

Fund Manager Commentary

Quarter ended 30 September 2018

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Market Review

The S&P/ASX 300 price index recorded marginal gains (+0.2%) over the September quarter, although with dividends added, the Accumulation index was 1.5% higher. The domestic equity market started July on a solid footing and was able to maintain its momentum during the August reporting season, supported by a large cohort of growth stocks which drove the market higher. However, the euphoria quickly lapsed in September as a confluence of macro thematic factors drove investor sentiment, including the ongoing Sino-US trade conflict, as well as rising global bond yields and the oil price. The Royal Commission also remained an overhang for the Financials (-0.2%) sector, with Banks (-0.5%) in particular seeing limited buying support. The interim report of the Royal Commission was released at the end of September.

In terms of sector performance, Financials, Materials (-1.2%), Consumer Staples (-1.0%) and Utilities (-3.9%) registered negative returns for the quarter. Gold miners (-11.9%) were hit the hardest as the gold price continued to slide due to a higher greenback and rising global bond yields. The US 10-year bond yield closed the quarter at 3.06%, whereas the Australian 10-year bond yield was 39bp lower at 2.67%. Newcrest Mining (NCM, -10.3%) and Evolution Mining (EVN, -23.4%) recorded double-digit losses. 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. A similar theme was also found in EVN's quarterly production update released in July. Diversified miners (+2.0%) managed to provide some offset to these losses. BHP (+5.0%) delivered a satisfactory set of results in August, whereas South 32 (S32, +11.1%) continue to benefit from strengthening prices for coal, manganese and alumina. Following intervention from the Brazilian Government, the world's largest alumina refinery, Alunorte, has been operating at only half its capacity since March this year, placing a supply constraint on the alumina market.

On the other side of the spectrum, the recently beleaguered Communication Services (+24.8%) sector was the best performing sector over the quarter. Investor sentiment was bolstered by the announcement of TPG (TPM, +65.2%) 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, +26.1%). Vocus Group (VOC, +42.0%) advanced after announcing its fully operational Australia-Singapore cable - a project that spanned two years and was completed on time.

Information Technology (+10.2%) also recorded double-digit gains over the period. The sector now trades on a 30x next 12-months (NTM) P/E multiple, compared to the broad market's 15-16x. While some of the sector heavyweights such as Computershare (CPU, +9.4%), Xero (XRO, +8.9%) and Link Administration (LNK, +8.0%) generated good gains, a number of the smaller companies were the main performance contributors. Altium (ALU, +22.1%), Wisetech (WTC, +41.2%), and Afterpay Touch (+92.0%) were all part of that cohort. 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.

Lastly, Health Care (+4.6%) also recorded solid gains over the quarter, as sector heavyweight CSL (CSL, +5.1%) reported strong headline growth and margin expansion. 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 continuous growth in the group's higher-margin therapies. Similarly, results from respiratory products manufacturer, Resmed (RMD, +12.9%), 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.

Portfolio performance

The Pandal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned 1.58% (post-fee, pre-tax) for the quarter, outperforming its benchmark by 0.08%.

Contributors

Overweight Metcash

The share price of Metcash (MTS, +18.1%) bounced back in the September quarter, helped by its extended buyback and a general improvement in investor sentiment. The wholesale grocery supplier managed to seal the supply contract with Foodland Supermarket in South Australia, providing some relief to concerns that arose after losing the Drake's account.

Our investment thesis of MTS is largely predicated on a turnaround of the company's food and grocery business. In our view it is only half-way, at best, through the transition program implemented to turn the company around. One key positive area is the removal of 6,000 low-value, low-turnover items and their replacement with 3,000 higher turnover units in their food and grocery business. This is in the early days of roll-out through IGA stores and there is evidence emerging of sales growth in those stores where it has taken place. In addition, there are further gains to be made in hardware as the integration continues. As such, we uphold our conviction in MTS.

Overweight Santos

Santos' (STO, +16.6%) share price advanced over the quarter, as the rising global oil price and the tight supply in the LNG market reported continue to support the company's free cash flow generation, as well as balance sheet de-gearing. In August, STO reported its second-half earnings (EBITDA) results, which exceeded market consensus. The gas explorer impressed the market with its cost control and the dividend was reinstated as net debt continued to decline. On corporate activities, STO made a proposed takeover bid for privately-held Quadrant Energy, which was received positively 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.

Overweight Telstra

Investor sentiment had been on a downward spiral lately for Telstra (TLS, +26.1%) as its fixed line business becomes more immaterial, whilst competition for its mobiles business continues to ratchet up. However, its share price bounced back over the September quarter, as investor sentiment improved following the announcement of TPG's proposed merger with Vodafone. Once approved and settled, the deal is likely to see the industry dynamic improve. As communicated previously, while Telstra may well continue to endure some short-term volatilities, our view remains that we will ultimately see rationalisation among mobile providers. The company continues to grow its subscriber base and is signalling that it will defend its market share.

Insurance Australia Group - not held

At the beginning of July, there was some negative media coverage on Insurance Australia Group (IAG, -11.9%) around potential malpractices being identified by company-led examinations. The company refuted these reports. Nevertheless, taking the lead from AMP's recent experience of

falling under the Royal Commission spotlight, the reports led to investor concerns which weighed on IAG's share price. The following results release in August was also viewed negatively by the market. Although the company delivered a reasonable underlying result, it tempered the market's enthusiasm on its outlook. The company has been trading on a 21x next-12-month (NTM) price/earnings multiple and the negative price reaction reflects the market's dim view on its valuation for an insurance company without significant earnings momentum.

Detractors

Overweight Origin Energy

The share price of gas explorer/energy retailer, Origin Energy (ORG, -17.7%), declined over the September quarter after the company was negatively impacted by an ACCC report on the domestic power market in July, and further impacted by an underwhelming results release in August. Whilst its liquefied natural gas (LNG) division continues to do well, the power generation/retailing business was impacted by a change to the accounting treatment of its hedging, which effectively detracted 6% from profits. ORG 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 has become a significant headwind for the power sector.

Woodside Petroleum - not held

The oil price rose through the quarter in response to an expected tightening of supply by the market. This is being driven by US-led sanction on Iran, the third-largest oil producer of the OPEC cartel. Despite this, other members of OPEC decided not to increase their output level at their latest gathering in September. As a result, the share price of Woodside Petroleum (WPL, +11.0%) advanced over the quarter. We do not own WPL as its valuation appears full based on our assessment. Santos (STO, +16.6%) remains our preferred exposure.

Brambles - not held

Brambles' (BXB, +24.3%) share price advanced over the quarter after a number of brokers increased their target price for the company in July, followed by a set of satisfactory results released in August. 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 valuation hard to justify in the current environment.

Overweight Caltex

Shares of Caltex (CTX, -6.3%) 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. However, what dampened investor sentiment the most 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

The portfolio outperformed the Index over the third quarter. Several of the highest conviction positions did well, including Metcash, which enjoyed a rally upon the news that it had signed a 10-year contract with several of its largest customers in South Australia, allaying concerns over the potential for further large contract losses in the wake of the break with Drake's supermarket chain. Other non-consensus positions such as JB Hi-Fi and Telstra did well as their FY18 results and outlooks were not as bad as many feared.

LNG producer Santos also continued to outperform. At this point the fundamentals are well aligned to support the price for oil and LNG. OPEC is comfortable with the supply-demand dynamic for oil, while in LNG specifically, a lack of investment in new production over the past few years is keeping the market reasonably tight. We retain a modest overweight to this area, primarily via the position in Santos which, with recent reductions in leverage costs and increases in operational efficiencies, has the highest leverage to the LNG price in the Australian market.

The mining sector was under pressure for much of the quarter, although it enjoyed a rebound in September. The issue is increasing trade friction between the US and China and the implied uncertainty over the rate of economic growth - and commodity demand for the latter - should sanctions ratchet higher.

There has been no sign of rapprochement between the Trump administration and China's authorities on trade and the Republican Party - playing to a domestic audience - seems to have little motivation to ease pressure ahead of the mid-term Congressional elections in early November. However, at the same time China's authorities continue to signal their intention to reverse the cooling policy stance of the past year and offset trade-induced economic pressure with looser monetary and fiscal policy. We see this as the logical response to slowing economic momentum.

We have reduced our exposure to miners since the start of the year, taking significant profit from our position in BHP and the overall sector exposure to a broadly neutral stance. However, further weakness on macro fears could provide a good opportunity here in the next few months. We have also built a position in mining and infrastructure services, which is building a good pipeline of contract work from the transport project pipeline on the East coast and mine replacement spending in the West.

Finally, US bond yields continue to rise as the US Federal Reserve (Fed) hiked rates in September. This has weighed on the yield-sensitive stocks in the Australian market and prompted a late-quarter rotation away from this sector into Resources. We are underweight yield sensitives such as REITs and infrastructure which has been beneficial for recent performance. Looking forward, we think that yields may continue to rise, but ultimately they are unlikely to rise too far in absolute terms, which will ultimately put a base of support under the defensive yield stocks. We do have exposure to this part of the market but are content to remain underweight for the moment.

Pendal Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation Index finished the September quarter 1.1% higher, underperforming its large cap counterpart by 0.4%. While Small Industrials (+3.4%) outperformed, Small Resources (-6.9%) weighed on the overall index. Miners generally suffered as they were caught in the crossfire of escalating trade tensions between the US and China. The gold price declined over the period due to the confluence of a higher greenback and rising global bond yields. The US 10-year bond yield closed the quarter at 3.06%, whereas the Australian 10-year bond yield

was 39bp lower at 2.67%. Government intervention remains a key source of risk given the prevailing populist trends in Western democracies. The banking, wealth, insurance and energy sectors have already been impacted by this paradigm. The aged care sector joined the fold in September as the Federal Government flagged a potential Royal Commission into the sector in response to adverse media coverage. As such, key players including Estia (EHE, -26.0%), Regis Healthcare (REG, -9.8%) and Japara Healthcare (JHC, -21.1%) all retreated. That said, Health Care (+7.9%) managed to finish the quarter with a positive return, helped by Mayne Pharma (MYX, +49.4%) and Mesoblast (MSB, +45.3%). MSB announced continued strong survival outcomes through day 180 in children with steroid refractory acute Graft Versus Host Disease (aGVHD) treated with the company's Phase 3 product candidate, Remestemcel-L.

In terms of other sector performance, seven out of the 11 GICS sectors finished the quarter with a positive return. Information Technology (+17.1%) and Energy (+18.3%) were the standout performers, recording the largest contribution to the headline index return and the largest absolute return. Within Information Technology, Afterpay Touch (APT, +92.0%) saw its market cap almost double as the company boosted its FY18 earnings outlook, ahead of market expectations. FY18 group earnings (EBITDA) are now expected to reach A\$33-34m. Similarly, Wisetech (WTC, +41.2%) 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. Conversely, a rising oil price, supported by expectations of tightening supply following the US-led sanction on Iran, the third largest OPEC oil exporter, helped lift the Energy sector over the quarter. Beach Energy (BPT, +22.6%) was the largest contributor to sector performance. The company reported its FY18 results, which saw oil production for the year reach 26.7 million barrels per day, 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.

On the other side of the spectrum, Materials (-15.6%) fared the worst in absolute return terms, and was the largest detractor from index performance. Regis Resources (RRL, -25.9%) and St. Barbara (SBM, -26.3%) recorded double-digit losses reflecting the declining gold price. A common theme seen in both companies' latest market update is the rise in production costs, which also weighed on investor sentiment. Sims Metal (SGM, -21.3%) experienced a significant share price decline in August as geopolitical risks took the reign, adding to these losses. Increasing tension between the US and Turkey, alongside challenges within Turkey's domestic economy, 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. Accordingly, the company expects first-quarter earnings to be consistent with that of the last quarter for FY18. Lithium miner, Pilbara Minerals (PLS, +4.0%), rebounded in early September after the announcement of production ramp-up projects as well as an increase in planned production rates. The company appears on track to deliver its first spodumene concrete shipment.

Portfolio performance

The Pandal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned 1.38% (post-fee, pre-tax) for the quarter, outperforming its benchmark by 0.28%.

Contributors

Overweight Technology One

Technology One (TNE) 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 dent future profits. Management updated the market on this issue in July, reiterating its 10-15% target for annual growth profit and stating that underlying free cash flow would not be affected. This relief was reinforced by the news late in the quarter that it had won a 10-year digital transformation contract with the Cairns Regional Council.

Overweight Seven Group

Seven Group (SVN) is a diversified investment company which owns a large stake in media company Seven West Media (SWM) as well as equipment companies, Coates and WestTrac. The latter two parts of its portfolio have helped drive an improved outlook for earnings in recent months as demand picks up on the back of both the pipeline of transport infrastructure projects on the East coast and increased spending by the miners in the West. At the same time, management have been improving efficiencies within these businesses, moving to a digital system which has helped drive margin improvements. At this point, SVN offers the ability to gain exposure to medium-term cyclical tailwinds in the resource sector, but with greater visibility on earnings than is often the case with some of the small-cap miners.

Detractors:

Overweight RCR Tomlinson

RCR Tomlinson (RCR) 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. As the company continues to execute on its order book and win new work we expect confidence to be restored, which should result in a material re-rating of the stock. In the meantime, the stock screens favourably as a potential takeover target by one of its larger peers.

Underweight Afterpay Touch

Afterpay Touch (APT) is part of the cohort of tech and health care stocks which have surged from already-hefty valuations in recent months as investors chase growth. There is no doubt that APT's business model has done well and the stock's surge is in large part, a response to the early-quarter update when the company reported a 287% increase in volumes over FY17. However, at this point we believe the valuation has, for the moment, outstripped a reasonable outlook for its earnings. This is particularly so given the existence of some binary risks for the outlook in its Australian business and the uncertainties inherent in its plans for overseas expansion. We do not hold the stock, preferring other names in the software sector, and the underweight detracted from relative performance this quarter.

Strategy and outlook

The S&P/ASX Small Ordinaries Index made positive gains over the September quarter, with the surge in tech stocks up to and during reporting season driving a material portion of performance. The Fund's outperformance was driven by strong gains from some of the positions in mining services such as Seven Group. Positions in technology (Technology One), consumer (Bapcor), health care (Ryman Health care) and financials (OFX Group) also helped.

In recent months we have continued to increase our exposure to mining services. Trade friction between China and the US has seen mining stocks come under pressure of late, although there was some relief in September. We think that the Chinese authorities are likely to loosen monetary and fiscal policy in response to any sanction-induced pressure on economic growth, which can provide a supportive floor for commodity prices and mining stocks.

However, as always we prefer to gain resource exposure via the 'picks and shovels' - the mining service companies, such as Seven Group and Monadelphous. Small cap miners are often subject to the kind of binary risks that we seek to avoid in the portfolio, given they often rely on one asset or opportunity. In this environment, attraction to the service companies also lies in the greater visibility on the earnings outlook as the large miners look to expand to replace depleted production or scale up equipment maintenance following several years of tighter control on costs. For some of the service stocks, this pipeline of contracts from the west coast mining sector is supplemented by work on the east coast transport infrastructure pipeline. This diversification of opportunity provides another leg for the thesis in this sector.

Outside of this, we continue to look for earnings visibility and robust business models, given a broader environment in which organic growth remains relatively muted. We continue to see opportunity in niche financials such as OFX Group and Austbrokers, in relatively defensive retailers such as Bapcor, in reasonably-valued technology such as Technology One, and in areas of structural growth such as Ryman Health Care and IDP Education.

International Shares

Pendal Concentrated Global Share Fund

Market review

Global equities delivered a strong return for the quarter as a result of three consecutive months of positive returns. Gains were led by a strong rally in US stocks, with investor sentiment held aloft on continued positive news on the economy and corporate earnings. Implications from the Trump tariffs appeared as a side show, although the impacts were more prevalent in Asia and other emerging markets. European markets experienced a more volatile quarter, commencing July positively before weakening in August and recovering somewhat in September. The benchmark MSCI World ex Australia Index closed the quarter with a return of 7.4%.

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, although some weakness emerged in the mega technology players following the latest round of earnings releases. Twitter, Netflix and Facebook experienced rapid sell-downs following their earnings announcements, although sectors like Industrials and other cyclical sectors fared considerably better. 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 the quarter with the S&P500 delivering a total return of 7.2%, while the NASDAQ also rallied with a return of 7.1%.

European markets exhibited a mixed set of returns, driven by a number of country-specific factors. The region was spooked by the prospect of contagion from the deteriorating economic conditions in Turkey and Italy, although these impacts appeared to be contained. Markets took some confidence out of the latest economic data which showed headline inflation for the region advanced 2.1% for September although core inflation remains low at 0.9%. European Central Bank (ECB) President Mario Draghi noted the "relatively vigorous" pickup in inflation, indicating firmer expectations particularly in light of strengthening labour markets. A similar direction for inflation was noted for the UK market, which ended the quarter down 1.7% after the boost from higher oil prices was offset by concerns over the prospect of a hard Brexit. Switzerland (+5.6%) and France (+3.2%) were the

best performing markets, while Germany (-0.5%), Italy (-4.2%) and Spain (-2.4%) weighed on the broader region's relatively flat return.

Asian equity markets posted a mixed set of returns. Another increase in US interest rates and imposition of tariffs by the US on US\$200 billion worth of imports from China impacted returns from China's Shanghai Composite index (-0.9%), although southeast Asia markets like Thailand (+10.1%) and Malaysia (+6.0%) advanced. Japan (+8.1%) was the standout performer in September. Higher US bond yields kept a lid on the yen, while Shinzo Abe's successful election for a third consecutive term as Liberal Democratic Party leader provided a boost to markets.

The Australian dollar continued to weaken on concerns related to China and emerging markets. The local unit was 0.9% lower against the US dollar and 0.5% against the British pound but 0.3% firmer against the euro.

Portfolio performance

The Pandal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned 4.04% (post-fee, pre-tax) for the quarter, underperforming its benchmark by 3.31%.

The September quarter ended with the S&P 500 Index up by almost 200 points, outperforming all other major indices (in US\$ terms) and posting its largest quarterly gain since 2013. The move higher in US markets comes despite a US rate hike, no apparent headway with the US/China trade negotiations and a constant stream of headlines out of Washington. However, political turmoil was not isolated to the US, with the UK Brexit negotiations continuing to provide a challenge for Theresa May, while Italy has once again found itself under the scrutiny of the European Commission after missing fiscal targets.

During the quarter our team travelled to Japan, Europe and the US. In our meeting with companies, it was evident that technology and industrial companies in the US and Japan are seeing a slow-down, (albeit from elevated levels) in customer demand. In particular, customers in China appear to be showing some reticence in placing orders until there is more clarity on the outcome of trade negotiations. However, those companies with the bulk of their exposure in the US domestic market appear to be less concerned about the outlook, with many commenting that business conditions had continued to improve ahead of expectations.

Our underperformance this quarter stemmed from a tough month in August. Our European financials underperformed amid ongoing uncertainty regarding Brexit negotiations and an economic crisis in Turkey. While neither issue has been completely resolved, the sector did perform better in September and some of that underperformance in August was clawed back. We remain of the view that the sector offers compelling value; balance sheets are in good shape, credit quality is being controlled, and costs are being managed. As long term, fundamental investors, these are the metrics we are most focused on and we will continue to be patient while collecting our >4% dividends. Being modestly underweight the broader US market and not having a position in Amazon and Apple which rose by 18% and 22%, respectively, has also weighed on performance this quarter. The dilution of our weighting to the US market in recent quarters has not been based on any particular view of the macro-economic environment. The decision to sell or dilute any of our positions has been based on our view of valuations and we remain committed to exercising that discipline to ensure sustainable long term performance.

Our US railway holdings, Norfolk Southern and Union Pacific, continued to outperform the broader market this quarter (up 20% and 15%, respectively). While both companies are clearly benefiting from US economic strength and favourable quarterly results, we continue to be impressed by management teams who remain focused on efficiencies and cost control. Union Pacific held a call with analysts and investors in September to outline their new operating model (Unified Plan 2020), based on what is in the industry referred to as precision scheduled railroading (PSR). Rail-road practise in the past meant that trains were held in a yard until they were full. With PSR, deliveries are given priority and each asset is used and monitored constantly, enabling customers to better

plan shipments. We remain confident that the labour productivity gains as a result of this plan will bring Norfolk Sothorn's labour expenses more in line with industry best practise and allow them to comfortably meet operating ratio targets for 2020.

The broader Health Care sector rose 14% for the quarter and our two US pharmaceutical holdings, Pfizer (+21%) and Merck (+17%), outperformed the market and the broader sector. Pfizer benefited from the release of encouraging Phase 2 data for a drug developed to treat an auto-immune disease causing hair loss. While this announcement is pleasing, it is one of many we expect from the Pfizer Phase 2 pipeline. Merck benefited from a string of positive announcements in relation to their oncology drug. Keytruda is set to become one of the largest oncology drugs in the world and while we expect it to underpin growth for the broader company, we are also confident of growth in the emerging oncology business, as well as their animal health and vaccine businesses.

Strategy and outlook

As we enter the third year of the Fund, we expect interest rates in the US and the UK to continue to ratchet higher. Whilst the European Central Bank has signalled the end of quantitative easing at year end, at this point interest rates will remain at record lows. However, we remain of the view that over time, rates in Europe will also normalise. As a result, we believe equity markets will become more volatile, exacerbated by the formation of a number of populist governments around the world. Our view at the Fund's inception was that owning a select portfolio of companies, rather than having broader market exposure, was the best way to optimise investment returns. We remain of that view today and look forward to the investment opportunities arising from that increased volatility.

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, although some weakness emerged in the mega technology players following the latest round of earnings releases. Twitter, Netflix and Facebook experienced rapid sell-downs following their earnings announcements, although sectors like Industrials and other cyclical sectors fared considerably better. 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 the quarter with the S&P500 delivering a total return of 7.2%, while the NASDAQ also rallied with a return of 7.1%.

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September although core inflation remains low at 0.9%. ECB President Mario Draghi noted the “relatively vigorous” pickup in inflation, indicating firmer expectations particularly in light of strengthening labour markets. A similar direction for inflation was noted for the UK market, which ended the quarter down 1.7% after the boost from higher oil prices was offset by concerns over the prospect of a hard Brexit. Switzerland (+5.6%) and France (+3.2%) were the best performing markets, while Germany (-0.5%), Italy (-4.2%) and Spain (-2.4%) weighed on the broader region’s relatively flat return.

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The Australian dollar continued to weaken on concerns related to China and emerging markets. The local unit was 0.9% lower against the US dollar and 0.5% against the British pound but 0.3% firmer against the euro.

Portfolio performance

The Pandal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned 5.95% (post-fee, pre-tax) for the September quarter, underperforming its benchmark by 1.40%.

Thematically, underperformance in the US was largely due to negative performance in our valuation and quality signals, offset somewhat by positive performance of investor sentiment and industry momentum measures. Value was similarly weak in Europe, along with industry momentum measures. The underperformance in Japan was due to negative performance in industry momentum and quality measures, with momentum generating an offsetting positive contribution for stock selection within industries.

From a stock and industry attribution perspective, active industry tilts were a positive contributor. However, intra-industry stock selection detracted more significantly from performance over the month. At a sector level, an overweight position in Materials was the largest detractor from active returns, although this was outweighed by the positive results from an overweight position in Information Technology and an underweight position in Financials. However, within sectors the underperformance of stock selection within Information Technology drove the overall underperformance of the Fund over the third quarter, with the positive performance from stock selection within Energy being the largest offset.

At a stock level, the largest contributors to active returns came from overweight positions in Abiomed, a manufacturer of medical implant devices headquartered in the US; Humana Inc., a for-profit American health insurance company based in Kentucky; Southwest Airlines Co., a major US discount airline; Walmart Inc., an American multinational retail corporation; and Microsoft Corporation, an American multinational technology company with headquarters in Washington state. The largest detractors over the quarter came from an overweight position in Facebook Inc., an American online social media and social networking service company; an overweight position in Micron Technology Inc., a US-headquartered manufacturer of semi-conductors and data storage; an overweight position in Covestro AG, a German adhesive manufacturing company; an underweight position in Visa Inc., an American multinational financial services corporation headquartered in California; and an overweight position in Applied Materials, Inc., an American corporation that supplies equipment, services and software to enable the manufacture of technology.

Strategy and outlook

Entering October, 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 dropped midway through the quarter before rising into the end of September. This followed swings in global macro sentiment during the period where geopolitical concerns intensified then cooled by quarter-end. Meanwhile, there was little action regarding domestic monetary policy with the Reserve Bank of Australia (RBA) leaving rates unchanged over the quarter. The RBA's monthly statements were largely unchanged over the quarter; however, its communication did offer a more constructive view on the Australian labour market and global economic conditions. Overall though, the Board's communication over the period suggested rates will remain on hold over the near-term. Regarding domestic data, GDP growth surprised to the upside with a solid 0.9% for the second quarter, which brought the year-on-year rate to 3.4%. Labour market data was also reasonably healthy with 50,900 jobs added in July and 44,000 added in September. Meanwhile second quarter inflation was weaker-than-anticipated with the RBA's preferred gauge, the trimmed mean, growing only 0.5% for the quarter and 1.9% year-on-year. Finally on market movements, Australian 3 and 10 year rates rose 1bp and 4bp to 2.08% and 2.68%, respectively. At the very front-end, 90 day BBSW fell a modest 17bp to 1.94%; however, the spread versus OIS remained elevated relative to historical levels.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned -0.11% for the September quarter (post-fees, pre-tax), underperforming its benchmark by 0.65%.

In the alpha overlay, the largest detractor was the FX strategy. This experienced losses on EUR short positions when the currency rebounded in August and on long USD versus EM FX after a rebound in emerging market currencies in September. The recovery in emerging markets also hurt the Macro strategy late in the quarter due to several buy protection positions on EM sovereigns and CDS indices. In the Duration strategy losses on long duration German Bund positions were partly offset by returns on Australian duration trades. Similarly, a long Australia versus US position helped offset losses from a long US versus Germany position later in the quarter. In the Relative Value losses were incurred from an Australian EFP widener and US 5 year invoice spread. In contrast, the Yield Curve strategy realised a small gain from steepeners in Australia and Japan.

The Government bond component underperformed over the quarter. The Duration, Yield Curve and Cross-Market strategies were roughly flat overall. In contrast the Relative Value strategy was a small detractor and the beta component outperformed its benchmark.

Finally the credit component outperformed with overweights in the infrastructure and utilities sectors, and an underweight exposure to supranationals contributing to excess returns.

Strategy and outlook

The RBA left the cash rate unchanged again in September and October with no change in monetary policy is imminent. Calls for no change in 2019 are starting to increase. The key data release for October will be third quarter inflation, although the RBA in their most recent statement expect that one-off declines in some administered prices will see inflation for 2018 being a little lower than otherwise. Their projections see underlying inflation remaining subdued further out, 2% at the end of 2019 and 2.25% by the end of 2020. The unemployment rate is not forecast to be below 5% despite healthy GDP growth forecasts of 3-3.25%.

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 Statement on Monetary Policy, to be released in early November, will provide a clearer picture into the likely path for monetary policy. There is little to suggest that there is likely to be a change anytime soon.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bond yields dropped midway through the quarter before rising into the end of September. This followed swings in global macro sentiment during the period where geopolitical fears intensified then cooled by quarter-end. Trade wars were one of the chief concerns for investors early in the quarter as US and Chinese policymakers implemented successive rounds of tariffs and threats of further action. However, concerns eased during September as markets began to believe an endgame was in sight. Similarly, worries over emerging markets contagion receded with several positive developments for individual countries. Meanwhile in the US, the FOMC delivered a 25bp rate hike in September (as widely expected). The Committee's target rate dot plot was closely scrutinised with their projections suggesting another rate hike in December and three increases in 2019. This outlook was reinforced by solid US economic data over the quarter. In Europe, the ECB left policy unchanged during the quarter and offered no change to its forward guidance. Also in the region the EU was also displeased with Italy's proposed 2019-2021 budget that suggested a deficit-to-GDP of 2.4%. This caused a sharp increase in the country's 10 year yields to 3.3%. Finally on market movements, US 2- and 10-year yields increased a sizeable 29bp and 20bp to 2.82% and 3.06%, respectively.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned -1.46% for the September quarter (post-fees, pre-tax), underperforming its benchmark by 0.80%.

The Duration strategy experienced losses on long duration positions in the Japanese and US long-end early in the quarter. In September negative returns were due to long duration positions on German Bunds. Meanwhile, performance from Australian duration trades were more mixed over the period.

The FX strategy was the largest detractor due to a range of positions over the period. These included short EUR trades against the USD and other counter currencies after it recovered in August. In September, short USD versus EM cost performance as emerging market currencies rebounded. Meanwhile several long vol trades experienced small gains, including AUD/USD.

The Yield Curve strategy generated a small gain during the period. This was tied to steepener positions in Japan over the quarter, as well as on the Australian curve in September. These gains were partly offset by losses on a European curve flattener.

The Cross Market strategy experienced a small loss, which was mainly from a long US versus Germany position in September that was subsequently stopped out. A long Australia versus US trade in August added value.

In the Macro strategy, strong returns were generated in August from buy protection positions on CDX EM and individual EM sovereigns including Turkey, Brazil and South Africa. However, the gains turned to losses in September after a rebound in emerging market debt.

Finally, in the Relative Value strategy the US 5-year invoice spread widener cost performance while returns from the Australian EFP widener were more mixed.

Strategy and outlook

The continued tightening of global liquidity conditions means that investors' tolerance for poor fundamentals is unlikely to improve. Global PMI data points to trade tensions starting to bite into sentiment and likely to reflect in worsening growth momentum. Latest export and activity data from Europe is leading the way in this regard. In addition, renewed political and fiscal concerns in Italy have been exerting downward pressure on the Euro. With Draghi and the ECB seemingly determined on their own path of monetary policy normalisation due to "relatively vigorous" momentum in inflation, we remain puzzled by the distinct lack of risk premium in European credit spreads.

Credit

Pendal Enhanced Credit Fund

Market review

Credit spreads reversed their upward trajectory from previous months and ended the September quarter tighter. The turn was driven by a swing in global risk sentiment as fears over geopolitical risks intensified, then subsided during the period. This included the market becoming less sensitive to successive rounds of tariffs and threats of further levies from Chinese and US policymakers. Additionally, the market's fears of emerging markets contagion were appeased in part by a 625bp rate hike from Turkey's central bank.

Meanwhile, in the domestic market the BBSW-OIS spread narrowed during the quarter. However, the level remained elevated relative to historical levels and in turn higher funding costs were cited as a reason an out-of-cycle mortgage rate hike by three of the four major banks.

Turning to market activity, issuance was light in July then picked up later in the quarter with the strongest September volumes since 2009. The four major banks all tapped the market for debt capital during the period including deals from CBA for A\$3.5b, NAB for A\$2b, ANZ for A\$2b and Westpac for A\$400m. Offshore financials also conducted large issues, while one of the biggest corporate deals was a A\$1,325m issue from AT&T.

The Australian iTraxx index (Series 29 contract) traded in a wide 20bp range finishing the quarter 15.5bp tighter to +65bp. The new series 30 contract closed the quarter at 74.5bp. Physical credit spreads were on average a touch wider with the best performing sectors being infrastructure, domestic banks and utilities all unchanged whilst the worst performing sectors were telecom, real estate and industrials widening 4, 4 and 3bp, respectively. Semi-government bonds underperformed widening 4bp to government bonds over the quarter.

Portfolio performance

The Pandal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 0.69% for the September quarter (post-fees, pre-tax), underperforming the benchmark return by 0.08%.

Overweights in the infrastructure and utilities sectors, and an underweight exposure to supranationals contributed to excess returns.

Purchases over the quarter were relatively light, given a more cautious tone in credit markets. Activity during the period included the purchase of a sustainable bond issue by Macquarie University and issuance from US telco AT&T among others.

Strategy and outlook

Our macro credit view remains neutral. Whilst we continue to be cautiously constructive on a fundamental basis, we acknowledge risks have increased due to increasing volatility across markets. This has been driven in part by firmer expectations for US rate normalisation and higher inflation. Geopolitical risks have also flared up in 2018 and markets appear less forgiving, as witnessed by the reaction to Italian political uncertainty in May, the rout in emerging markets and ongoing Sino-US trade tensions.

Over the next year, it is expected there will be further cash rate increases in the US, as reinforced by the Fed in September. Additionally, the ECB has effectively halted asset purchases. Market price dislocations will occur should expectations of central bank actions and incoming data not align to market positioning.

Balancing these risks are solid corporate fundamentals and in turn we are constructive on investment grade credit. Balance sheets are generally strong and earnings are improving as evidenced by solid corporate earnings seasons in Australia, the US and Europe. Further, Australian domestic issuers have not increased balance sheet leverage over the past number of years. The major Australian banks have stronger capital ratios than previous years 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 housing appears to be softening. The domestic market is also enduring an elevated BBSW-OIS spread, that has created concern among investors. As such we continue to recommend a defensive approach with any overweights in operationally resilient sectors such as Utilities and Infrastructure that provide higher yield to index returns.

Cash

Pendal Managed Cash Fund and Pendal Enhanced Cash Fund

Market review

Australian bond yields dropped midway through the quarter before rising into the end of September. This followed swings in global macro sentiment during the period where geopolitical concerns intensified then cooled by quarter-end.

Trade wars were one of the chief concerns for investors early in the quarter as US and Chinese policymakers implemented successive rounds of tariffs and threats of further action. However, concerns eased during September as markets began to believe an endgame was in sight. Similarly, fears of emerging markets' contagion receded with several positive developments for individual countries. The event that had the largest impact on turning sentiment was a 625bp rate hike by Turkey's central bank.

In contrast there was little action regarding domestic monetary policy with the RBA leaving rates unchanged over the quarter. The RBA's monthly statements were largely unchanged over the quarter, but did offer more upbeat comments on local and global economic conditions. Late in the quarter, the September meeting minutes revealed a more constructive view on the Australian labour market. Overall the Board's communication over the period suggested rates will remain on hold over the near-term. In turn, rate expectations were little changed with only a 40% probability of a hike for the cash rate priced in late next year.

In terms of domestic data, GDP growth surprised to the upside with a solid 0.9% for the second quarter, which brought the year-on-year rate to 3.4%. Labour market data was also reasonably healthy with 50,900 jobs added in July and 44,000 added in September. Meanwhile second quarter inflation was weaker-than-anticipated with the RBA's preferred gauge, the trimmed mean, growing only 0.5% for the quarter and 1.9% year-on-year. Other noteworthy domestic developments included three of the four major banks delivering out-of-cycle mortgage rate hikes that they attributed to higher funding costs.

Turning to the US, the FOMC delivered a 25bp rate hike in September as widely expected. The Committee's target rate dot plot was closely scrutinised with their projections suggesting another rate hike in December and three increases in 2019. This outlook was reinforced by solid US economic data over the quarter, such as the ISM manufacturing survey hitting its highest since 2004.

In Europe, the ECB left policy unchanged during the quarter and offered no change to its forward guidance. However, comments from President Draghi post the September meeting suggested a more hawkish view on inflation. Meanwhile Eurozone data was generally weaker including falls in the composite PMI, industrial production, retail sales and consumer confidence. Also in the region, EU policymakers rejected the Brexit proposal terms from UK Prime Minister Theresa May. The EU was also displeased with Italy's proposed 2019-2021 budget that suggested a deficit-to-GDP of 2.4%. This caused a sharp increase in the country's 10 year yields to 3.3%.

Australian rate movements were not as extreme, the 3 and 10 year rates rose 1bp and 4bp to 2.08% and 2.68%, respectively. At the very front-end, 90 day BBSW fell a modest 17bp to 1.94%, however, the spread versus OIS remained elevated relative to historical levels. In the US, 2 and 10 year yields increased a sizeable 29bp and 20bp to 2.82% and 3.06%, respectively. Despite an increasingly negative AU-US yield spread, the AUD/USD was roughly flat over the month.

Portfolio performance

Managed Cash

The Pental Managed Cash Fund (formerly the BT Wholesale Managed Cash Fund) returned 0.48% for the September quarter (post-fees, pre-tax), marginally underperforming its benchmark by 0.04%.

Themes and credit exposure remain consistent with prior quarters, with excess spread from A-1 rated issuers and yield curve positioning likely to be the main driver of outperformance. The fund ended the quarter with a weighted average maturity of 65 days (maximum limit of 70 days). The RBA 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 had expected BBSW to rise in September following spikes in the last month of the previous 3 quarters. Whilst other funding markets again showed some signs of stress (albeit more subdued than the June quarter), Australian major banks showed little need to increase short end funding during the month and consequently 3 and 6 month bank bill rates ended the quarter unchanged from their August close. Against the more benign environment the funds' weighted average maturity was lengthened late in the quarter.

Enhanced Cash

The Pental Enhanced Cash Fund (formerly the BT Wholesale Enhanced Cash Fund) returned 0.64% for the September quarter (post-fees, pre-tax), marginally outperforming the benchmark by 0.12%.

Positive performance came from financials and industrial sectors. Activity during the quarter included reducing exposure to the resources sector, investing in domestic banks, education, industrials and telecoms as well as a long credit position in Australia iTraxx.

As at the end of the quarter, the portfolio had a credit spread of 74bp over bank bills, interest rate duration of 0.07 years and credit spread duration of 2.37 years.

Strategy and outlook

The RBA left the cash rate unchanged again in September and October with no change in monetary policy is imminent. Calls for no change in 2019 are starting to increase. The key data release for October will be third quarter inflation, although the RBA in their most recent statement expect that one-off declines in some administered prices will see inflation for 2018 being a little lower than otherwise. Their projections see underlying inflation remaining subdued further out, 2% at the end of 2019 and 2.25% by the end of 2020. The unemployment rate is not forecast to be below 5% despite healthy GDP growth forecasts of 3-3.25%.

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 Statement on Monetary Policy, to be released in early November, will provide a clearer picture into the likely path for monetary policy. There is little to suggest that there is likely to be a change anytime soon.

Australian Property

Pendal Property Securities Fund

Market review

The A-REIT sector generated a total return of up 1.98% for the September 2018 quarter, outperforming the broader market which was up 1.5%. Globally, REITs were down 1.4% (in US\$ terms) for the quarter, with Australia the strongest REIT market and Europe the worst performer (-3.8%).

The best performing A-REIT over the quarter was Mirvac (+11%), reflecting a strong earnings result and higher earnings guidance for 2019 despite a weakening housing market. Other performers were Dexus (+8.7%, with values supported by the Investa takeover activity) and Goodman Group (+7.6%, reflecting strong result and earnings guidance). Underperformers over the quarter included Scentre Group (-7.2%) and Unibail (-3.9%), both sold down on the back of retail and balance sheet concerns.

It was a solid quarter for both equity markets and growth assets; the S&P500 was up 7%. The Fed lifted the Fed Funds rate for an eighth time with the rate now at 2.00%. Most commentators expect another four hikes over the next year. US 10-year bond yields ticked up 18bp to close at 3.05%, and the US yield curve (US10Y/ US 1Y) steepened to 24bp. The RBA left the cash rate unchanged at 1.5% over the quarter. Over the quarter the Australian 10-year yield remained unchanged at 2.67%, reflecting a weaker economic outlook for Australia.

The US unemployment rate was steady at 3.8%, the lowest level since December 1969 and average hourly earnings were +2.7% higher over the prior year. The ABS National House Price Index fell 0.8%, falling across Australia for the first time since September 2012. A combination of tighter credit with banks enforcing current guidelines and muted sentiment is likely to see further falls in 2018. Total private sector credit growth was just 0.5% in September, while total credit growth was at 4.5%

It was a busy quarter for A-REITs with M&A activity supporting the sector. Investa Office Fund received a rival takeover offer from Oxford Properties, offering \$5.60/security cash which was a 5% premium to an improved Blackstone offer. Propertylink received a \$1.15 offer from Asian fund manager, ESR. Meanwhile, Propertylink proposed a merger with Centuria Industrial REIT to form a larger industrial platform. The most significant property acquisition for the quarter was the Scentre Group purchase of a 50% stake in regional mall, Eastgardens, for \$720m for a 50% share representing a 4.25% cap rate. Whilst pushing their gearing levels up, the transaction does underpin valuations for this asset class.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned 3.04% for the September quarter (post-fee, pre-tax), outperforming its benchmark by 1.06%.

Overweight positions in Mirvac, Charter Hall Group and Dexus assisted performance. An underweight position in Scentre Group was our strongest contributor. Overweight positions in Unibail RW and Stockland detracted from performance.

Strategy and outlook

The A-REIT sector is now priced on an FY19 dividend yield of 5.3%, a P/E ratio of 17.0 times (x), well ahead of its 27-year average of 13.4x, but in line with its long term average relative to Industrials (0.97x). Office and industrial cap rates will likely compress further in the next reporting period (on the back of recent transaction evidence), but asset valuation uplift thereafter will depend on income growth and tenancy retention. We expect to see cap rates soften for retail assets, especially lower quality malls in the next 6-12 months. Balance sheets are stable, with sector gearing at 27%.

International Property

Pendal Global Property Securities Fund

Market review (in US\$)

For the quarter ended September 30, 2018, performance of the global property securities market (on an ex-Australia basis) as measured by the FTSE EPRA Nareit Developed Index returned -0.2%. Europe (-1.8%) was the weakest performing region, followed by Asia Pacific (-1.3%), while North America (+0.8%) was a positive performer. Within Europe, results were mixed. The Netherlands (-8.9%) was the weakest performer, followed by Spain (-7.0%) and the United Kingdom (-6.2%). Conversely, notable positive performers within the region included Sweden (+10.4%), Austria (+6.6%), and Finland (+5.7%). In Asia Pacific, results were mixed across the region. Hong Kong (-2.0%) and Japan (-1.6%) were negative performers, while Singapore (+2.4%) and New Zealand (+1.2%) were positive performers. Within North America, the US and Canada returned 0.6% and 4.3%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund (formerly the BT Wholesale Global Property Securities Fund) returned 0.51% for the September quarter (post-fee, pre-tax), outperforming the benchmark by 0.31%.

North America

For the September quarter, the North America portfolio returned 1.02% before fees and taxes, outpacing the FTSE/EPRA NAREIT North America Index by 25bp. Outperformance relative to the benchmark was driven by both positive stock selection results and positive sector allocation results. In terms of stock selection, results were strongest in the diversified, data centre, and office sectors and were weakest in the regional mall, shopping centre, and hotel sectors. Regarding sector allocation, positive results were attributable to the portfolio's overweight to the outperforming data center and regional mall sectors. Conversely, the portfolio's underweight to the outperforming triple net lease sector was a notable negative performer. Among the portfolio's holdings, top individual contributors to relative performance included a lack of exposure to underperforming Essex Property Trust (ESS) and overweight positions in outperforming CyrusOne (CONE) and AvalonBay Communities (AVB). Detractors most notably included overweight positions in underperforming

CubeSmart (CUBE) and Penn REIT (PEI), and a lack of exposure to outperforming Realty Income (O).

Europe

For the September quarter, the European portfolio returned -0.49% before fees and taxes, exceeding the FTSE/EPRA NAREIT Developed Europe Index by 131 basis points. Outperformance relative to the benchmark was attributable to both positive stock selection results and positive country allocation results. In terms of stock selection, results were strongest in the Netherlands, the United Kingdom, and Germany and were weakest in Norway, Spain, and Austria. Regarding country allocation, positive results were driven by the portfolio's overweight to the outperforming Sweden and Norway. Conversely, the portfolio's overweight to the underperforming Belgium and Finland were notable detractors to relative performance. Among the portfolio's holdings, top positive contributors to relative performance included overweight positions in outperforming Faberge AB (Sweden), Wihlborgs Fastigheter AB (Sweden), and Vonovia SE (Germany). Detractors most notably included overweight positions in underperforming Workspace Group PLC (United Kingdom) and Segro PLC (United Kingdom), and a lack of exposure to outperforming Hemfosa Fastigheter AB (Sweden).

Asia

For the September quarter, the Asia portfolio returned -1.14% before fees and taxes, outperforming the regional EPRA benchmark by 18 basis points. Outperformance relative to the benchmark was attributable to positive stock selection results, which were partially offset by negative country allocation results. In terms of stock selection, results were strongest in Japan and Singapore and weakest in Hong Kong. Regarding country allocation, negative results were driven by the portfolio's underweight to the outperforming Singapore. Among the portfolio's holdings, top contributors to relative performance included overweight positions in outperforming Link REIT (Hong Kong) and Suntec REIT (Singapore), and a lack of exposure to underperforming City Developments (Singapore). Detractors most notably included an overweight position in underperforming UOL Group (Singapore) and a lack of exposure to outperforming CapitaLand (Singapore) and Sino Land (Hong Kong).

Active Balanced

Pendal Active Balanced Fund

Markets review

The Australian share price index recorded marginal gains (+0.2%) over the September quarter, although with dividends added, the Accumulation index was 1.5% higher. The domestic equity market started July on a solid footing and was able to maintain its momentum during the August reporting season, supported by a large cohort of growth stocks which drove the market higher. However, the euphoria quickly lapsed in September as a confluence of macro thematic factors drove investor sentiment, including the ongoing Sino-US trade conflict, as well as rising global bond yields and the oil price. The Royal Commission also remained an overhang for the Financials (-0.2%) sector, with Banks (-0.5%) in particular seeing limited buying support. The interim report of the Royal Commission was released at the end of September.

Financials, Materials (-1.2%), Consumer Staples (-1.0%) and Utilities (-3.9%) registered negative returns for the quarter. Gold miners (-11.9%) were hit the hardest as the gold price continued to slide due to a higher greenback and rising global bond yields. On the other side of the spectrum, the recently beleaguered Communication Services (+24.8%) was the best performing sector over

the quarter. Information Technology (+10.2%) also recorded double-digit gains over the period. The sector now trades on a 30x next 12-months (NTM) P/E multiple, compared to the broad market's 15-16x. Lastly, Health Care (+4.6%) also recorded solid gains over the quarter, as sector heavyweight CSL (CSL, +5.1%) reported strong headline growth and margin expansion.

Global equities delivered a strong return for the quarter as a result of three consecutive months of positive returns. Gains were led by a strong rally in US stocks, with investor sentiment held aloft on continued positive news on the economy and corporate earnings. Implications from the Trump tariffs appeared as a side show, although the impacts were more prevalent in Asia and other emerging markets. European markets experienced a more volatile quarter, commencing July positively before weakening in August and recovering somewhat in September. The benchmark MSCI World ex Australia Index closed the quarter with a return of 7.4%.

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, although some weakness emerged in the mega technology players following the latest round of earnings releases. Twitter, Netflix and Facebook experienced rapid sell-downs following their earnings announcements, although sectors like Industrials and other cyclical sectors fared considerably better. 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 the quarter with the S&P500 delivering a total return of 7.2%, while the NASDAQ also rallied with a return of 7.1%.

European markets exhibited a mixed set of returns, driven by a number of country-specific factors. The region was spooked by the prospect of contagion from the deteriorating economic conditions in Turkey and Italy, although these impacts appeared to be contained. Markets took some confidence out of the latest economic data which showed headline inflation for the region advanced 2.1% for September although core inflation remains low at 0.9%. European Central Bank (ECB) President Mario Draghi noted the "relatively vigorous" pickup in inflation, indicating firmer expectations particularly in light of strengthening labour markets. A similar direction for inflation was noted for the UK market, which ended the quarter down 1.7% after the boost from higher oil prices was offset by concerns over the prospect of a hard Brexit. Switzerland (+5.6%) and France (+3.2%) were the best performing markets, while Germany (-0.5%), Italy (-4.2%) and Spain (-2.4%) weighed on the broader region's relatively flat return.

Asian equity markets posted a mixed set of returns. Another increase in US interest rates and imposition of tariffs by the US on US\$200 billion worth of imports from China impacted returns from China's Shanghai Composite index (-0.9%), although southeast Asia markets like Thailand (+10.1%) and Malaysia (+6.0%) advanced. Japan (+8.1%) was the standout performer in September. Higher US bond yields kept a lid on the yen, while Shinzo Abe's successful election for a third consecutive term as Liberal Democratic Party leader provided a boost to markets.

The Australian dollar continued to weaken on concerns related to China and emerging markets. The local unit was 0.9% lower against the US dollar and 0.5% against the British pound but 0.3% firmer against the euro.

Australian bond yields dropped midway through the quarter before rising into the end of September. This followed swings in global macro sentiment during the period where geopolitical concerns intensified then cooled by quarter-end. Meanwhile, there was little action regarding domestic monetary policy with the RBA leaving rates unchanged over the quarter. The RBA's monthly statements were largely unchanged over the quarter; however, its communication did offer a more constructive view on the Australian labour market and global economic conditions. Overall though, the Board's communication over the period suggested rates will remain on hold over the near-term. Regarding domestic data, GDP growth surprised to the upside with a solid 0.9% for the second quarter, which brought the year-on-year rate to 3.4%. Labour market data was also reasonably healthy with 50,900 jobs added in July and 44,000 added in September. Meanwhile

second quarter inflation was weaker-than-anticipated with the RBA's preferred gauge, the trimmed mean, growing only 0.5% for the quarter and 1.9% year-on-year. Finally on market movements, Australian 3 and 10 year rates rose 1bp and 4bp to 2.08% and 2.68%, respectively. At the very front-end, 90-day BBSW fell a modest 17bp to 1.94%.

Global bond yields dropped midway through the quarter before rising into the end of September. This followed swings in global macro sentiment during the period where geopolitical fears intensified then cooled by quarter-end. Trade wars were one of the chief concerns for investors early in the quarter as US and Chinese policymakers implemented successive rounds of tariffs and threats of further action. However, concerns eased during September as markets began to believe an endgame was in sight. Similarly, worries over emerging markets contagion receded with several positive developments for individual countries. Meanwhile in the US, the FOMC delivered a 25bp rate hike in September (as widely expected). The Committee's target rate dot plot was closely scrutinised with their projections suggesting another rate hike in December and three increases in 2019. This outlook was reinforced by solid US economic data over the quarter. In Europe, the ECB left policy unchanged during the quarter and offered no change to its forward guidance. Also in the region the EU was also displeased with Italy's proposed 2019-2021 budget that suggested a deficit-to-GDP of 2.4%. This caused a sharp increase in the country's 10-year yields to 3.3%. Finally on market movements, US, 2 and 10-year yields increased a sizeable 29bp and 20bp to 2.82% and 3.06%, respectively.

Portfolio performance

The Pandal Active Balanced Fund (formerly the BT Wholesale Active Balanced Fund) returned 1.49% (post-fee, pre-tax) for the September quarter, underperforming its benchmark by 0.82%.

The Fund delivered a positive return over the September quarter, supported by exposure to Australian and offshore equity and listed property markets. The Australian fixed income market also generated a positive, albeit modest return which contributed to performance but global fixed income was negative for the quarter, largely related to rising US bond yields. Exposure to alternatives detracted from returns this quarter. At a Fund level, the contribution to performance was primarily driven by asset allocation outcomes, while manager contribution detracted value across a select number of strategies.

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

The key factors influencing the alpha generated through active management returns were stock selection outcomes within Australian equities. Within the Australian equity strategy, overweight positions in Metcash, Santos and Telstra plus holding no exposure to Insurance Australia Group contributed to returns. These contributions were partially reduced by overweight positions in Origin Energy and Caltex, and holding no exposure to Woodside Petroleum and Brambles.

Within the global equities portfolio, the Concentrated and Core portfolios fell short of the benchmark but positively contributed to overall returns, given the strong performance of global equity markets.

Our Alternatives core portfolio detracted from returns this quarter, with three of the eight sub-strategies within the core portfolio delivering negative returns, which more than offset the positive impact from two other sub-strategies. The Alternatives strategy delivered a total return (before fees) of -1.54% versus a cash return of 0.52%.

The Equity Market Neutral and Dedicated Short Bias strategies made detracted from returns this quarter in line with expectations in a positive market. Similarly, the Managed Futures strategy contributed to performance, largely from positioning within Energy, Metals and Agriculture sectors and long positions in equity Index markets. The Convertible Arbitrage strategy benefitted from a

general appreciation of convertible bonds over the quarter, while event driven strategies made a small detraction.

In relation to our tactical positioning within the Alternatives component of the Fund, the overall positioning had a neutral impact on performance. Our long position in equity market futures, primarily in the US generated returns, although this contribution was offset by a long position in copper. At the end of July we re-established a short position in US bonds, having been either short or square since the end of February. The Gold position was switched from long to short at the end of July and Copper switched from long to short at the end of August.

Strategy and outlook

We are continuing to see growing dispersion in the performance of different capital markets, reflective of both fundamental and technical underlying forces. Consider the strength of US corporate earnings and the rise in the S&P500 Index which has increased by over 150% in the past seven years, together with US bond yields continuing on an upward path as the Fed normalises interest rates. This is considerably contrasted against the benign interest rate environment in Australia and Europe. We think that bond yields may continue to rise here, but ultimately they are unlikely to rise too far. The forthcoming RBA's Statement on Monetary Policy will provide a clearer picture into the likely path for monetary policy. But there is little to suggest that there is likely to be a change anytime soon.

In Europe, the central bank authorities are somewhat optimistic based on commentary on emerging inflation and employment data, but appear some way behind the curve of US monetary settings. These challenges in reflating and sustaining economies may persist due to imbalances across markets, which warrant a degree of caution. Growing dispersion is often accompanied by higher market volatility, which increases risk but also opportunities through mis-pricing. The recent spike in volatility has demonstrated that opportunities can arise when employing a dynamic approach to allocating capital. Pendal continues to apply its multi-faceted approach to generating additional returns on these investments and managing risks, most notably with a balanced allocation across traditional markets and the diversifying properties of alternatives.

Performance as at 30 September 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									
Total Return (post-fee, pre-tax)	-0.97	158	8.68	158	14.59	13.72	1154	8.51	10.05
Total Return (pre-fee, pre-tax)	-0.90	178	9.11	178	15.52	14.63	12.43	9.37	11.06
Benchmark	-1.19	150	9.99	150	14.03	11.50	12.16	8.19	9.99
Pendal Imputation Fund									
Total Return (post-fee, pre-tax)	-1.10	154	10.20	154	13.91	12.81	10.74	7.43	9.62
Total Return (pre-fee, pre-tax)	-1.02	177	10.69	177	14.94	13.82	1173	8.40	10.63
Benchmark	-1.19	150	9.99	150	14.03	11.50	12.16	8.19	8.79
Pendal Focus Australian Share Fund									
Total Return (post-fee, pre-tax)	-0.32	173	8.86	173	16.18	15.77	13.70	10.41	9.51
Total Return (pre-fee, pre-tax)	-0.24	194	9.03	194	17.38	17.23	14.83	11.53	10.63
Benchmark	-1.19	150	9.99	150	14.03	11.50	12.16	8.19	7.65
Pendal Ethical Share Fund									
Total Return (post-fee, pre-tax)	-0.74	194	8.38	194	14.14	13.82	1158	8.76	8.70
Total Return (pre-fee, pre-tax)	-0.67	2.18	8.90	2.18	15.23	14.90	12.64	9.79	9.76
Benchmark	-1.19	150	9.99	150	14.03	11.50	12.16	8.19	8.18
Australian Shares - Mid Cap									
Pendal MidCap Fund									
Total Return (post-fee, pre-tax)	0.58	177	7.46	177	21.19	16.20	18.61	15.25	11.08
Total Return (pre-fee, pre-tax)	0.65	2.00	7.73	2.00	22.91	17.69	19.93	16.79	13.30
Benchmark	-0.45	3.24	9.79	3.24	20.29	14.27	18.59	13.77	6.42
Australian Shares - Small Cap									
Pendal Smaller Companies Fund									
Total Return (post-fee, pre-tax)	-0.83	138	7.47	138	20.47	11.76	14.13	10.73	13.36
Total Return (pre-fee, pre-tax)	-0.74	170	8.14	170	21.98	13.15	15.55	12.11	14.66
Benchmark	-0.35	1.10	8.86	1.10	20.32	11.31	16.97	8.75	7.96
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund									
Total Return (post-fee, pre-tax)	1.16	4.39	7.68	4.39	16.71	11.95	19.34	17.88	18.55
Total Return (pre-fee, pre-tax)	1.25	4.70	8.33	4.70	17.46	13.76	21.29	21.67	23.67
Benchmark	-0.35	1.10	8.86	1.10	20.32	11.31	16.97	8.75	3.62
International Shares									
Pendal Core Global Share Fund									
Total Return (post-fee, pre-tax)	-0.34	5.95	9.55	5.95	16.97	16.73	10.37	14.36	6.10
Total Return (pre-fee, pre-tax)	-0.27	6.20	10.07	6.20	18.09	17.84	11.42	15.46	7.26
Benchmark	0.55	7.35	13.29	7.35	20.82	18.07	12.43	15.25	7.63
Pendal Global Emerging Markets Opportunities Fund - WS									
Total Return (post-fee, pre-tax)	-0.88	0.05	0.78	0.05	7.09	12.44	10.75	10.78	10.83
Total Return (pre-fee, pre-tax)	-0.76	0.40	1.49	0.40	8.59	14.00	12.30	12.44	13.02
Benchmark	-0.58	1.00	-3.49	1.00	7.56	13.34	11.25	9.07	10.30
Pendal Concentrated Global Share Fund									
Total Return (post-fee, pre-tax)	0.63	4.04	8.89	4.04	18.56	18.51	N/A	N/A	16.71
Total Return (pre-fee, pre-tax)	0.70	4.28	9.37	4.28	19.80	19.86	N/A	N/A	18.06
Benchmark	0.55	7.35	13.29	7.35	20.82	18.07	N/A	N/A	16.57
Property									
Pendal Property Securities Fund									
Total Return (post-fee, pre-tax)	-1.47	3.04	12.92	3.04	13.88	5.65	10.30	12.42	7.64
Total Return (pre-fee, pre-tax)	-1.42	3.21	13.28	3.21	14.61	6.34	11.02	13.15	8.45
Benchmark	-1.55	1.98	12.00	1.98	13.25	5.36	10.30	12.59	7.48
Pendal Global Property Securities Fund									
Total Return (post-fee, pre-tax)	-1.77	0.51	7.97	0.51	5.73	4.21	6.82	8.97	9.12
Total Return (pre-fee, pre-tax)	-1.71	0.73	8.44	0.73	6.69	5.17	7.80	9.98	10.12
Benchmark	-1.83	0.20	7.37	0.20	5.22	3.76	6.97	9.22	8.82
Fixed Interest									
Pendal Fixed Interest Fund									
Total Return (post-fee, pre-tax)	-0.71	-0.11	134	-0.11	3.32	0.85	180	3.90	6.34
Total Return (pre-fee, pre-tax)	-0.66	0.01	159	0.01	3.84	1.35	2.31	4.42	6.90
Benchmark	-0.42	0.54	136	0.54	3.72	1.46	2.85	4.28	6.57
Pendal Global Fixed Interest Fund									
Total Return (post-fee, pre-tax)	-0.95	-1.46	-0.87	-1.46	-0.18	-1.03	120	3.82	5.79
Total Return (pre-fee, pre-tax)	-0.91	-1.33	-0.61	-1.33	0.35	-0.51	174	4.37	6.37
Benchmark	-0.54	-0.66	-0.49	-0.66	0.79	-0.05	2.72	4.56	6.71
Pendal Enhanced Credit Fund									
Total Return (post-fee, pre-tax)	-0.18	0.69	131	0.69	3.45	2.49	3.26	4.38	5.68
Total Return (pre-fee, pre-tax)	-0.15	0.80	154	0.80	3.91	2.95	3.73	4.85	6.20
Benchmark	-0.16	0.77	154	0.77	3.60	2.52	3.33	4.38	5.79
Cash & Income									
Pendal Enhanced Cash Fund									
Total Return (post-fee, pre-tax)	0.22	0.64	1.17	0.64	2.50	2.82	2.72	2.84	4.90
Total Return (pre-fee, pre-tax)	0.24	0.70	130	0.70	2.76	3.07	2.97	3.10	5.23
Benchmark	0.16	0.52	101	0.52	1.87	1.82	1.94	2.19	4.83
Pendal Managed Cash Fund									
Total Return (post-fee, pre-tax)	0.16	0.48	0.93	0.48	1.82	1.82	1.94	2.16	6.39
Total Return (pre-fee, pre-tax)	0.18	0.53	104	0.53	2.04	2.04	2.16	2.39	6.69
Benchmark	0.16	0.52	101	0.52	1.87	1.82	1.94	2.19	6.46
Pendal Monthly Income Plus Fund									
Total Return (post-fee, pre-tax)	-0.24	0.79	194	0.79	4.92	3.63	4.01	4.51	5.43
Total Return (pre-fee, pre-tax)	-0.19	0.96	2.28	0.96	5.61	4.30	4.69	5.20	6.10
Benchmark	0.12	0.38	0.75	0.38	1.51	1.51	1.63	1.94	2.86
Diversified									
Pendal Active Balanced Fund									
Total Return (post-fee, pre-tax)	-0.69	149	5.25	149	9.16	9.05	7.71	7.98	7.69
Total Return (pre-fee, pre-tax)	-0.61	173	5.75	173	10.21	10.08	8.73	9.01	8.76
Benchmark	-0.41	2.31	6.95	2.31	10.79	8.97	8.96	8.22	7.55

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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

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