PENDAL

Fund Manager Commentary

Month ended 31 December 2018

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Market Review

Saved by the largest post-Boxing Day bounce since the GFC, the S&P/ASX 300 Accumulation Index managed to contain its losses to 0.2% in December. Nevertheless, it was a tough year for the domestic equity market, finishing the period 7.1% lower, or 3.1% after accounting for dividends. It is the first negative calendar year since 2011: Resources (+2.3%) continued to benefit from the elevated level of commodity prices, despite the recent plunge of the oil price; whilst Industrials (-4.3%) were the laggard. What started as a year of expected synchronised global growth ended up with US-China trade tensions, a tightening Fed that the market is fearful for its potential missteps, a tightening domestic credit market, as well as geopolitical uncertainties stemming from the Eurozone.

Sector performance was somewhat mixed in December, with five of the eleven GICS sectors finishing the month in the black. These include Materials (+5.1%), Health Care (+2.7%), Real Estate (+1.1%), Consumer Staples (+1.2%) and Utilities (+2.8%). Large miners, BHP (BHP, +11.5%) and Rio Tinto (RIO, +7.1%) led the gains within Materials, as investors favoured the surge in the iron ore price (+10%). In addition, BHP completed the US$5.2b off-market buy-back and confirmed a fully franked special dividend of US$1.02. Similarly, gold miners also recorded good performance, as investor rotation to safe haven assets against the backdrop of recent market volatilities supported the price of precious metals - gold in particular was 4.5% higher over the month. Offsetting some of these gains, Incitec Pivot (IPL, -12.8%) finished December in the red - IPL announced third party gas supply issues that are impacting operations at its Gibson Island, Phosphate Hill and St Helens plants. Building material manufacturer Adelaide Brighton (ABC, -17.6%) also downgraded its FY18 profit guidance by 7%, citing ramp-up delays at one of its major Australian infrastructure projects and a slow start to the 2H of the year in the Western Australian construction market.

Elsewhere, CSL (+4.4%) was the largest contributor to the Health Care sector, followed by Resmed (RMD, +6.2%), Ramsay (RHC, +6.2%) and Cochlear (COH, +2.5%). CSL held a well-received R&D day in December, providing insights into the company's pipeline of clinical programs. In particular, Seqirus is progressing well towards its production expansion of the cell-based influenza vaccines. Management also noted a number of early/late-stage products in development, which could be new additions to CSL's product suite. Hospital operator Ramsay also saw its share price rebound on the back of the improving trend of the UK NHS volumes. The latest October data released in December revealed that RHC gained market share in terms of admissions. It was a meaningful step-up compared to the September data, as well as that of the same period last year.

On the other side of the tally board, index heavy-weight Financials (-3.1%) were dragged down mainly by the banks. Three of the four ‘Big Four’ finished the month in the red, with the exception of Commonwealth Bank (CBA, +1.6%). The Reserve Bank of New Zealand released its initial consultation paper on banking system capital, which has direct implications for the Australian Big Four banks that constitute the bulk of the Kiwi system via their subsidiaries. The RBNZ’s proposal of minimum core tier one capital raised from 8.5% to 16% - versus 10.5% in Australia – appears quite penal. That said, this is an initial stance and there are questions over implementation, such as whether APRA would allow banks to offset the higher capital held in NZ against their domestic level. ANZ has the largest New Zealand NPAT exposure (30%) but is also best placed in terms of capital. The higher allocation of capital against its NZ business could see ANZ breach APRA’s limits on offshore capital, perhaps forcing it to partially float its NZ subsidiary. Outside the banks, insurance company QBE (QBE, -10.8%) was also a performance laggard - the drag from a reversal in yields has been exacerbated by the market’s disappointment with the cost saving strategy outlined over the month. The insurer has flagged a target of $120m of cost savings, on around $12b of premiums, while competitors Suncorp (SUN, -5.2%) and IAG (IAG, -3.8%) are delivering close to $200m savings off an $8b premium base. At the same time, an updated reinsurance arrangement has left investors feeling more cautious.

Portfolio performance

The Pendal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned -1.08% (post-fee, pre-tax) in December, underperforming its benchmark by 0.85%.

Contributors

Overweight BHP Billiton

The iron ore price surged in December, which in turn supported the share price of major miners, including BHP Billiton (BHP, +11.5%). It was led by the price increase of Chinese hot rolled coil (HRC), due to reports claiming the easing of property market restrictions in a number of China cities. In addition, BHP completed the US$5.2b off-market buy-back and confirmed a fully franked special dividend of US$1.02. Australian miners remain cash generative and disciplined in their capital allocation. We remain cautious near-term given the risks, but are keeping a close watch on the sector, ready to take advantage if we see sentiment turning too negative.

QBE Insurance Group – not held

QBE (QBE, -10.8%) had enjoyed a reasonable run on the back of higher bond yields. However, the drag from a reversal in yields has been exacerbated by the market's disappointment with the cost saving strategy outlined in December. The insurer has flagged a target of $120m of cost savings, on around $12b of premiums, while competitors Suncorp (SUN, -5.2%) and IAG (IAG, -3.8%) are delivering close to $200m savings off an $8b premium base. At the same time, an updated reinsurance arrangement has left investors feeling more cautious.

Overweight CSL

CSL (+4.1%) held a well-received R&D day in December, providing insights into the company's pipeline of clinical programs. In particular, Seqirus is progressing well towards its production expansion of the cell-based influenza vaccines, given their efficacy over the egg-based counterparts. Management also noted a number of early and late-stage products in development, which could be new additions to CSL's product suite. It remains our preferred growth stock, with earnings growth justifying the elevated rating.

Overweight Ramsay Health Care

Hospital operator Ramsay Health Care (RHC, +6.2%) saw its share price rebound on the back of the improving trend of the UK NHS volumes. The latest October data released in December revealed that RHC gained market share in terms of admissions. It was a meaningful step-up compared to the September data, as well as that of the same period last year. We retain our conviction in Ramsay, and stock valuation remains supportive.

Detractors

Overweight ANZ Banking Group

The Reserve Bank of New Zealand released its initial consultation paper on banking system capital, which has direct implications for the Australian Big Four banks that constitute the bulk of the Kiwi system via their subsidiaries. The RBNZ's proposal of minimum core tier one capital raised from 8.5% to 16% - versus 10.5% in Australia – appears quite penal. That said, this is an initial stance and there are questions over implementation, such as whether APRA would allow banks to offset the higher capital held in NZ against their domestic level. ANZ has the largest New Zealand NPAT exposure (30%) but is also best placed in terms of capital. The higher allocation of capital against its NZ business could see ANZ breach APRA's limits on offshore capital, perhaps forcing it to partially float its NZ subsidiary.

Overweight Metcash

The market was disappointed with Metcash's (MTS, -11.9%) result, despite a material improvement in underlying sales comps in its supermarkets business. While the liquor and hardware divisions continue to perform well, the market is focused on the IGA segment. The worry is that sales trends are declining and management are running out of areas to save costs and support earnings. We think the reaction is on the harsh side. The sales decline has slowed materially and is now driven by broader grocery deflation rather than competitive pressure, while we also believe there is further to go in terms of cost savings. MTS is on 10-11x NTM P/E, with a strong balance sheet, roughly 6% yield and continues to buy back stock. We still see opportunity here.

Overweight Caltex

Caltex (CTX, -7.4%) announced its FY18 profit guidance in December, which was below market consensus, largely attributed to lower refining margins. In addition, the unplanned outages at Lytton also contributed to the lowered profit guidance. Given the market rating (12x next-twelve-month PE) stock is trading at, we believe most of the negatives have been reflected in the share price.

Overweight Nine Entertainment

Nine Entertainment (NEC, -21.4%) sold off during the month despite reasonably positive underlying news, as the market focused on negative data in terms of TV ad growth – which was complicated by the timing of the NRL grand final – rather than management's upgraded synergy targets from the deal to merge with Fairfax (FXJ). Investors also remain jittery of the earnings outlook for Domain, which will be part of the new merged entity, given the weakening domestic property market.

Strategy and outlook

One interesting feature of market volatility in the last few months of 2018 is that some of the hardest-hit stocks were those that had outperformed in the first three quarters of the year. The withdrawal of market liquidity is clearly having an effect on the elevated rating of the growth stocks which had done well earlier in the year. However, fears over trade and global growth are also dragging on value stocks as well; the price/earnings de-rating has been greatest in the cheapest decile of stocks. This material shift in the market is pertinent for the portfolio, which underperformed over the quarter, driven in part by a decline in stocks such as Nine Entertainment (NEC) and Aristocrat Leisure (ALL) which had helped it outperform over the earlier part of the year.

NEC was the largest detractor in December, with the market wary over television advertising trends and the potential for a softer housing market to drag on earnings for Domain, its online property site. Here, the implied earnings drag only accounts for about half the price action, with a valuation de-rating from an already low multiple explaining the remainder. We have seen this trend – of a valuation de-rating rather than earnings-driven declines - across most of the market's worst-performing stocks during the quarter. This is also the case for some other recent portfolio detractors such as CYBG (CYB) and James Hardie (JHX). Sentiment-driven moves can create opportunities and we are looking closely among those stocks which have been hard hit; however, we remain mindful that valuation alone does not constitute an investment thesis and that for some of these stocks the market will need to see some signs of the cycle stabilising before a re-rating can occur.

We are in an environment of elevated macro uncertainty which, in combination with the persistent withdrawal of market liquidity as various central banks wind back quantitative easing and credit growth slows, is driving sharp swings in the market. The market has been focused on two issues;

the risks to growth from the Fed over-tightening rates and from trade friction between the US and China. The market has been in a more upbeat mood on both these issues in recent weeks, however uncertainties remain. Any disappointing developments here could see the market re-rest its December lows. At the same time, data suggests that both the Chinese and European economies continue to soften. The outcomes here are difficult to predict; the key takeaway, in our view, is that investors must remain mindful of a high-than-usual macro risk and position portfolios accordingly. We do not think it is the time to be driving large macro thematic risks through the portfolio in areas such as resources, currency or bond-sensitives given the degree of uncertainty.

Australian equities bounced back in late December from what looked to be on oversold level. While sentiment has improved, we remain relatively cautious on the near term outlook for the broad market given the macro uncertainty. The P/E de-rating has returned the Australian market to reasonably value at 14x next-12-month (NTM) P/E, sandwiched between the US market at 16x and Europe at 12x. The latter demonstrates the risk to the Australian market if the growth outlook starts to soften. However at this point we stand by our view that the domestic economy remains in reasonable shape, supported by growth in jobs, in wages, and by the boost to discretionary budgets from lower fuel and utility prices. It is important to keep a weather eye on the US, with the upcoming earnings season an important gauge.

While lower liquidity may act as a market headwind, it does mean that stock-specific factors assume increased prominence in determining returns and should see greater dispersion within the market. This environment plays to our strength as active stock pickers. Even as we counsel some caution on the market near-term, we have been buying specific stocks such as Ramsay Health Care (RHC) and Flight Centre where we think the sentiment-driven sell-off has created material mis-pricing given our view on the earning outlook.

Pendal Smaller Companies Fund

Market review

Similar to its large cap counterpart, S&P/ASX Small Ordinaries Accumulation Index lost ground in December, edging 4.2% lower. We saw the final quarter of 2018 wipe out gains from the two previous quarters completely, resulting in a total loss of 8.7% for the index over the year; with Small Industrials (-6.5%) outperforming Small Resources (-16.0%). The index now trades on a one-year forward Price/Earnings rating of 14.6x, representing a 3% discount to its five-year average.

All the eleven GICS sectors finished the month in the red, with the exception of the more defensive Real Estate (+2.5%). The largest detracting sector was Energy (-9.3%): While the ongoing decline of the global oil price, on the back of oversupply fears, dampened sentiment for the likes of Beach Energy (BPT, -11.8%) and Viva Energy (-8.9%), sector heavyweight WorleyParsons (WOR, -13.5%) was the largest performance detractor over the month. WOR provided an update on its recently announced acquisition of Jacobs ECR, where anti-trust regulatory clearance was obtained at the beginning of the month. The acquisition is expected to complete towards the end of the first quarter of 2019. Following this transaction and the latest index rebalancing, WOR is now a constituent of the S&P/ASX 100 index.

Elsewhere, index heavyweight Materials (-2.0%) outperformed the headline index in December. Following the recent market volatility the gold price has reacted positively as investors rotate to safe haven assets. This benefited the gold miners including Saracen Mineral (SAR, +18.6%), Regis Resources (RRL, +13.9%) as well as St. Barbara (SBM, +5.9%). Resolute Mining (RRL, +21.6%) also recorded outstanding gains, after commencing the sublevel cave mining at its Syama plant. (It is the world's first purpose built sublevel gold mine with full automation.) The positive gains however were more than offset by losses posted by the lithium miners. Galaxy Resources (GXY, -19.6%) reported lower pricing in the December quarter, attributed to weakening market conditions in China. The negative sentiment also extended to GXY's peer miners Pilbara Minerals (PLS, -25.6%) and Orocobre (ORE, -25.2%). Also dragging down the sector performance, rare earth miner Lynas (LYC, -24.5%) saw its shares sold off, following a review of its Malaysian operations. The local government now prohibits the accumulation of waste residue at LYC's domestic plant, a decision that the company is likely to appeal.

Some companies performed strongly over the month on the back of potential corporate transactions. These include Asaleo (AHY, +39.7%), Graincorp (GNC, +25.6%) and Sigma Healthcare (SIG, +16.3%). AHY managed to lock in a deal to sell its loss-making Australian Consumer Tissue business, at a price that exceeded market expectation. Management noted that the proceeds will be deployed towards paying down debt and the company will be able to focus more on its core personal care products. Gains from both GNC and SIG on the other hand come from non-binding indicative acquisition proposals - Long-Term Asset Partners offered $10.42/share to acquire GNC via a scheme of arrangement, whereas API was the suitor after SIG. The share price of both companies soared but settled below the offer price.

On the other side of the tally board, BWX (-52.1%) was the worst performing stock in December. Management now expects FY19 normalised EBITDA to be in the range of $27m - 32m, representing a 27% downgrade from that of FY18 and what Management previously guided. A combination of soft market conditions in China and a loss of sales momentum in the US was cited as the culprits.

Portfolio performance

The Pendal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned -4.61% (post-fee, pre-tax) in December, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.43%.

Contributors

Underweight WorleyParsons (WOR)

Engineering company WorleyParsons has underperformed the market over both the quarter and in December as the oil price weakened. At the same time, the company has raised capital to fund the purchase of Jacobs Engineering Group's Energy, Chemical and Resources division. This is an example of several deals across the market in 2018 which, while superficially accretive at an earnings per share level, have not been well particularly well received as the market expressed concern over the long-term return to be earned form the deal.

Overweight AUB Group (AUB)

Insurance brokers to small business AUB group – previously known as Austbrokers – was among the few stocks able to buck the market’s weakness and post a positive result for the month. It was helped in this regard by signs or further consolidation in the industry as Suncorp implemented a review of its general insurance distribution division.

Detractors

Underweight Graincorp (GNC)

Graincorp surged in early December following a non-binding, indicative takeover proposal from asset managers Long Term Asset Partners. We do not hold GNC, which dragged on relative performance.

Overweight Seven Group (SVW)

Seven Group is well placed to benefit both from the pick-up in mining capital expenditure and the pipeline of east coast transport infrastructure via its Coates Hire and Westrac businesses. It has been weak recently on the combined effect of slowing growth in US-listed Caterpillar (CAT) – Westrac is a Caterpillar dealer – as well as caution over mining more generally. We believe the implications from CAT's result are limited, with the critical need to increase mining spending a more important factor in driving SVW's medium-term outlook. At the same time, the company is benefiting from cyclical tailwinds in other parts of its portfolio, as well as recent technology investments which are improving margins, and better capital allocation as it cleans up its corporate structure.

Strategy and outlook

Both the month and quarter of December were volatile in the small cap market. We are in an environment of elevated macro uncertainty which, in combination with the persistent withdrawal of market liquidity as various central banks wind back quantitative easing and credit growth slows, is driving sharp swings in the Small Ordinaries and across the market more broadly.

The market has been focused on two issues; the risks to growth from the Fed over-tightening rates and from trade friction between the US and China. The market has been in a more upbeat mood on both these issues in recent weeks, however uncertainties remain – any disappointing developments here could see the market re-rest its December lows. At the same time, data suggests that both the Chinese and European economies continue to soften. The outcomes here are difficult to predict; the key takeaway, in our view, is that investors must remain mindful of a high-than-usual macro risk and position portfolios accordingly.

The recent falls have been broad-based. The withdrawal of market liquidity is clearly having an effect on the elevated rating of the growth stocks which had done well earlier in the year. This is evident in the Small Ordinaries in the underperformance of previous market darlings such as Afterpay Touch (APT). At the same time, a weaker oil price concerns over slowing Chinese demand have weighed on the resource sector – including the producers and the contractors who service them. However beyond this there were very few parts of the market which have proved immune to selling over the quarter.

At this point the broad earnings outlook remains relatively stable and it has been a valuation de-rating driving market falls. We think that the domestic economy remains in reasonable shape, supported by growth in jobs, in wages, and by the boost to discretionary budgets from lower fuel and utility prices. Small caps, in particular, harbour pockets of good growth in Australia – in areas such as agriculture, tourism, education and mining services. Given this view, the sentimental nature of recent falls can throw up opportunities. For example, we believe the outlook for mining services looks attractive as miners start to spend on long-delayed and much-needed replacement production and equipment maintenance.

Australian equities bounced back in late December from what looked to be on oversold level. While sentiment has improved, we remain relatively cautious on the near term outlook for the broad market given the macro uncertainty. The P/E de-rating has returned the Small Ordinaries index to 14.8x next-12-month (NTM) P/E, Several of the growth names remain on relatively demanding valuation given that excess market liquidity – which has been partly responsible for driving growth stock outperformance – is now declining. However other parts of the market are looking good value. While lower liquidity may act as a market headwind, it does mean that stock-specific factors assume increased prominence in determining returns and should see greater dispersion within the market. This environment plays to our strength as active stock pickers. So, even as we counsel some caution on the broad market near-term, we have been buying specific stocks where we think the sentiment-driven sell-off has created material mis-pricing given our view on the earning outlook.

International Shares

Pendal Concentrated Global Share Fund

Market review

Global equity markets experienced a broad-based sell-off in December to close the year in negative territory. The negative sentiment was symptomatic of a confluence of issues, ranging from political, economic growth and monetary policy concerns through to commodity prices and heightened valuation multiples within many of the growth oriented stocks. Investors became preoccupied with concerns over an impending global slowdown following an extended period of growth in the US and commenced selling the market. The crude oil price fell victim to such fears, falling to a 15-month low as investors weighed the probability of oversupply if economic growth slows and expansion of US shale output along with OPEC retaining a bias towards not cutting production.

The US share market experienced a significant devaluation as investors raised concerns over the extent to which Fed tightening in 2019 will impact growth. Trump's comments on Chairman Powell's impending actions to suggest they will stifle the economy's growth added to the bearish tone, along with the prospect of a Government shutdown in response to the impasse with Congress on funding of Trump's wall on the Mexican border. The shutdown came to fruition prior to Christmas. The environment saw investors shift towards defensive sectors like utilities, real estate and consumer staples and away from economically sensitive sectors like financials and energy. For the month the S&P500 lost 9.2% while the NASDAQ fell 9.5%.

European share markets experienced similar disdain as investors reacted to both offshore developments and regional concerns. The prevailing uncertainty over the Brexit deal and the prospect of a no deal outcome weighed on market confidence. Considering the implications for the broader economy in such a scenario, the Bank of England kept its official cash rate unchanged at 0.75%. Sector performance across the region was mixed and not reflective of a specific bias towards defensives, while a declining oil price weighed on energy and materials stocks. Social unrest in Paris also contributed to declines on France's stock exchange, leading to a monthly return of -5.5%, while the FTSE 100 lost 3.6% and Germany's DAX fell by 6.2%.

Asian equity markets exhibited a high degree of variance in returns, with some markets supported by an easing in trade tensions, lower oil prices and a lower US dollar. China's Shanghai Composite index ended the month 3.6% lower as investors focused on signs of further weakness in the domestic economy and the implications of weaker global growth. Hong Kong (-2.5%) was also carried in this direction, while the performance of Singapore (-1.6%), Korea (-3.8%), Taiwan (-1.6%) and Japan (-10.5%) highlighted the disparate nature of investor sentiment across the region.

The Australian dollar lost ground against all major currencies, reflecting the risk-off tone on equity markets and the slide in key commodity prices. The local unit rose 3.6% against the US dollar, 4.5% against the euro, 6.9% on the Japanese yen and 3.4% against the British pound. Commodity markets witnessed a strong correction as the crude oil price fell by 11% to close at US$45.40 per barrel and the Trade-Weighted Index (TWI) declined 4.1%. The Gold price naturally rose to a 5% gain, closing at US$1282.45.

Portfolio performance

The Pendal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned -3.71% (post fee, pre-tax) in December, outperforming its benchmark by 0.56%.

Notable this month was the underperformance of the US market relative to most other global markets, reversing a trend which has been in place for all of 2018. 2018 saw the S&P500 and the Nasdaq 100 down 1.7%, and 7%, respectively, posting their worst return since 2008, yet still outperforming most global markets for the year. The fund returned 3.58% in 2018. Markets in December were roiled by a combination of factors: Front and centre was the uncertainty regarding the US and China relationship, coupled with a US Government shut-down, the spectre of a more intrusive regulatory environment for big tech in 2019, and yet another delay in a Brexit resolution. The uncertainty was further exacerbated by mixed US data points, with US consumer confidence falling to levels not seen since July 2015, yet a Mastercard measure of the US consumer indicated overall retail spending across all payment types during the holiday sales period was the best in six years. FedEx cut 2019 earnings estimates, however pointed to moderate US growth, yet also noted the global economy had shifted downward rapidly, particularly in Europe. The US Federal Reserve ended the year with their fourth rate hike for 2018 (and their ninth increase since they began raising rates in 2016). Another two rate hikes have been forecast for 2019 rather than the previous forecast for three hikes. Unsurprisingly the VIX Index (a measure of volatility) eclipsed February 2018 highs in December.

Our holding in Rio Tinto outperformed this month, up 4.8% after announcing the completion of the sale of their interest in the Grasberg copper mine in Indonesia for US$3.5b. While the sale was flagged earlier in the year, terms were still subject to negotiations with both the operator Freeport McMoran and the Indonesian Government. Outstanding issues relating to the smelter, the environment and long term mining rights have now been resolved, and as a consequence Rio Tinto will have no further remaining interest in Grasberg. While RIO had rights to 40% of copper production over a production threshold until 2021, in reality RIO has received very little from the mine as production thresholds had not been met. The deal will satisfy the Indonesian Government's requirement for natural resources to be majority owned by the Government and allow RIO's management an opportunity to exit an agreement in which they were not the operator of the mine, a circumstance that current management had indicated posed unnecessary risks. The sale brings the total divestment proceeds over the last two years to >$11b. Over the same period, courtesy also of underlying strength in commodities, RIO has been able to return over $18b to shareholders. We look forward to getting a further update on their capital return program in February 2019.

Our holding in Pernod Ricard also outperformed this month, up 1.5% following the revelation that activist shareholder Elliot Management had accumulated a stake in "excess of 2.5%", noting Pernod's "outstanding portfolio of leading international spirit brands". While acknowledging Pernod's leading portfolio, Elliot have also called for a more aggressive "operational improvement plan". Pernod Ricard oversees13 strategic brands operating in 86 countries, with 90 production sites around the world. It is interesting that Elliot, an activist shareholder, has accumulated a stake with the stock price near all-time highs and with earnings showing solid momentum. While some in the market have pointed to that fact that operating margins are below that of peer Diageo, we would also highlight that Pernod have been focused on a strategy of delivering top-line growth. While they do have a cost-cutting initiative in place, half of profits are currently being reinvested into priority brands. The momentum in top-line growth (management guiding for 5-7% in 2019) will in our view lead to operational leverage over time, and result in an improvement in margins. Despite the shares being up in 2018 compared with a 7% fall in the CAC Index, the family shareholders who control 20% of the voting rights of the company continue to buy back shares. We remain confident that the company is being managed for long term success; the Elliot stake and the continued accumulation of shares by the family only serve to reinforce our confidence.

Our holding in Oracle underperformed this month (-7.4%) after reporting their second quarter results in December. While overall revenues came in at the high end of guidance, up 2% in constant currency terms, the quality of the earnings lift was questioned given the $10b buy-back (5% of company) and lower tax rate (offset somewhat by FX headwinds). We are however encouraged by the success Oracle appear to be having with their apps ecosystem which grew 7% year on year, courtesy of Netsuite and their Fusion Enterprise Resource Planning product. In the near term we feel the share price is underpinned by the remaining $10b of already authorised buyback, however in the longer term we believe that the Oracle's transition to a provider of cloud services on subscription will result in EPS growth driven by operating income rather than buybacks, which is not being reflected in current multiples.

Strategy and outlook

The current market volatility, while creating global headlines, in our view will also create investment opportunities. The volatility is a result of a transition in financial markets from an environment where investors benefitted from lower interest rates and excess liquidity. We are currently in the midst of transitioning to a higher interest rate environment and quantitative tightening, and as such we expect the volatility to continue. We are long term investors, and focused on owning companies that are equipped with robust business models, nimble management teams and dominant market shares. We buy these companies when valuations are compelling and have confidence they are able to withstand, but also prosper regardless of what the economic cycle has to offer. Our cash position stood at 14% at the end of December, and we look forward to deploying it in 2019 as opportunities arise.

Our view since fund inception has been that the normalisation of interest rates would lead investors to reassess their exposure across asset classes, resulting in increased market volatility. The geopolitical uncertainty that has beset markets for the last two years will also in our view only serve to exacerbate what we expect to be further volatility in markets. The pace of rate hikes appear to be slowing in the US, however global quantitative tightening appears to have some way to go. We do not claim to have a crystal ball in regard to the actions of Central Banks or Governments, however our portfolio has benefitted from a normalisation in interest rates since 2016. This has led to an uplift in earnings in a number of the fund's holdings, with share prices and multiples re-rating accordingly. We will continue to be disciplined in selling positons, which in our view no longer represent compelling long term value. We will also remain vigilant in looking for opportunities to buy businesses that are trading in our view at significant discounts to what we consider to be their long term value. We remain very much of the view that in order to optimise equity market returns, investors are best placed by owning a concentrated portfolio of companies, which are in strong positions to sustain their business models over the longer term.

Pendal Core Global Share Fund
(managed by AQR Capital Management)

Market review

Global equity markets experienced a broad-based sell-off in December to close the year in negative territory. The negative sentiment was symptomatic of a confluence of issues, ranging from political, economic growth and monetary policy concerns through to commodity prices and heightened valuation multiples within many of the growth oriented stocks. Investors became preoccupied with concerns over an impending global slowdown following an extended period of growth in the US and commenced selling the market. The crude oil price fell victim to such fears, falling to a 15-month low as investors weighed the probability of oversupply if economic growth slows and expansion of US shale output along with OPEC retaining a bias towards not cutting production.

The US share market experienced a significant devaluation as investors raised concerns over the extent to which Fed tightening in 2019 will impact growth. Trump's comments on Chairman Powell's impending actions to suggest they will stifle the economy's growth added to the bearish tone, along with the prospect of a Government shutdown in response to the impasse with Congress on funding of Trump's wall on the Mexican border. The shutdown came to fruition prior to Christmas. The environment saw investors shift towards defensive sectors like utilities, real estate and consumer staples and away from economically sensitive sectors like financials and energy. For the month the S&P500 lost 9.2% while the NASDAQ fell 9.5%.

European share markets experienced similar disdain as investors reacted to both offshore developments and regional concerns. The prevailing uncertainty over the Brexit deal and the prospect of a no deal outcome weighed on market confidence. Considering the implications for the broader economy in such a scenario, the Bank of England kept its official cash rate unchanged at 0.75%. Sector performance across the region was mixed and not reflective of a specific bias towards defensives, while a declining oil price weighed on energy and materials stocks. Social unrest in Paris also contributed to declines on France's stock exchange, leading to a monthly return of -5.5%, while the FTSE 100 lost 3.6% and Germany's DAX fell by 6.2%.

Asian equity markets exhibited a high degree of variance in returns, with some markets supported by an easing in trade tensions, lower oil prices and a lower US dollar. China's Shanghai Composite index ended the month 3.6% lower as investors focused on signs of further weakness in the domestic economy and the implications of weaker global growth. Hong Kong (-2.5%) was also carried in this direction, while the performance of Singapore (-1.6%), Korea (-3.8%), Taiwan (-1.6%) and Japan (-10.5%) highlighted the disparate nature of investor sentiment across the region.

The Australian dollar lost ground against all major currencies, reflecting the risk-off tone on equity markets and the slide in key commodity prices. The local unit rose 3.6% against the US dollar, 4.5% against the euro, 6.9% on the Japanese yen and 3.4% against the British pound. Commodity markets witnessed a strong correction as the crude oil price fell by 11% to close at US$45.40 per barrel and the Trade-Weighted Index (TWI) declined 4.1%. The Gold price naturally rose to a 5% gain, closing at US$1282.45.

Portfolio performance

The Pendal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned -4.11% (post-fee, pre-tax) in December, marginally underperforming its benchmark by 0.16%.

Most of the Fund's active returns were generated in Europe, with North America and developed Asia also producing mild outperformance.

Outperformance in Europe was driven positive performance of our business stability and management signalling factors, outweighing weakness in value themes. Conversely, outperformance in Japan was driven by positive performance in valuation themes, which was offset by weakness in momentum and stability factors. In the US, outperformance was due to the positive performance of stability and momentum themes, outweighing the negative performance of value and earnings quality signals.

From a stock and industry attribution perspective, intra-industry stock selection drove outperformance, while industry selection detracted from active returns over the month. At a sector level, an underweight in Utilities was the most notable detractor, while an underweight in Financials was the largest positive offset. Stock selection within industries was strongest within Financials, Energy and Consumer Staples, which outweighed the underperformance of active positioning within Materials and Consumer Discretionary.

At a stock level, the largest contributors to active returns came from underweight positions in Wells Fargo, a US multi-national financial services company; Citigroup, Inc., a US multi-national investment bank and financial services corporation; Exxon Mobil Corporation, a US-headquartered multi-national oil and gas corporation; Bank of America Corporation, a US multi-national investment bank and financial services company; and J.P Morgan Chase & Co., a US multi-national investment bank and financial services company. The largest detractors from active returns over the month came from overweight positions in Humana Inc., a for-profit US health insurance company; Southwest Airlines Co., a major US discount airline; HollyFrontier Corporation, a US petroleum refiner and distributor of petroleum products; Covestro AG, a producer of high tech polymers and adhesives, based in Germany; and Best Buy Co, Inc., a US-headquartered consumer electronics retailer operating in North America.

Strategy and outlook

Entering 2019, the largest sector tilts are overweights in Health Care and Consumer Discretionary and underweight positions in Financials and Consumer Staples.

Australian Fixed Income

Pendal Fixed Interest Fund

Market review

Australian bond yields sank on safe-haven demand as global equities endured a sizeable sell-off. A number of factors eroded investor confidence including ongoing trade war worries, the US government shutdown, weaker Chinese data and an unpopular rate hike from the Federal Reserve. In contrast, domestic monetary policy was again fairly uneventful with the RBA leaving the cash rate at 1.50%. Despite communication suggesting an eventual hike was preferred to a cut, market pricing for the next year shifted to the latter. The cash market was also guided by offshore developments as a widening in the US LIBOR-OIS spread fuelled a similar increase in its domestic BBSW-OIS cousin. Data-wise, a disappointing third quarter GDP figure revealed 0.3% growth over the quarter. Meanwhile, 37,000 jobs were added over the month and the unemployment rate ticked up to 5.1% (due to a rise in participation). Leading indicators were mixed with a fall in business conditions and confidence, but a small rise in retail sales and consumer confidence. Finally, Australian 3 and 10 year yields fell by 22bps and 27bps to 1.84% and 2.33% respectively. At the same time, 90 day BBSW rose 14bps to 2.09%.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned 1.14% in December (post-fees, pre-tax), underperforming its benchmark by 0.36%.

The portfolio underperformed its benchmark in December, which was driven by the alpha overlay. The FX strategy was the largest detractor due to a range of positions with the largest losses accumulated on a EUR/USD short and USD/MXN short. Other positioning in Europe including short Italian duration and a Euro Curve flattener resulted in negative returns overall for the Yield Curve and Duration strategies. The Macro strategy also detracted after being stopped out on short emerging market credit exposure mid-way through the month. Meanwhile, the US 5-year invoice spread trade cost performance in the Relative Value strategy. In contrast, the Cross-Market strategy added value from a long Europe, short Japan position. Finally, the government bond and credit components were flat versus their benchmarks.

Strategy and outlook

Fourth-quarter inflation data released in late January will be the key economic data release before the Reserve Bank's next meeting in February (no meeting is held in January). The recent movements in commodity prices along with the lack of imported inflation pressure despite a weaker currency, indicate that inflation will likely undershoot the Reserve Bank's inflation forecast in the first half of 2019. Add the weaker than expected economic growth data released in early December and it is difficult to see the Reserve Bank tightening monetary policy any time soon. The overnight index swap (OIS) market now implies that the next move from the Reserve Bank could be further monetary policy easing, assigning around a 45% probability at month end of a 25 basis point cut by the end of 2019.

Disappointing manufacturing survey data released in China and the United States in early January along with an earnings downgrade from Apple that cited the US-China trade war as part of the reason for weak iPhone sales in China are indicative of increasing risks to slowing global growth. Add political risks that remain with Brexit and Italy and a slowing European economy and the risks remain skewed to the downside. Credit markets are being affected by higher short end yields and reduced liquidity due to central bank balance sheet tightening in the United States.

Against such a backdrop it is not difficult to envisage the Reserve Bank leaving monetary policy unchanged over 2019. The Board will look through any near term inflation weakness, and wage inflation data released in late February will also be of interest given labour market strength and recent signs of some wage growth in Australia.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bond yields sank on safe-haven demand as equities endured a sizeable sell-off. A number of factors eroded investor confidence, including fears of a trade war escalation that were reignited after Huawei's CFO was arrested. Market concerns were later compounded by disagreements between Trump and House Democrats on US border protection funding, which eventuated in a partial US Government shutdown. Further sapping investor sentiment was an ill-received 25bps interest rate increase from the Federal Reserve and another two hikes projected 2019. Data-wise, payrolls revealed a softer-than-expected 155k addition and core PCE rose a marginal 0.1% to take the annual rate to 1.9%. Leading indicators were more encouraging as the ISM Manufacturing survey rose from 57.7 to 59.3 alongside an increase in consumer confidence over the month. Meanwhile, some progress was made on policy issues in Europe, including the Italian budget and UK PM Theresa May survived a leadership challenge. In Asia, weaker Chinese data added to investors' woes as the NBS gauge of manufacturing activity fell 0.6 to 49.4, firmly into contractionary territory. Finally the US 2 year and 10 year rates both fell by 30bps to 2.49% and 2.69% respectively.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned 1.72% in December (post-fees, pre-tax), underperforming its benchmark by 0.08%.

Over the month, the Macro strategy added to performance and Yield Curve strategy was flat, while Relative Value, Duration, Cross-Market and FX strategies detracted. The portfolio risk level started at 5 risk units and increased to 8 risk units before finishing the month at 6 risk units.

The Duration strategy detracted from performance over the month. The largest losses were from short duration positions along the Japanese curve in both the front end and the long end. Our short duration positions in the Italian BTPs also contributed to losses. However, we have a high conviction on the unsustainability of the Italian fiscal outlook and added to the position during the month. Related to this view, we continued to hold long duration positions in the German Bund and received position in EUR front end swap curve, both of which added to performance and neutralised the loss in short BTPs. In the month our tactical long duration position in US front end also added to performance as the market continued to price out Fed hikes.

The FX strategy detracted from performance over the month. The performance in DM currencies performance was roughly flat for the month. We reduced short USD and short EUR positions in the first half of the month. In EM currencies, long exposures via options in CNH and MXN incurred losses due to time decay and lower implied volatility. Long positions in IDR and PHP were added during the month and were broadly flat for the month. We also initiated short THB against SGD position as a structural way to express our concerns on the Thai economy. This position experienced some losses this month.

The Yield Curve strategy was largely flat over the month. We continued to hold our curve flattening position in the long end of Europe. Earlier in the month we added to the steepening position in NZD, and the steepening position in AUD was closed. All three positions recorded roughly flat performance for the month.

Macro strategy was the largest contributor of the month. Gains were mainly contributed by our buy protection positions in CDX HY, CDX IG and Europe Main. As credit widening accelerated we added buy protection positions in the US via CDX IG and HY. Credit spread moves in emerging markets were relatively muted and our positions in Korea and Turkey were largely flat.

The Relative Value strategy detracted from performance this month. Most of the losses were from the US 5-year invoice spread. The Australian 3-year EFP spread position was closed early in the month with flat performance.

The Cross-Market strategy experienced losses over the month, mainly from long Europe against short Japan in the front end of the curve. The long New Zealand vs short Australia front end was broadly flat in performance for the month.

Strategy and outlook

There is one theme from 2018 that is sure to repeat itself in 2019: the continued withdrawal of central bank liquidity, still led by the Fed. As we heard from Chairman Powell in December, quantitative tightening is still very much on auto-pilot. The first round of pain hit emerging markets in 2018, but the subsequent rounds are likely to hit closer to home, especially the over-levered parts of corporate America. Already, December saw the lowest US corporate bond issuance volumes since 2011. As such, the majority of our short credit exposures are focused on US investment grade and high yield, and we maintain our structural short exposure to European credit as our bearish economic outlook for the Eurozone remains unchanged. In addition, we've also increased our short BTP exposure this month as we take advantage of the improved sentiment surrounding the passing of the Italian budget. In our view, avoiding EU disciplinary measures is not a 'win' when the result will be recession and a ballooning Italian debt-to-GDP ratio.

Credit

Pendal Enhanced Credit Fund

Market review

Domestic credit generated another positive return for the month. This was driven by a fall in underlying yields that more than offset an increase in credit spreads. A broad deterioration in risk appetite and sell-off in global equities drove demand for safe-havens during the period. This was linked to ongoing trade war worries, the US government shutdown, weaker Chinese data and an unpopular rate hike from the Federal Reserve.

Amid the risk-off environment, primary issuance in Australia was practically non-existent. Although issuance is typically lighter during the holiday season, it was the weakest December on record. It also followed sizeable issuance during November. The only deal from a domestic issuer during the final month of the year was from Bank of Queensland for A$100m.

Finally, the Australian iTraxx index (Series 30 contract) traded in a wide 14p range finishing the month 8bps wider to +95bps. On average, physical credit spreads closed the month 4bps wider, with the worst performing sectors being infrastructure and utilities both pushing out +8bps. The best performing sector was supranationals which was 3bps wider. Semi-government bonds also underperformed widening 4bps to government bonds over the month.

Portfolio performance

The Pendal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 0.89% in December (post-fees, pre-tax), matching the benchmark return.

A fall in underlying rates was the largest contributor to returns, which more than offset a widening in physical credit spreads. Positions in infrastructure and utilities, where the fund is overweight, underperformed versus other sectors. Portfolio purchases over the period included ANZ and Airport Motorway Trust.

Strategy and outlook

Our overall credit view remains neutral. We have been constructive on corporate fundamentals, but are also wary that sentiment towards credit has deteriorated recently. This has been driven by broader macro concerns as well as fears that troubles for specific US corporates, such as GE, could reflect broader systemic issues. However, we believe corporate fundamentals on balance are healthy for the bulk of investment grade issuers. Balance sheets are generally strong and earnings are improving as evidenced by solid corporate earnings seasons in 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.

From a macro standpoint, we acknowledge that risks have risen due to increasing volatility across markets. This has been driven in part by flare-ups of geopolitical risks and less forgiving markets. This was reflected by the Italian political uncertainty in May, the rout in emerging markets from mid-year and ongoing Sino-US trade tensions. That said, the impact of developments such as trade wars and attitudes towards monetary policy normalisation have shown a tendency to shift quickly. For example in December, the Fed's decision to hike rates, although well-broadcast in advance, was poorly received by markets.

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

Cash

Pendal Managed Cash Fund and Pendal Enhanced Cash Fund

Market review

Australian bond yields followed their global counterparts lower during the month. Their sizeable fall was tied to broad risk-off sentiment and a significant sell-off in equities that drove investors to safe-haven assets. While there was no clear catalyst, a number of causes were cited including ongoing trade war concerns, the US government shutdown, weaker Chinese data and an unpopular rate hike from the Federal Reserve.

In contrast, domestic monetary policy was again fairly uneventful with the RBA leaving the cash rate unchanged at 1.50%. Communication over the month continued to suggest that the Board's bias was towards an eventual hike rather than a cut. Nonetheless, market pricing shifted over the month and projected a cut was more likely over the coming year. The cash market was also guided by offshore developments as a widening in the US LIBOR-OIS spread fuelled a similar increase in its domestic BBSW-OIS cousin.

In terms of domestic data, a disappointing third quarter GDP figure revealed 0.3% growth over the quarter, which brought the year-on-year rate to 2.8%. Employment figures were more mixed with 37k jobs added and an increase in the unemployment rate to 5.1% (due to a rise in participation). Leading indicators were also mixed with a fall in business conditions and confidence, but a small rise in retail sales and consumer confidence.

In the US, there were a number of headlines that guided investors over the month. After a 90 day trade war truce was settled at the outset of December, fears of an escalation were reignited after Huawei's CFO was arrested on charges of breaching sanctions against Iran. Concerns were later compounded by disagreement between Trump and House Democrats on US border protection funding, which eventuated in a partial US Government shutdown.

Making matters worse was an ill-received 25bps interest rate increase from the Federal Reserve over the month. The FOMC also indicated the potential for another two hikes in 2019 and one more in 2020. The ratchet higher was not overwhelmingly supported by data during the month with payrolls revealing a softer-than-expected 155k addition. Core PCE also rose a marginal 0.1% to take the annual rate to 1.9%. Leading indicators were more encouraging as the ISM Manufacturing survey rose from 57.7 to 59.3 alongside an increase in consumer confidence over the month.

Looking elsewhere, political problems in Europe found some respite, but are arguably far from being completely resolved. Italian policymakers made concessions to bring their budget deficit closer to the 2.0% limit imposed by the European Commission. Meanwhile, forward-looking data for the Eurozone softened as the Composite PMI slid 1.4 points to 51.3 and consumer confidence fell 3.9 points to -6.2. Further north, UK PM Theresa May survived a leadership challenge, but remained unable to reach an agreement on a Brexit deal.

In Asia, weaker Chinese data added to investors' woes as the NBS gauge of manufacturing activity fell 0.6 to 49.4. This was the fourth consecutive decline and brought the measure into contractionary territory and its lowest level since February 2016. Industrial production, exports and retail sales were also weaker than prior months.

Finally on market movements, Australian 3 and 10 year yields fell by 22bps and 27bps to 1.84% and 2.33% respectively. In contrast, 90 day BBSW rose 14bps to 2.09%. In the US, the 2 year and 10 year rates both fell by 30bps to 2.49% and 2.69% respectively. Meanwhile the Australian Dollar fell by 3.5% as the risk-off environment overshadowed a 9.8% recovery in iron ore prices.

In credit markets, spreads for major global CDS indices widened with the broader sell-off in risk-assets. This was tied to the aforementioned drivers including trade war developments, the rate hike from the Federal Reserve, weaker Chinese data as well as another sizeable leg lower for crude oil prices. US corporates also remained out-of-favour as mass closures by GM and tainted baby powder from Johnson & Johnson added to concerns created by GE in the previous month.

The Australian iTraxx index (Series 30 contract) traded in a wide 14p range finishing the month 8bps wider to +95bps. On average, physical credit spreads closed the month 4bps wider, with the worst performing sectors being infrastructure and utilities both pushing out +8bps. The best performing sector was supranationals which was 3bps wider. Semi-government bonds also underperformed widening 4bps to government bonds over the month.

Portfolio performance

Managed Cash

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

With a higher running yield than the index the fund remains well positioned to outperform. Themes and credit exposure remain consistent with prior months, with excess spread from A-1 rated issuers and yield curve positioning likely to be the main driver of outperformance. The fund ended the month with a weighted average maturity of 62 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. The widening Libor-OIS spread in the US spilled over to the Australian short end with BBSW rates moving higher over the month. The fund was well positioned for this and extended the weighted average maturity later in the month at higher yields.

Enhanced Cash

The Pendal Enhanced Cash Fund (formerly the BT Wholesale Enhanced Cash Fund) returned 0.14% in December (post-fees, pre-tax) underperforming the benchmark by 0.01%.

The positive accrual of the fund was offset by widening credit spreads. We continued to reduce credit exposure given our cautious outlook. Activity included reducing exposure to financials, industrials and infrastructure while increasing our cash weighting.

As at the end of the month, the fund had a credit spread of 54bps over bank bills, interest rate duration of 0.14 years and credit spread duration of 0.95 years.

Strategy and outlook

Fourth quarter inflation data released in late January will be the key economic data release before the Reserve Bank's next meeting in February (no meeting is held in January). The recent movements in commodity prices, along with the lack of imported inflation pressure despite a weaker currency, indicate that inflation will likely undershoot the Reserve Bank's inflation forecast in the first half of 2019. Add the weaker than expected economic growth data released in early December and it is difficult to see the Reserve Bank tightening monetary policy any time soon. The overnight index swap (OIS) market now implies that the next move from the Reserve Bank could be further monetary policy easing, assigning around a 45% probability at month end of a 25 basis point cut by the end of 2019.

Disappointing manufacturing survey data released in China and the United States in early January along with an earnings downgrade from Apple that cited the US-China trade war as part of the reason for weak iPhone sales in China are indicative of increasing risks to slowing global growth. Add political risks that remain with Brexit and Italy and a slowing European economy and the risks remain skewed to the downside. Credit markets are being affected by higher short end yields and reduced liquidity due to central bank balance sheet tightening in the United States.

Against such a backdrop it is not difficult to envisage the Reserve Bank leaving monetary policy unchanged over 2019. The Reserve Bank will look through any near term inflation weakness and wage inflation data released in late February will also be of interest given labour market strength and recent signs of some wage growth in Australia.

Australian Property

Pendal Property Securities Fund

Market review

The ASX 300 A-REIT index was up 1.7% in December, outperforming the ASX 300 (-0.2%) by 190bp. Over 2018, A-REITs were +3.3%, 6.3% ahead of the broader market. The key themes for the month were capital raisings, ongoing buy back activity and asset valuation updates. Globally REITs were -5.4% (in USD terms) for the month.

During the month, Charter Hall Long WALE raised $125m in equity to acquire a $207m agri-logistics portfolio, leased on long term leases to Inghams. Centuria Industrial Trust also raised $51m in equity to acquire two industrial properties. Vicinity Centres, Mirvac Group and Lend Lease continued to buy back shares. Stockland Trust Group announced the $202m sale of its Grove residential estate in Melbourne to Frasers Australia. The sale was at a 59% premium to book value and will crystalise a $75m profit, to be released between FY19-21. Directors of Propertylink Group accepted ESR’s $1.20 cash offer. Also during the period a number of REITs announced asset revaluations, with industrial and office assets continuing to show solid gains (GPT, DXS), however a number of retail REITs either showed cap rates levelling out (AVN @ 6.7%) or softening (SCP cap rates increased 4bp to 6.37%).

In the US, the S&P500 was down 9% in December, with investors concerned about a slowdown in activity caused by Chinese trade tensions, slowing data in China/EU and a rising Fed Fund rate. This saw the yield curve flatten and actually invert in the middle of the curve (2/5 year spread). Despite this, the US economy continues to perform well with unemployment of 3.9% and core retail sales +0.7%, slightly ahead of market expectations.

In Australia, the RBA left interest rates on hold, employment rose solidly (+28.8k) and the unemployment rate fell from 5.2% to 5.1%. However, data released in December showed GDP growth slowed in 3Q18 to 2.8%, down from 3.1% in the pcp, driven largely by a slowdown in household spending. The household savings rate declined to 2.4%, the lowest level since the GFC. The Australian dollar fell 3.6% versus the USD and the 10 year bond yield fell 27bp to 2.32%.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned 2.33% in December (post-fee, pre-tax), outperforming its benchmark by 0.60%.

The portfolio outperformed over the month with positive attribution from overweight positions in GDI Property Group and Charter Hall Group and underweight positions in Unibail Rodamco Westfield, Vicinity Centres and Investa Office Fund. Underweight positions in Viva Energy REIT, Abacus Property Group and Growthpoint Properties and overweight positions in Lifestyle Communities and Rural Funds Group detracted from performance.

Over the month we moved from underweight to overweight positions in Scentre Group and GPT Group and increased our overweight position in Mirvac Group. This was funded by exiting our position in Propertylink as well as moving our position in Unibail Rodamco Westfield from an overweight to an underweight. We also reduced our overweight positions in Charter Hall Group, Dexus Property Group and Goodman Group and increased our underweight in Stockland Trust Group.

Strategy and outlook

The A-REIT sector is now priced on an FY19 dividend yield of 5.5%, a P/E ratio of 16.6 times and a 19% premium to NTA, slightly above its long-term average of 16%. 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 28%.

International Property

Pendal Global Property Securities Fund

(managed by AEW)

Market review (in US$)

Performance of the global property securities market (on an ex-Australia basis) as measured by the FTSE EPRA Nareit Developed Index was negative in December with a total return of -5.6%. North America (-8.1%) was the weakest performer, followed by Europe (-4.0%) and Asia Pacific (-0.2%). In Europe, results were largely negative across the region. Finland (-9.5%) posted the largest decline, followed by the Netherlands (-9.3%) and Ireland (-5.7%). Sweden (+3.7%), Belgium (+2.4%) and Norway (+1.3%) were notable positive performers within the region. Results in Asia Pacific were mixed. New Zealand (-1.0%) posted the largest decline, followed by Japan (-0.8%), while Hong Kong (+0.6%) and Singapore (+0.4%) were positive performers. Within North America, the US and Canada returned -8.2% and -6.4%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund (formerly the BT Wholesale Global Property Securities Fund) returned -6.28% in December (post-fee, pre-tax), outperforming the benchmark by 0.13%.

North America

The North America portfolio returned -8.15% in December (before fees and taxes), slightly trailing the FTSE EPRA Nareit North America Index by two basis points. Marginal underperformance relative to the benchmark was driven by negative sector allocation results, while stock selection results were largely neutral. Regarding sector allocation, slightly negative results were driven by the portfolio's underweight to the outperforming triple net lease sector. In terms of stock selection, results were strongest in the health care, industrial, and diversified sectors and were weakest in the triple net lease, shopping center, and regional mall sectors. Among the portfolio's holdings, top individual contributors to relative performance included an overweight position in the outperforming American Assets Trust (AAT), an underweight position in the underperforming Prologis (PLD), and a lack of exposure to the underperforming SL Green Realty (SLG). Detractors most notably included overweight positions in the underperforming Pennsylvania REIT (PEI) and Boston Properties (BXP), and a lack of exposure to the outperforming Realty Income (O).

Europe

The European portfolio returned -3.87% in December (before fees and taxes), outperforming the regional EPRA benchmark by 13 basis points. Outperformance relative to the benchmark was driven by positive country allocation results and, to a lesser extent, positive stock selection results. Regarding country allocation, positive results were attributable to the portfolio's overweight to the outperforming markets of Sweden and Norway. In terms of stock selection, results were strongest in Sweden, the Netherlands and Spain and were weakest in France, the United Kingdom and Germany. Among the portfolio's holdings, top contributors to relative performance included overweight positions in the outperforming Fabege AB (Sweden), Wihlborgs Fastigheter AB (Sweden), and Entra ASA (Norway). Detractors most notably included overweight positions in the underperforming Vonovia SE (Germany) and Gecina SA (France), and a lack of exposure to the outperforming Fastighets AB Balder B (Sweden).

Asia

The Asia portfolio returned -0.27% in December (before fees and taxes), trailing the regional EPRA benchmark by 11 basis points. Underperformance relative to the benchmark was attributable to negative stock selection results in Japan, which were partially offset by positive results in Hong Kong and Singapore. Country allocation results were neutral. Among the portfolio's holdings, top contributors to relative performance included a lack of exposure to the underperforming Aeon Mall (Japan) and Hang Lung Properties (Hong Kong), and an overweight position in outperforming Link REIT (Hong Kong). Detractors included an overweight position in the underperforming Mitsui Fudosan (Japan) and a lack of exposure to the outperforming Japan Retail Fund Investment (Japan) and Japan Hotel REIT Investment (Japan).

Active Balanced

Pendal Active Balanced Fund

Markets review

Saved by the largest post-Boxing Day bounce since the GFC, the S&P/ASX 300 Accumulation Index managed to contain its losses to 0.2% in December. Nevertheless, it was a tough year for the domestic equity market, finishing the period 7.1% lower, or 3.1% after accounting for dividends. It is the first negative calendar year since 2011: Resources (+2.3%) continued to benefit from the elevated level of commodity prices, despite the recent plunge of the oil price; whilst Industrials (-4.3%) were the laggard. What started as a year of expected synchronised global growth ended up with US-China trade tensions, a tightening Fed that the market is fearful for its potential missteps, a tightening domestic credit market, as well as geopolitical uncertainties stemming from the Eurozone. Sector performance was somewhat mixed in December, with five of the eleven GICS sectors finishing the month in the black. These include Materials (+5.1%), Health Care (+2.7%), Real Estate (+1.1%), Consumer Staples (+1.2%) and Utilities (+2.8%).

Global equity markets experienced a broad-based sell-off in December to close the year in negative territory. The negative sentiment was symptomatic of a confluence of issues, ranging from political, economic growth and monetary policy concerns through to commodity prices and heightened valuation multiples within many of the growth oriented stocks. Investors became preoccupied with concerns over an impending global slowdown following an extended period of growth in the US and commenced selling the market. The crude oil price fell victim to such fears, falling to a 15-month low as investors weighed the probability of oversupply if economic growth slows and expansion of US shale output along with OPEC retaining a bias towards not cutting production.

The US share market experienced a significant devaluation as investors raised concerns over the extent to which Fed tightening in 2019 will impact growth. Trump's comments on Chairman Powell's impending actions to suggest they will stifle the economy's growth added to the bearish tone, along with the prospect of a Government shutdown in response to the impasse with Congress on funding of Trump's wall on the Mexican border. The shutdown came to fruition prior to Christmas. The environment saw investors shift towards defensive sectors like utilities, real estate and consumer staples and away from economically sensitive sectors like financials and energy. For the month the S&P500 lost 9.2% while the NASDAQ fell 9.5%.

European share markets experienced similar disdain as investors reacted to both offshore developments and regional concerns. The prevailing uncertainty over the Brexit deal and the prospect of a no deal outcome weighed on market confidence. Considering the implications for the broader economy in such a scenario, the Bank of England kept its official cash rate unchanged at 0.75%. Sector performance across the region was mixed and not reflective of a specific bias towards defensives, while a declining oil price weighed on energy and materials stocks. Social unrest in Paris also contributed to declines on France's stock exchange, leading to a monthly return of -5.5%, while the FTSE 100 lost 3.6% and Germany's DAX fell by 6.2%.

Asian equity markets exhibited a high degree of variance in returns, with some markets supported by an easing in trade tensions, lower oil prices and a lower US dollar. China's Shanghai Composite index ended the month 3.6% lower as investors focused on signs of further weakness in the domestic economy and the implications of weaker global growth. Hong Kong (-2.5%) was also carried in this direction, while the performance of Singapore (-1.6%), Korea (-3.8%), Taiwan (-1.6%) and Japan (-10.5%) highlighted the disparate nature of investor sentiment across the region.

The Australian dollar lost ground against all major currencies, reflecting the risk-off tone on equity markets and the slide in key commodity prices. The local unit rose 3.6% against the US dollar, 4.5% against the euro, 6.9% on the Japanese yen and 3.4% against the British pound. Commodity markets witnessed a strong correction as the crude oil price fell by 11% to close at US$45.40 per barrel and the Trade-Weighted Index (TWI) declined 4.1%. The Gold price naturally rose to a 5% gain, closing at US$1282.45.

Australian bond yields sank on safe-haven demand as global equities endured a sizeable sell-off. A number of factors eroded investor confidence including ongoing trade war worries, the US government shutdown, weaker Chinese data and an unpopular rate hike from the Federal Reserve. In contrast, domestic monetary policy was again fairly uneventful with the RBA leaving the cash rate at 1.50%. Despite communication suggesting an eventual hike was preferred to a cut, market pricing for the next year shifted to the latter. The cash market was also guided by offshore developments as a widening in the US LIBOR-OIS spread fuelled a similar increase in its domestic BBSW-OIS cousin. Data-wise, a disappointing third quarter GDP figure revealed 0.3% growth over the quarter. Meanwhile 37k jobs were added over the month and the unemployment rate ticked up to 5.1% (due to a rise in participation). Leading indicators were mixed with a fall in business conditions and confidence, but a small rise in retail sales and consumer confidence. Finally, Australian 3 and 10 year yields fell by 22bps and 27bps to 1.84% and 2.33% respectively. At the same time, 90 day BBSW rose 14bps to 2.09%.

Global bond yields sank on safe-haven demand as equities endured a sizeable sell-off. A number of factors eroded investor confidence, including fears of a trade war escalation that were reignited after Huawei's CFO was arrested. Market concerns were later compounded by disagreements between Trump and House Democrats on US border protection funding, which eventuated in a partial US Government shutdown. Further sapping investor sentiment was an ill-received 25bps interest rate increase from the Federal Reserve and another two hikes projected 2019. Data-wise, payrolls revealed a softer-than-expected 155k addition and core PCE rose a marginal 0.1% to take the annual rate to 1.9%. Leading indicators were more encouraging as the ISM Manufacturing survey rose from 57.7 to 59.3 alongside an increase in consumer confidence over the month. Meanwhile, some progress was made on policy issues in Europe, including the Italian budget and UK PM Theresa May survived a leadership challenge. In Asia, weaker Chinese data added to investors' woes as the NBS gauge of manufacturing activity fell 0.6 to 49.4, firmly into contractionary territory. Finally the US 2 year and 10 year rates both fell by 30bps to 2.49% and 2.69% respectively.

Portfolio performance

The Pendal Active Balanced Fund (formerly the BT Wholesale Active Balanced Fund) returned -1.05% (post-fee, pre-tax) for the month of December, underperforming its benchmark by 0.22%.

The Fund's negative return for the December quarter was largely a function of its exposure to Australian and offshore equity markets which declined in value through the month. Exposure to alternatives also detracted from returns. Diversification through exposure to Australian and global fixed income delivered positive contributions to performance as Australian and US bond yields eased.

Underperformance was primarily driven by manager contribution within Australian equities and alternatives. Our tactical asset allocation decisions saw the Fund's underweight exposure to Australian and global equities contribute to relative returns.

The key factors influencing the alpha generated through active management were stock selection outcomes within Australian equities. Within the Australian equity strategy, overweight positions in BHP Billiton, CSL and Ramsay Health Care, plus holding no exposure to QBE Insurance Group contributed to returns. These contributions were more than offset by overweight positions in ANZ Banking Group, Metcash, Nine Entertainment and Caltex.

Within the global equities portfolio, the Concentrated and Dynamic Market equity strategies significantly outperformed their benchmarks while the core strategy detracted from relative performance.

Our Alternatives core portfolio registered a negative return this month, whereby four of the eight sub-strategies delivered negative returns, while two had a positive impact and the remaining two strategies were neutral in impact. The Alternatives strategy delivered a total return (before fees) of –0.05% versus a cash return of 0.15%.

The Equity Market Neutral, Dedicated Short Bias and Long-Short Equity generated positive returns this month. The Equity Market Neutral strategy benefited from strong performance of Quality and Sentiment themes over the month while the other two benefited from weakness in equity markets. Meanwhile, the Global Macro strategy was negatively impacted by developed currency, developed bond, and global interest rate relative-value sub-strategies.

In relation to our tactical positioning within the Alternatives component of the Fund, the overall positioning had a negative impact on performance. Gains through short positions in certain equity market futures were offset by losses in others, together with detractions from volatility positioning.

Strategy and outlook

We are in an environment of elevated macro uncertainty which, in combination with the persistent withdrawal of market liquidity as various central banks wind back QE and credit growth slows, is driving sharp swings in share markets. Key risks to growth are centred around two primary issues – the potential for over-tightening of interest rates in the US and the future of trade policy between the US and China. The market has been in a more upbeat mood on both these issues in recent weeks, although uncertainties remain and any disappointing developments here could see the market re-test its December lows. Europe's economy is also continuing to soften and given present uncertainties around the nature of Brexit this presents an additional area of risk.

Volatility in equity markets witnessed in recent weeks have naturally made investors feel uncomfortable. However, as we have discussed recently, this can be seen as a return to more normal market conditions. Even with the turmoil experienced in the S&P500 in February, April, October and December, the actual volatility of returns is not out of step with many other historical observations. Volatility also provides opportunities to acquire undervalued assets and we are focused on identifying areas to add value.

We will continue to apply a multi-faceted approach to generating additional returns on investments and managing risks, most notably with a balanced allocation across traditional markets and the diversifying properties of alternatives.

Performance as at 31 December 2018

(%)	1 Month	3 Months	6 Months	FYTD	1 year (pa)	2 Years (pa)	3 Years (pa)	5 Years (pa)	Since Incp. (pa)
Australian Shares - All Cap									
Pendal Australian Share Fund									**APIR - RFA0818AU**
Total Return (post-fee, pre-tax)	-1.08	-10.40	-8.99	-8.99	-4.61	4.75	5.08	5.40	9.49
Total Return (pre-fee, pre-tax)	-1.02	-10.23	-8.63	-8.63	-3.86	5.59	5.91	6.24	10.49
Benchmark	-0.23	-8.41	-7.03	-7.03	-3.06	4.17	6.65	5.60	9.52
Pendal Imputation Fund									**APIR - RFA0103AU**
Total Return (post-fee, pre-tax)	-0.78	-8.46	-7.05	-7.05	-1.83	4.63	5.26	4.84	8.98
Total Return (pre-fee, pre-tax)	-0.71	-8.25	-6.63	-6.63	-0.95	5.57	6.21	5.78	9.99
Benchmark	-0.23	-8.41	-7.03	-7.03	-3.06	4.17	6.65	5.60	8.17
Pendal Focus Australian Share Fund									**APIR - RFA0059AU**
Total Return (post-fee, pre-tax)	-1.64	-11.24	-9.71	-9.71	-4.33	5.51	6.33	6.95	8.38
Total Return (pre-fee, pre-tax)	-1.58	-11.09	-9.37	-9.37	-3.36	6.80	7.27	8.04	9.49
Benchmark	-0.23	-8.41	-7.03	-7.03	-3.06	4.17	6.65	5.60	6.82
Pendal Ethical Share Fund									**APIR - RFA0025AU**
Total Return (post-fee, pre-tax)	-1.51	-10.94	-9.21	-9.21	-5.65	4.11	4.75	5.62	7.86
Total Return (pre-fee, pre-tax)	-1.43	-10.73	-8.78	-8.78	-4.75	5.11	5.75	6.63	8.91
Benchmark	-0.23	-8.41	-7.03	-7.03	-3.06	4.17	6.65	5.60	7.52
Australian Shares - Mid Cap									
Pendal MidCap Fund									**APIR - BTA0313AU**
Total Return (post-fee, pre-tax)	-2.55	-14.11	-12.59	-12.59	-7.23	7.60	9.07	10.66	9.21
Total Return (pre-fee, pre-tax)	-2.47	-13.91	-12.19	-12.19	-5.82	8.98	10.19	12.05	11.37
Benchmark	-2.56	-13.31	-10.50	-10.50	-7.39	6.44	9.69	9.81	4.83
Australian Shares - Small Cap									
Pendal Smaller Companies Fund									**APIR - RFA0819AU**
Total Return (post-fee, pre-tax)	-4.61	-15.30	-14.13	-14.13	-7.44	4.07	3.85	6.67	12.51
Total Return (pre-fee, pre-tax)	-4.51	-15.03	-13.59	-13.59	-6.28	5.37	5.14	8.00	13.79
Benchmark	-4.18	-13.70	-12.75	-12.75	-8.67	4.70	7.45	5.62	7.27
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund									**APIR - RFA0061AU**
Total Return (post-fee, pre-tax)	-2.81	-12.27	-8.42	-8.42	-7.64	6.95	9.23	14.08	16.96
Total Return (pre-fee, pre-tax)	-2.53	-11.87	-7.73	-7.73	-6.40	8.71	10.93	17.56	21.95
Benchmark	-4.18	-13.70	-12.75	-12.75	-8.67	4.70	7.45	5.62	2.36
International Shares									
Pendal Core Global Share Fund									**APIR - RFA0821AU**
Total Return (post-fee, pre-tax)	-4.11	-13.90	-8.78	-8.78	-4.75	4.23	4.47	8.23	5.43
Total Return (pre-fee, pre-tax)	-4.03	-13.69	-8.34	-8.34	-3.84	5.23	5.47	9.26	6.59
Benchmark	-4.27	-11.10	-4.56	-4.56	1.52	7.28	7.49	9.81	7.07
Pendal Global Emerging Markets Opportunities Fund - WS									**APIR - BTA0419AU**
Total Return (post-fee, pre-tax)	0.28	-5.00	-4.95	-4.95	-5.07	10.83	8.67	7.29	9.46
Total Return (pre-fee, pre-tax)	0.40	-4.65	-4.27	-4.27	-3.70	12.38	10.19	8.88	11.63
Benchmark	0.97	-4.91	-3.96	-3.96	-5.10	9.83	10.45	6.64	9.00
Pendal Concentrated Global Share Fund									**APIR - BTA0503AU**
Total Return (post-fee, pre-tax)	-3.71	-7.14	-3.39	-3.39	3.58	9.47	N/A	N/A	11.38
Total Return (pre-fee, pre-tax)	-3.62	-6.92	-2.94	-2.94	4.58	10.69	N/A	N/A	12.65
Benchmark	-4.27	-11.10	-4.56	-4.56	1.52	7.28	N/A	N/A	9.28
Property									
Pendal Property Securities Fund									**APIR - BTA0061AU**
Total Return (post-fee, pre-tax)	2.33	-2.07	0.91	0.91	3.32	4.99	7.60	12.22	7.44
Total Return (pre-fee, pre-tax)	2.38	-1.91	1.24	1.24	3.99	5.68	8.30	12.95	8.25
Benchmark	1.73	-1.71	0.24	0.24	3.27	4.85	7.55	12.53	7.30
Pendal Global Property Securities Fund									**APIR - RFA0051AU**
Total Return (post-fee, pre-tax)	-6.28	-5.77	-5.28	-5.28	-3.54	2.31	3.10	7.67	8.51
Total Return (pre-fee, pre-tax)	-6.21	-5.54	-4.85	-4.85	-2.66	3.25	4.05	8.66	9.50
Benchmark	-6.41	-6.03	-5.85	-5.85	-4.39	1.84	3.07	7.87	8.19
Fixed Interest									
Pendal Fixed Interest Fund									**APIR - RFA0813AU**
Total Return (post-fee, pre-tax)	1.14	1.45	1.33	1.33	3.81	3.44	2.76	4.18	6.33
Total Return (pre-fee, pre-tax)	1.18	1.58	1.59	1.59	4.33	3.96	3.28	4.70	6.89
Benchmark	1.50	2.24	2.80	2.80	4.54	4.09	3.70	4.67	6.59
Pendal Global Fixed Interest Fund									**APIR - RFA0032AU**
Total Return (post-fee, pre-tax)	1.72	1.96	0.47	0.47	1.39	1.64	2.48	4.14	5.82
Total Return (pre-fee, pre-tax)	1.76	2.10	0.74	0.74	1.93	2.18	3.02	4.69	6.40
Benchmark	1.80	2.44	1.77	1.77	2.38	2.62	3.39	4.96	6.76
Pendal Enhanced Credit Fund									**APIR - RFA0100AU**
Total Return (post-fee, pre-tax)	0.89	1.43	2.13	2.13	3.57	4.04	3.80	4.50	5.68
Total Return (pre-fee, pre-tax)	0.93	1.54	2.36	2.36	4.04	4.51	4.27	4.97	6.20
Benchmark	0.89	1.48	2.26	2.26	3.79	4.12	3.88	4.54	5.79
Cash & Income									
Pendal Enhanced Cash Fund									**APIR - WFS0377AU**
Total Return (post-fee, pre-tax)	0.14	0.41	1.05	1.05	2.16	2.68	2.68	2.75	4.86
Total Return (pre-fee, pre-tax)	0.16	0.47	1.18	1.18	2.42	2.94	2.94	3.01	5.20
Benchmark	0.15	0.48	0.99	0.99	1.92	1.84	1.91	2.15	4.80
Pendal Managed Cash Fund									**APIR - WFS0245AU**
Total Return (post-fee, pre-tax)	0.16	0.48	0.96	0.96	1.86	1.82	1.92	2.13	6.35
Total Return (pre-fee, pre-tax)	0.18	0.54	1.07	1.07	2.08	2.05	2.14	2.35	6.65
Benchmark	0.15	0.48	0.99	0.99	1.92	1.84	1.91	2.15	6.42
Pendal Monthly Income Plus Fund									**APIR - BTA0318AU**
Total Return (post-fee, pre-tax)	0.42	-0.64	0.15	0.15	1.34	3.89	3.64	4.08	5.21
Total Return (pre-fee, pre-tax)	0.48	-0.47	0.48	0.48	2.00	4.57	4.32	4.76	5.88
Benchmark	0.13	0.38	0.76	0.76	1.51	1.51	1.59	1.89	2.82
Diversified									
Pendal Active Balanced Fund									**APIR - RFA0815AU**
Total Return (post-fee, pre-tax)	-1.05	-7.00	-5.61	-5.61	-3.66	3.90	3.98	5.63	7.35
Total Return (pre-fee, pre-tax)	-0.97	-6.77	-5.16	-5.16	-2.74	4.88	4.96	6.63	8.42
Benchmark	-0.83	-5.25	-3.06	-3.06	0.07	4.60	5.88	6.34	7.29

For more information contact your
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Pendal is the issuer of the following products:

Pendal Australian Share Fund ARSN 089 935 964

Pendal Smaller Companies Fund ARSN 089 939 328

Pendal Concentrated Global Share Fund ARSN 613 608 085

Pendal Core Global Share Fund ARSN 089 938 492 #

Pendal Global Fixed Interest Fund ARSN 099 567 558

Pendal Enhanced Credit Fund ARSN 089 937 815

Pendal Fixed Interest Fund ARSN 089 939 542

Pendal Property Securities Fund ARSN 089 939 819

Pendal Global Property Securities Fund ARSN 108 227 005

Pendal Managed Cash Fund ARSN 088 832 491

Pendal Enhanced Cash Fund ARSN 088 863 469

Pendal Active Balanced Fund ARSN 088 251 496

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

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