in bonds or equities. Whilst the narrative of 'US exceptionalism' has been widely reflected in relative price movements this month, the momentum in corporate earnings and underlying economic data continues to support this trend. Against this backdrop, deficit emerging economies will continue to feel the pressure, and all the more so if foreigners have been heavily relied upon to fund those deficits.

Credit

Pendal Enhanced Credit Fund

Market review

Australian credit generated another positive return for the month. This was driven by a fall in underlying yields, reasonable accruals and a small tightening in credit spreads. Spreads narrowed into month-end after an earlier widening on the back of trade war and emerging market contagion fears. Domestic concerns over the elevated BBSW-OIS spread also eased to a degree.

In terms of market activity, issuance was a sizeable $12.9b, which was more than twice the previous month. Financials accounted for the bulk of deals with CBA tapping the market for $3.5b of debt capital. Issuance from offshore banks was also strong and included $1.75b from BNS, $1.55b from BMO and $1b from HSBC. Corporates also returned to the market with some of the larger deals including Singtel Optus ($500m) and Macquarie University ($250m).

In terms of market movements, the Australian iTraxx index (Series 29 contract) traded in a 6bp range finishing the month 1bp tighter to +73.5bp. On average, physical credit spreads finished the month unchanged. Resources, utilities and domestic banks outperformed tightening 1bp respectively while telcos, real estate and supranationals underperformed widening 2, 1 and 1bp respectively. Semi-government bonds also underperformed widening 3bp to government bonds over the month.

Portfolio performance

The Pendal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 0.69% in August (post-fees, pre-tax), underperforming the benchmark by 0.01%.

A large fall in underlying swap rates made the largest contribution to returns, while accruals and a small tightening in credit spreads also added to returns. Positions in Infrastructure, where the fund is overweight performed well over the period. Portfolio activity over the period included reducing exposure to ANZ, the purchase of a green bond issue from Macquarie University, as well as purchases of issuance from Suncorp and KFW.

Strategy and outlook

The RBA left the cash rate unchanged again in August and no change in monetary policy is imminent. Calls for no change in 2019 are starting to increase. 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 and we expect house prices to keep coming off, particularly as housing markets focus on Labor's limits on negative gearing. However, built-up demand from owner occupiers, particularly first home buyers, should see prices eventually stabilise and activity pick up at the new level. For the right buyers (owner occupiers, less than 80% LVR) mortgage rates are in some cases falling despite recent bank hikes.

The RBA's economic forecasts contained in their Statement on Monetary Policy released in August support the argument for no change in policy in the near term. Underlying inflation is expected to remain subdued (2% at the end of 2019 and 2.25% by the end of 2020) and the unemployment rate is not forecast to be below 5% despite healthy GDP growth forecasts of 3-3.25%. Comments from the Reserve Bank are doing nothing to dispel the market's perception either. It is unlikely we see any change from the RBA anytime soon.

Regarding credit markets, we maintain our neutral view on investment grade credit.

Extremely accommodative monetary policy settings had helped support risk sentiment and driven credit spreads lower in previous years. As these settings are reversed it has removed an element of support for credit and spurred an increase in general market volatility. This has partly contributed to a widening in credit spreads during 2018. Additionally, the shift in central bank policy has left markets more sensitive to negative geopolitical developments. We have seen this exemplified in cases like the Italian political turmoil earlier in the year, trade war fears and a rout in emerging markets. More broadly, further geopolitical disruptions pose a greater threat to credit markets than in previous years. With these risks in mind, we prefer to be cautiously positioned until further clarity is gained.

At the same time, we do acknowledge strong corporate fundamentals remain with healthy balance sheets, positive earnings growth and low high yield default rates. This has been evident in solid second quarter earnings results abroad and a reasonable full-year domestic reporting season.

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.

Cash

Pendal Managed Cash Fund and Pendal Enhanced Cash Fund

Market review

Australian bond yields fell with another flattening of the curve in August. During the month, the Reserve Bank left rates on hold once again, with little changes in their communication. This reaffirmed an outlook for no policy changes in the near-term and the market-implied probability of a hike in late 2019 decreased. This was reinforced by second quarter wage growth figures that revealed a 0.6% increase over the period, taking the year-on-year rate to a still subdued 2.1%. Employment figures were also discouraging with 3.9K jobs lost for the month and although the unemployment rate dropped to 5.3%, it was driven by a fall in the participation rate. Other economic data was mixed with better-than-expected retail sales growth of 0.4%, but falls in business conditions and consumer confidence.

Looking abroad, trade wars and the rout in emerging markets continued to drive global investor sentiment. The US proceeded with tariffs on an additional US$16b of Chinese imports, while raising the proposed tariff on a flagged US$200b from 10% to 25%. Policymakers in China responded in kind with a 25% tariff on US$16b of imports from the US. In contrast, positive progress was made on trade negotiations between the US and Mexico, while there no constructive steps on a deal with Canada. Meanwhile, concerns in emerging markets and of broader contagion were stoked as the US doubled its tariffs on Turkey. This fuelled a further sell-off in the Lira which lost roughly a third of its value versus the US Dollar over the month.

Broad US Dollar strength was supported by firmer expectations for at least one additional rate increase by the Federal Reserve before year-end. This was reaffirmed by Jerome Powell's Jackson Hole address where the chairman offered a positive outlook for the US economy. Separately, his counterparts at the Bank of England appeared constructive on the UK labour market and local inflation with a 25bp hike in August. Meanwhile, the ECB and BOJ did not meet during the month.

In China, economic data continued to disappoint with slowing industrial production and credit growth figures. Policymakers' concern over the economy's slowdown was evident in their decision to add further stimulus during the month. This was also likely driven by a desire to offset negative effects of the trade war.

Turning to market movements, the Australian 3 year and 10 year yields dropped 10bp and 13bp to 2.00% and 2.53% respectively. At the very short end, the 3 month bank bill rate fell marginally by 2bp to 1.95%. While this contributed to a small tightening in the BBSW-OIS spread, it remains elevated compared to historical levels. In the US, the 2 year yield fell 4p to 2.63% and the 10 year declined 10bp to 2.86%. Finally, the Australian Dollar suffered a -3.1% slide on the back of broad US Dollar strength and expectations that the RBA would retain record low rates for longer.

Portfolio performance

Managed Cash

The Pendal Managed Cash Fund (formerly the BT Wholesale Managed Cash Fund) returned 0.16% in August (post-fees, pre-tax), underperforming the benchmark by 0.01%.

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 65 days (maximum limit of 70 days). The

Reserve Bank is unlikely to tighten monetary policy in the near term and yields further out the curve continue to offer better relative value. The weighted average maturity has consistently been longer than benchmark due to this. We do expect bank bill yields to rise in September as we move into financial year end for 3 of the 4 major banks (CBA has a June year end) and will look to extend the weighted average maturity of the fund should this eventuate.

Enhanced Cash

The Pendal Enhanced Cash Fund (formerly the BT Wholesale Enhanced Cash Fund) returned 0.20% in August (post-fees, pre-tax) outperforming the benchmark by 0.03%.

Positive performance came from financials, industrials and infrastructure sectors. Activity during the month included investing in domestic banks and education sectors funded out of cash.

As at the end of the month, the portfolio had a credit spread of 65bp over bank bills, interest rate duration of 0.08 years and credit spread duration of 1.68 years.

Strategy and outlook

The RBA left the cash rate unchanged again in August and no change in monetary policy is imminent. Calls for no change in 2019 are starting to increase. 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 and we expect house prices to keep coming off, particularly as housing markets focus on Labor's limits on negative gearing. However, built-up demand from owner occupiers, particularly first home buyers, should see prices eventually stabilise and activity pick up at the new level. For the right buyers (owner occupiers, less than 80% LVR) mortgage rates are in some cases falling despite recent bank hikes.

The RBA's economic forecasts contained in their Statement on Monetary Policy released in August support the argument for no change in policy in the near term. Underlying inflation is expected to remain subdued (2% at the end of 2019 and 2.25% by the end of 2020) and the unemployment rate is not forecast to be below 5% despite healthy GDP growth forecasts of 3-3.25%. Comments from the Reserve Bank are doing nothing to dispel the market's perception either. It is unlikely we see any change from the RBA anytime soon.

Australian Property

Pendal Property Securities Fund

Market review

The S&P/ASX A-REIT index returned +2.7% in August, outperforming the broader market (+1.4%) after being driven by falling Australian bond yields. The 10-year Government Bond yield declined by 13bp, closing at 2.52%. For the 12-month period, A-REITs have returned 15.8%, slightly above the return of the broader Australian equity market (+15.4%). Globally, the performance of REITs has been more muted, with an A$ hedged return of +0.1% for the month and 3.1% for the year to August. Australia was the best-performing REIT market in both periods, followed by Europe (+8.9%) and the US (+6%). Emerging market REITs were the worst performers (-7.6%).

August featured the company reporting season and overall results were largely in line with forecasts, although the larger retail REITs had slightly lower comparable income growth (Scentre Group and Vicinity Centres had -4.5% and -4% leasing spreads) and office/industrial REITs achieved slightly higher than expected income and solid net tangible asset (NTA) growth over the prior period. The best performing REITs over the month were those that delivered strong earnings (EPS) growth. Goodman Group (GMG, +11%) provided guidance of +7% distribution growth for FY19 and Mirvac Group (MGR) provided comparable guidance of +6.6% and delivered 8% earnings growth for FY18. Conversely, Abacus Property Group (-7%) underperformed as the Group is expected to rebase its earnings to materially lower levels over the next few years. During the period, National Storage REIT raised $175m to reduce gearing, fund acquisitions and finance developments. Blackstone also improved its offer for Investa Office Fund from $5.15 to $5.35/share.

Within global equities, the MSCI World Index (A$) returned 0.6% for the month, driven by the Information Technology (+5.1%) and Health Care (+2.8%) sectors. The US Federal Reserve left the Fed Funds Rate on hold but reiterated that it would continue with “further gradual increases” where “appropriate”. US headline consumer price inflation (CPI) came in at +0.1%, with year over year growth of +2.3%. The US yield curve flattened by 6bp as US Treasury yields fell 10bp to 2.86%.

In Australia, the RBA left interest rates on hold and Scott Morrison was sworn in as Prime Minister. Australian wages growth for the June quarter was 0.6% and +2.1% for the year. Australian retail sales rose by 0.4%, driven by Food & Household goods sales and offset by falling department store sales (-1.2%). Employment fell slightly (4,000), but the unemployment rate fell by 0.1% to 5.3% as a result of a falling participation rate.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned 3.42% in August (post-fee, pre-tax), outperforming its benchmark by 0.81%.

The portfolio outperformed over the month, with positive attribution from underweight positions in Scentre Group and Abacus Property, and overweight positions in Goodman Group, Charter Hall Group and Mirvac Group. Overweight positions in Unibail-Rodamco Westfield, Arena REIT, Stockland Group and Charter Hall Long WALE and an underweight position in Vicinity Centres all detracted from performance.

Over the month we increased our overweight position in Charter Hall Group, Stockland Group and Rural Funds and built (new) overweight positions in National Storage REIT and PropertyLink Group. This was funded by increasing our underweight positions in GPT Group and Vicinity Centres, reducing our overweight in Mirvac Group and selling out of our positions in Investa Office Fund and Iron Mountain Inc.

Strategy and outlook

The A-REIT sector is now priced on an FY19 distribution yield of 5.0%, a price-earnings ratio of 17x and a 25% premium to NTA, above its long-term average of 16%. Cap rates are unlikely to compress any further from current levels and asset valuation improvements will be dependent on income growth and tenancy retention. Non-dominant discretionary malls with high specialty occupancy costs are actually expected to fall in value in the short to medium term, but for the sector overall, balance sheets are stable, with 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 climb in August, posting a total return of 1.0%. North America (+2.7%) was the only positive region, while Europe was largely flat and Asia Pacific (-2.4%) declined. In the Asia Pacific, results were negative across the region. Hong Kong (-4.4%) was the weakest performer, followed by Japan (-1.4%), New Zealand (-1.1%) and Singapore (-0.2%). In Europe, results were mixed. Israel (+8.8%) posted the largest increase, followed by Finland (+7.2%) and Germany (+5.5%). Notable negative performers included The Netherlands (-5.1%), Italy (-3.3%), and Spain (-2.9%). In North America, the US and Canada returned 2.7% and 2.1%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund (formerly the BT Wholesale Global Property Securities Fund) returned 1.45% in August (post-fee, pre-tax), outperforming the benchmark by 0.32%.

North America

The North America portfolio returned 3.22% in August (before fees and withholding taxes), exceeding the FTSE EPRA/NAREIT North America Index by 51 basis points (bp). Outperformance relative to the benchmark was attributable to positive stock selection results, which were partially offset by negative sector allocation results. In terms of stock selection, results were strongest in the diversified, office, and data centre sectors and were weakest in the hotel, health care, and shopping centre sectors. Regarding sector allocation, modest negative results were driven by the portfolio's underweight to the outperforming health care and triple net lease sectors. Among the portfolio's holdings, top individual contributors to relative performance included overweight positions in outperforming Rexford Industrial Realty (REXR), CyrusOne (CONE), and Welltower (WELL). Detractors most notably included overweight positions in the underperforming Extended Stay America (STAY) and Duke Realty (DRE), as well as a lack of exposure to outperforming Ventas (VTR).

Europe

The European portfolio returned 0.13% in August (before fees and withholding taxes), outperforming the regional EPRA benchmark by 23bp. Outperformance relative to the benchmark was driven by positive stock selection results, which were partially offset by negative country allocation results. In terms of stock selection, results were strongest in the Netherlands, Germany, and the United Kingdom and were weakest in Spain, Sweden, and Ireland. Regarding country allocation, negative results were attributable to the portfolio's underweight to the outperforming Switzerland. Among the portfolio's holdings, top contributors to relative performance included overweight positions in the outperforming Vonovia SE (Germany), ADO Properties SA (Germany), and NSI NV (Netherlands). Detractors most notably included overweight positions in the underperforming Fabege AB (Sweden) and Merlin Properties Socimi SA (Spain), and a lack of exposure to outperforming Tag Immobilien AG (Germany).

Asia

The Asia portfolio returned -2.33% in August (before fees and withholding taxes), outperforming the regional EPRA benchmark by nine basis points. Outperformance relative to the benchmark was driven by positive stock selection results, which were partially offset by negative country allocation results. In terms of stock selection, positive results in Japan and Hong Kong were partially offset by negative results in Singapore. Regarding country allocation, modest negative results were largely driven by the portfolio's underweight to the outperforming Singapore. Among the portfolio's holdings, top contributors to relative performance included overweight positions in the outperforming Nippon Building Fund (Japan) and NTT Urban Development (Japan), and a lack of exposure to the underperforming Wharf Holdings (Hong Kong). Detractors most notably included a lack of exposure to outperforming CapitaLand (Singapore) and United Urban Investment (Japan), and an overweight position in the underperforming CK Asset Holdings (Hong Kong).

Active Balanced

Pendal Active Balanced Fund

Markets review

The S&P/ASX 300 Price Index rose by 0.6% in August despite the political turmoil in Canberra. Adding dividends to the price return, the Accumulation Index was 1.4% higher. Industrials (+2.9%) led the gains of the headline index, whereas Resources (-4.5%) weighed on returns. Commodity prices fell across the board over the month, due to the confluence of President Donald Trump flagging a potential tariff increase in imports from China to 25% from 10%, along with new tariffs put in place on imports of steel and aluminium from Turkey. Somewhat offsetting this impact on the Resources sector was the rise in the crude oil price after export volume expectations from both Iran and Venezuela continued to remain low.

Reporting season results drove stock performance over the month, as we saw some unusually high price reaction on both the positive and negative sides. Biotechnology company CSL (CSL, +15.6%) reported both strong headline growth as well as margin expansion which was received favourably by the market. Resmed (RMD, +10.2%) also performed well. Its mask sales grew 15% as the F20 full-face masks and the N20 nasal mask continued to perform. Sales for devices were also strong over the period, as RMD continued to gain market share in the US. As a result, Health Care recorded a 10.4% return over the month.

The recently beleaguered Telecommunication Services (+13.0%) sector also fared well in August and recorded the highest total return of the sector groups. Investor sentiment was bolstered by the announcement of TPG (TPM, +50.0%) to merge with key competitor Vodafone Hutchinson Australia (VHA). Also recording a double-digit gain was Information Technology (+12.2%), which rose on the back of an already lofty valuation. The sector now trades on a 30x one-year forward price-earnings multiple, compared to the market's long term average of 16x.

On the other end of the spectrum, index heavyweight Materials (-4.9%) was the largest detractor from index performance. Share prices of the major miner duo - BHP (BHP, -4.7%) and Rio Tinto (RIO, -8.4%) - pulled back from their recent highs despite reporting satisfactory results. The ongoing strength of the US dollar also saw the gold price decline (-2.2%), which weighed on the fortunes of gold miner, Newcrest Mining (NCM, -9.7%). NCM reported FY18 results in August, with underlying profit 16% higher than the prior period.

Global equities kept investors placated with another positive return this month. Although the benchmark index posted a return of 1.3%, there was considerable dispersion in performance across regions. European markets were generally weaker, whereby the UK fell on concerns of continuing trade tensions and the potential flow-on effects on commodity prices, while European markets were dented by the prospect of contagion from the deteriorating economic conditions in Turkey and Italy. The latest trade sanctions from the US announced on steel and aluminium imports from Turkey had a ripple effect across the region. Turkey responded with a hefty tariff on US cars, alcohol and other products, sparking contemplation of a broadening of trade sanctions for the region. Budget woes for Italy's Government and concern over its ability to meet fiscal pledges to the European Union left market sentiment weaker. The region's markets were led lower by Italy (-8.8%), followed by Germany (-3.5%) and France (-0.5%), while the UK (-1.9%) was also weaker. Weakness in European markets was more than offset by another strong performance by US stocks to lead the global index higher.

The US stock market reached twin milestones in August by marking the longest ever bull run in the its history and reaching another all-time high. Supporting the market was another strong quarterly reporting season, led by cyclical sectors. Concerns over trade tensions simmered from the US perspective and the market distanced itself from the political arena to support businesses delivering strong earnings. The FAANG stocks (Facebook, Amazon, Apple, Netflix and Google's parent company Alphabet) again dominated market performance, with Apple reaching US$1 trillion in market capitalisation and Amazon touched the same level early in September. Indications from the US consumer provided further reasons for optimism, with the latest reading on consumer sentiment reaching an 18-year high. The market closed August with the S&P500 delivering a total return of 3.0%, while the NASDAQ rallied with a return of 5.7%.

Asian equity markets were also weaker, principally reflecting concerns over US-China trade tensions. The US followed up this month with a tariff increase from 10% to 25% on an additional US$200b worth of imports from China. Weaker economic data from China added to the concerns over its future growth trajectory, while Japan's market also weakened on similar trade concerns before recovering on strong corporate earnings results and news that the economy grew 0.5% over the quarter. Japan (+1.4%) and the Southeast Asian markets of Thailand (+1.2%) and Malaysia (+2.0%) performed well, while Hong Kong (-2.4%) and Singapore (-1.0%) declined.

The Australian dollar continued its recent trend of weakening against the majors this month, principally related to the prospects for China and the associated flow through to commodity prices. The local unit declined against the US dollar (-1.9%), Japanese yen (-2.1%), the euro (-1.7%) and British pound (-2.7%).

Australian bond yields fell with another flattening of the curve in August. During the month, the Reserve Bank left rates on hold once again, with little changes in their communication. This reaffirmed an outlook for no policy changes in the near-term and the market-implied probability of a hike in late 2019 decreased. This was reinforced by second quarter wage growth figures that revealed a 0.6% increase over the period, taking the year-on-year rate to a still subdued 2.1%. Employment figures were also discouraging with 3.9K jobs lost for the month and although the unemployment rate dropped to 5.3%, it was driven by a fall in the participation rate. Other economic data was mixed with better-than-expected retail sales growth of 0.4%, but falls in business conditions and consumer confidence. Turning to market movements, the Australian 3 year and 10 year yields dropped 10bp and 13bp to 2.00% and 2.53% respectively. At the very short end, the 3 month bank bill rate fell marginally by 2bp to 1.95%. While this contributed to a small tightening in the BBSW-OIS spread, it remains elevated compared to historical levels.

Global bond yields fell and curves flattened further in August, driven in part by concerns over trade wars and emerging markets contagion. The US proceeded with tariffs on an additional US$16b of Chinese imports, while raising the proposed tariff on a flagged US$200b from 10% to 25%. Policymakers in China responded in kind with a 25% tariff on US$16b of imports from the US. In contrast, positive progress was made on trade negotiations between the US and Mexico, while there no constructive steps on a deal with Canada. Meanwhile, concerns in emerging markets and of broader contagion were stoked as the US doubled its tariffs on Turkey. This fuelled a further sell-off in the Lira which lost roughly half its value versus the US dollar over the month.

Broad US dollar strength was supported by firmer expectations for at least one additional rate increase by the Federal Reserve before year-end. This was reaffirmed by Jerome Powell's Jackson

Hole address where the chairman offered a positive outlook for the US economy. Separately, his counterparts at the Bank of England appeared optimistic on the UK labour market and local inflation with a 25bp hike in August. Meanwhile, the ECB and BOJ did not meet during the month. Finally in terms of Treasury movements, the 2 year yield fell 4bp to 2.63% and the 10 year declined 10bp to 2.86%.

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 August, underperforming its benchmark by 0.45%.

The Fund delivered a positive return in August, albeit slightly below the benchmark return. Positive performance was supported by exposure to growth assets, with good returns from Australian and offshore equity and listed property markets. Australian fixed income markets also generated a positive return in August while global fixed income were more muted 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 detraction came from manager contribution within Australian equities.

Tactical asset allocation contributions were driven by the Fund's exposure to Australian and global shares and Australian listed property, 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 CSL, Santos and JB Hifi, together with an underweight to Woolworths contributed value. These contributions were more than offset by overweight positions in the manager's high conviction positions in Qantas and Caltex, together with overweights in Origin Energy and BHP.

Within the global equities portfolio, stock selection outcomes within the Core and Concentrated portfolios detracted from relative performance, although both segments 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 -0.72% versus a cash return of 0.17%.

The Equity Market Neutral, Dedicated Short Bias and Global Macro strategies accounted for most of the declines this month. Within Equity Market Neutral, losses were largely attributable to Value themes for intra-industry stock selection in major developed markets. The directionally short component of the Dedicated Short Bias strategy also produced losses, given the equity market rally over August. Partially offsetting these were gains from Managed Futures and Long-Short strategies, with strong results from short commodities positions and long positions in select equity and currency markets.

In relation to our tactical asset allocation positioning, our long position in Australian and US equity market futures contributed to returns as markets were strong in August, although a long position in Germany reduced some of the gains. A long position in gold and crude oil benefitted, although this was more than offset by a detraction from a long position in copper. At the end of the month the copper position switched from long to short and we established a new short in US bonds.

Strategy and outlook

Equity markets continue to be materially influenced by macro and geopolitical dynamics. The latest corporate reporting seasons in the US, Europe and Australia highlight this dichotomy, with many market segments performing well. However, there is a growing degree of dispersion across industries and stocks, and a concentration of risks in areas of the growth/cyclical stock universe that warrant closer scrutiny. As this environment evolves, it is reasonable to expect more variation in the performance of asset segments and therefore, some bouts of volatility. The tried and tested antidote to volatility is diversification - a key foundation of the Fund's investment strategy. We will continue to maintain our active approach and exposure to a range of diversifying strategies with the aim of reducing volatility and generating outperformance.

Performance as at 31 August 2018

(%)	1 Month	3 Months	6 Months	FYTD	1 year (pa)	2 Years (pa)	3 Years (pa)	5 Years (pa)	Since Incp. (pa)
Australian Shares - All Cap									
Pendal Australian Share Fund									APIR - RFA0818AU
Total Return (post-fee, pre-tax)	0.79	4.70	5.68	2.57	16.06	14.47	11.20	9.35	10.13
Total Return (pre-fee, pre-tax)	0.85	4.91	6.11	2.71	17.00	15.39	12.08	10.22	11.13
Benchmark	1.40	6.00	7.17	2.73	15.45	12.46	11.53	8.91	10.07
Pendal Imputation Fund									APIR - RFA0103AU
Total Return (post-fee, pre-tax)	0.92	5.79	7.31	2.66	15.88	13.75	10.19	8.11	9.73
Total Return (pre-fee, pre-tax)	0.99	6.03	7.79	2.82	16.92	14.77	11.18	9.08	10.74
Benchmark	1.40	6.00	7.17	2.73	15.45	12.46	11.53	8.91	8.90
Pendal Focus Australian Share Fund									APIR - RFA0059AU
Total Return (post-fee, pre-tax)	0.14	4.15	5.33	2.05	16.53	15.93	13.00	11.24	9.60
Total Return (pre-fee, pre-tax)	0.12	4.19	5.52	2.18	17.70	17.38	14.19	12.37	10.72
Benchmark	1.40	6.00	7.17	2.73	15.45	12.46	11.53	8.91	7.80
Pendal Ethical Share Fund									APIR - RFA0025AU
Total Return (post-fee, pre-tax)	0.87	4.94	4.99	2.70	15.32	14.12	11.09	9.57	8.79
Total Return (pre-fee, pre-tax)	0.95	5.19	5.49	2.87	16.42	15.21	12.14	10.61	9.85
Benchmark	1.40	6.00	7.17	2.73	15.45	12.46	11.53	8.91	8.29
Australian Shares - Mid Cap									
Pendal MidCap Fund									APIR - BTA0313AU
Total Return (post-fee, pre-tax)	0.73	2.25	4.80	1.18	21.51	15.52	17.95	15.93	11.11
Total Return (pre-fee, pre-tax)	0.81	2.40	5.32	1.34	23.38	17.00	19.29	17.48	13.35
Benchmark	2.52	5.55	7.16	3.71	21.39	14.23	18.11	14.62	6.52
Australian Shares - Small Cap									
Pendal Smaller Companies Fund									APIR - RFA0819AU
Total Return (post-fee, pre-tax)	3.30	1.86	7.69	2.23	24.05	12.61	15.30	11.80	13.45
Total Return (pre-fee, pre-tax)	3.42	2.18	8.37	2.45	25.61	14.02	16.74	13.19	14.74
Benchmark	2.49	2.53	6.75	1.46	22.32	12.35	16.90	9.19	8.00
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund									APIR - RFA0061AU
Total Return (post-fee, pre-tax)	2.49	4.28	4.42	3.20	18.99	13.26	19.23	18.99	18.58
Total Return (pre-fee, pre-tax)	2.59	4.60	5.05	3.41	19.99	15.16	21.37	22.97	23.72
Benchmark	2.49	2.53	6.75	1.46	22.32	12.35	16.90	9.19	3.67
International Shares									
Pendal Core Global Share Fund									APIR - RFA0821AU
Total Return (post-fee, pre-tax)	3.92	7.25	9.16	6.31	21.22	16.48	9.59	14.33	6.13
Total Return (pre-fee, pre-tax)	4.01	7.50	9.68	6.49	22.38	17.59	10.63	15.42	7.30
Benchmark	4.14	9.25	12.06	6.76	24.29	16.96	11.18	15.11	7.63
Pendal Global Emerging Markets Opportunities Fund - WS									APIR - BTA0419AU
Total Return (post-fee, pre-tax)	0.49	0.57	1.81	0.94	9.59	12.92	10.55	11.22	11.17
Total Return (pre-fee, pre-tax)	0.60	0.92	2.51	1.17	11.10	14.48	12.09	12.87	13.36
Benchmark	0.01	-0.29	-3.22	1.59	8.93	13.37	10.68	9.51	10.55
Pendal Concentrated Global Share Fund									APIR - BTA0503AU
Total Return (post-fee, pre-tax)	1.25	6.01	7.75	3.40	21.98	16.97	N/A	N/A	17.08
Total Return (pre-fee, pre-tax)	1.32	6.25	8.24	3.55	23.29	18.33	N/A	N/A	18.45
Benchmark	4.14	9.25	12.06	6.76	24.29	16.96	N/A	N/A	16.97
Property									
Pendal Property Securities Fund									APIR - BTA0061AU
Total Return (post-fee, pre-tax)	3.42	6.87	14.45	4.58	16.09	4.08	10.85	13.05	7.75
Total Return (pre-fee, pre-tax)	3.47	7.04	14.82	4.70	16.83	4.76	11.57	13.78	8.56
Benchmark	2.61	5.94	13.89	3.59	15.68	3.87	10.77	13.15	7.59
Pendal Global Property Securities Fund									APIR - RFA0051AU
Total Return (post-fee, pre-tax)	1.45	4.70	12.54	2.32	7.74	4.70	8.05	10.37	9.32
Total Return (pre-fee, pre-tax)	1.53	4.93	13.06	2.49	8.73	5.66	9.05	11.39	10.32
Benchmark	1.13	4.15	12.12	2.07	7.03	4.17	8.16	10.60	9.01
Fixed Interest									
Pendal Fixed Interest Fund									APIR - RFA0813AU
Total Return (post-fee, pre-tax)	0.72	1.39	2.74	0.60	3.70	1.05	2.10	4.17	6.39
Total Return (pre-fee, pre-tax)	0.76	1.51	2.99	0.68	4.22	1.55	2.61	4.69	6.95
Benchmark	0.81	1.45	2.65	0.97	3.84	1.56	3.08	4.48	6.61
Pendal Global Fixed Interest Fund									APIR - RFA0032AU
Total Return (post-fee, pre-tax)	0.15	0.20	1.23	-0.51	0.00	-0.59	1.91	4.22	5.88
Total Return (pre-fee, pre-tax)	0.19	0.33	1.50	-0.42	0.53	-0.06	2.45	4.77	6.46
Benchmark	0.16	0.20	1.32	-0.11	0.63	0.23	3.29	4.86	6.78
Pendal Enhanced Credit Fund									APIR - RFA0100AU
Total Return (post-fee, pre-tax)	0.69	1.18	1.90	0.88	3.58	2.60	3.35	4.53	5.71
Total Return (pre-fee, pre-tax)	0.73	1.30	2.14	0.96	4.04	3.06	3.82	5.00	6.24
Benchmark	0.70	1.30	2.13	0.93	3.72	2.60	3.44	4.53	5.82
Cash & Income									
Pendal Enhanced Cash Fund									APIR - WFS0377AU
Total Return (post-fee, pre-tax)	0.20	0.59	1.06	0.42	2.54	2.84	2.66	2.85	4.90
Total Return (pre-fee, pre-tax)	0.22	0.65	1.18	0.46	2.79	3.09	2.92	3.11	5.24
Benchmark	0.17	0.51	0.99	0.36	1.85	1.81	1.95	2.20	4.84
Pendal Managed Cash Fund									APIR - WFS0245AU
Total Return (post-fee, pre-tax)	0.16	0.47	0.92	0.32	1.81	1.82	1.94	2.17	6.40
Total Return (pre-fee, pre-tax)	0.18	0.53	1.04	0.36	2.04	2.04	2.17	2.40	6.70
Benchmark	0.17	0.51	0.99	0.36	1.85	1.81	1.95	2.20	6.47
Pendal Monthly Income Plus Fund									APIR - BTA0318AU
Total Return (post-fee, pre-tax)	0.62	1.57	2.17	1.04	5.20	3.70	4.12	4.72	5.51
Total Return (pre-fee, pre-tax)	0.67	1.73	2.51	1.15	5.88	4.38	4.80	5.40	6.18
Benchmark	0.13	0.38	0.76	0.26	1.51	1.51	1.65	1.95	2.87
Diversified									
Pendal Active Balanced Fund									APIR - RFA0815AU
Total Return (post-fee, pre-tax)	1.09	2.88	4.38	2.19	11.06	9.28	7.74	8.48	7.74
Total Return (pre-fee, pre-tax)	1.17	3.13	4.88	2.36	12.12	10.32	8.76	9.51	8.81
Benchmark	1.54	4.43	5.99	2.73	12.07	9.07	8.63	8.57	7.59

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