

Fund Manager Commentary

Quarter ended 31 December 2018

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Australian Shares

Pendal Australian Share Fund

Market Review

The S&P/ASX 300 Price Index pulled back by 9.2% (-8.4% for the Accumulation Index) over the course of the December quarter, marking the first negative year of the domestic equity market since 2011. The same index was 7.1% lower over the past 12 months, or -3.1% after accounting for dividends, as a result of market de-rating. The headline index now trades at a 13.8x next 12-months P/E multiple, compared to the 16.3x it was trading at a year ago. The change in market sentiment overshadows the positive earnings change posted by companies, particularly in relation to resource companies, which have been benefiting from an elevated level of commodity prices. In contrast, Financials have been a large drag on all fronts over the year. Revelations from the Royal Commission saw investor confidence for the sector plunge to historical lows; whereas the earnings outlook also remains subdued due to limited mortgage growth and higher funding costs for banks.

In addition, global macro environment remains challenging. What started as a year of expected synchronised global growth ended with US-China trade tensions, progressive policy tightening by the Fed to the extent that the market is fearful of potential mis-steps, a tightening domestic credit market, and geopolitical uncertainties stemming from the Eurozone.

Looking at sector performance more closely, all of the 11 GICS sectors finished the quarter lower, although some recorded smaller losses than others. Utilities (-3.1%) was the best performing sector, driven by AGL's (+5.6%) strong performance; whilst Energy (-21.6%) was the worst. September saw a demise of the Liberal Party's energy policy which added to complexity in the power sector. Further investment is needed in areas such as gas to offset the continued closure of coal-fired power stations. However, companies are unlikely to commit the capital required unless some politically bipartisan approach can be found which can provide some clarity on future earnings. It was followed by the Federal Government's announcement in October to adopt a number of the recommendations coming out of the retail electricity price inquiry recently conducted by the ACCC. As a result, investor sentiment for AGL plunged to historical lows. While government policy uncertainty remains a key risk for AGL, the improved stock valuation has seen some investors come back to the company's share register which supported AGL's share price in November and December. In contrast, investors remain concerned over the earnings outlook for Energy companies on the back of the drastic decline of the oil price over the last quarter of 2018 which dropped by 38% from US\$73/bbl to the vicinity of \$45/bbl, despite OPEC's latest effort to arrest the price decline via reducing output.

Elsewhere, Financials (-7.7%) was the largest detractor from the index return over the quarter. Three of the big four banks posted losses, with CBA (+1.4%) being the exception. The Reserve Bank of New Zealand (RBNZ) released its initial consultation paper on banking system capital, which has direct implications for the Australian major banks that constitute the bulk of the Kiwi system via their subsidiaries. The RBNZ's proposal of minimum core tier-one capital to be 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 (-10.6%) has the largest New Zealand earnings exposure (approximately 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 of the banks, AMP (-23.2%) further added to the sector's woes over the quarter. The company's sale of its wealth protection and mature businesses was poorly received by market. Despite management's claim that the sales would help the company to become a cleaner business, the market questioned the underwhelming sale price shareholders will receive from the transactions.

Portfolio performance

The Pandal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned -10.40% (post-fee, pre-tax) for the quarter, underperforming its benchmark by 1.99%.

Contributors

Overweight Qantas

National airliner Qantas (QAN, -1.9%), one of our highest conviction holdings, outperformed the index over the quarter. In the absence of new company news, the oil price slump accounted for much of the gains. The market has held doubts over whether Qantas would be able to absorb the additional fuel costs as the oil price has been edging higher. Whilst the oil price is one factor that we monitor, our investment thesis is mainly predicated on the emergence of a stable duopoly in the Australian domestic market, which is supporting pricing and, in combination with strong cost control, is driving strong cash flow. Management are also allocating this capital well, returning it to shareholders via buybacks and dividends.

Woodside Petroleum - not held

The crude oil price fell by more than 38% over the quarter to trade at \$45/bbl at December end. Reluctance from Russia to cut production, alongside President Trump's decision to grant waivers to a number of key oil importers from the US-led Iranian sanction, caused jitters around near-term excess supply. Whilst OPEC members reached agreement to cut production in December, the effect is likely to take some time to arrest further price declines. This, in turn, weighed on the share price of Woodside Petroleum (WPL, -18.8%). We do not own WPL and Santos (STO, -24.5%) remains our preferred exposure to the Energy sector.

Overweight Ramsay Health Care

The share price of hospital operator, Ramsay Health Care (RHC, +5.1%) has been under pressure in the second half of 2018 from a combination of shorter-term cyclical headwinds, including weak National Health Service (NHS) volumes in the UK, a subdued operating environment in Australia, and tariff headwinds in France. However, signs of a turn in the cycle on several fronts have seen RHC's share price bounce back in the final quarter. Recent data from the UK indicate a positive turn in volumes on the back of increased market share, while French volumes are also robust and at the top end of expectations, with some positive direction in tariffs. In Australia, evidence is emerging that the tougher market environment is disproportionately impacting smaller hospitals that are closing wards/entirely, providing more share for RHC helping to offset the subdued environment. For FY19 private health insurance premiums will rise at the slowest rate in memory which may alleviate some political pressure on the sector, whilst not prematurely exerting undue pressure on insurance providers before a potential change in Government.

RHC is part of the growth segment of our portfolio. We believe that the valuation multiple of many Australian growth stocks looks vulnerable in an environment of declining liquidity. However, RHC has underperformed on the issues mentioned above and as a result, is one of the few growth stocks which is not demanding in terms of valuation. Given its structural tailwinds, strong asset base and emerging signs of its recent cyclical headwinds bottoming out as well as upside from recent corporate activity, we retain our conviction in the company.

Overweight Evolution Mining

Amid the recent market volatility, a revival of the gold price to US\$1284.7/oz at December end, compared to the \$1196.2/oz it was trading at the start of the quarter, assisted the share price of gold miners in general, including Evolution Mining (EVN, +39.2%). Additionally, in November the mid-tier miner announced that its Board has approved a plant upgrade at Cowal, 12 months ahead of its original schedule. The processing rate will be lifted from 7.5Mtpa to 8.7Mtpa, with

commissioning expected in the third quarter. It is the first stage of capacity expansion at Cowal, where the market expects later expansions to eventually bring the plant's processing rate to 9.8 mtpa at the end of FY21.

Detractors

Overweight CYBG

CYB Group (CYB), which owns regional UK bank brands such as Clydesdale Bank, fell 44.0% in the December quarter. The stock has been sliding in recent months owing to uncertainty around Brexit negotiations. The share price was also impacted by the latest earnings results and unpleasing developments on its Virgin Money acquisition discussed above. At an unchallenging valuation of 0.6x price/book and 7.0x price/earnings, the stock presents significant value given the longer-term outlook for reasonable earnings growth. The risk from Brexit is somewhat binary in the near term and any rapprochement between the European Union and UK Government could very well see the stock re-rate. However, without further clarity on expected synergies from the merger, the timeline for earnings-driven stock price gains appears to have been pushed out, given the near-term margin pressure.

Overweight Santos

The crude oil price fell by more than 38% over the quarter to trade at \$45/bbl at December end, as noted above. This weighed on the share price of Energy companies, including our preferred exposure Santos (STO, -24.5%).

Underweight Woolworths

Supermarket giant Woolworths (WOW, +4.8%) fared well as a consumer defensive play over the December quarter, against what was a jittery market. In addition, it released the results for 1Q19 in early November, where like-for-like sales for food slowed from the previous quarter, due to the Little Shop promotion campaign from Coles. Price deflation also remained evident, with average prices dropping by 1% compared to the previous corresponding period (pcp). Offsetting some of these negatives, the turnaround of Big W appears to be on track, with sales up 1.3% compared to the prior period. Our preferred exposure to the sector remains Metcash.

Overweight Nine Entertainment

Nine Entertainment (NEC, -38.9%), alongside Fairfax Media (FXJ) and Domain (DHG) updated the market in October, ahead of their formal merger proceedings. This was not well received by an already jittery market. NEC's update was relatively benign. Market-wide advertising was slightly weaker than expected, in part due to declining viewership at Channel Ten, while NEC continues to take market share and management reiterated their expected guidance range for FY19. However, it was DHG—majority owned by FXJ—which concerned investors after the company revealed weaker than expected listings, particularly in its traditional heartland of Sydney's Inner West. In our view, NEC's fall looks less rational, given DHG will only account for one-third of the combined group. As stated previously, we believe the merger makes strategic sense given cost synergies and a more diversified business mix, which will leave the combined group less beholden to traditional media. With NEC's valuation now back to 8.5x next 12-months P/E, we think this is an over-reaction that could provide a buying opportunity.

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 in Q4. 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 of interest 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, although uncertainties remain and any disappointing developments here could see the market re-test its December lows. At the same time, data suggests both China's and Europe's economies continue to soften. The outcomes here are difficult to predict and in our view, the key takeaway is investors must remain mindful of a higher-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 an 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 a reasonable valuation level of 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, 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 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 in the 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 mispricing, considering our view on the earning outlook.

Pendal Smaller Companies Fund

Market review

Similar to its large cap counterpart, the S&P/ASX Small Ordinaries Accumulation Index lost ground in the December quarter, edging 13.7% lower. We saw the final quarter of 2018 completely wipe out gains from the two previous quarters, resulting in a total loss of 8.7% for the Index over the year, where Small Industrials (-6.5%) outperformed Small Resources (-16.0%). The Index now trades on a one-year forward price/earnings valuation multiple of 14.6x, representing a 3% discount to its five-year average.

The global macro environment remains challenging. What started as a year of expected synchronised global growth ended up with US-China trade tensions, further Fed tightening to the extent that the market is fearful of potential policy mis-steps, a tightening domestic credit market, and geopolitical uncertainties stemming from the eurozone.

All of the 11 GICS sectors finished the quarter in the red, with the exception of the more defensive Real Estate (+1.7%) sector. The sector's strong performance was largely led by gains from sector heavyweight, Shopping Centres Australasia (SCP, +9.2%). SCP bought 10 malls from Vicinity Centres (VCX, +2.2%) in early October, which led to a 3.8% increase to SCP's FY19 guidance and was well received by the market. Offsetting some of SCP's contributions, Aveo (AOG, -20.8%) was the largest detractor from sector performance. Management at the retirement village operator downgraded the company's FY19 sales targets, while also failing to confirm earnings guidance due to sales volumes uncertainty.

Other sectors that outperformed the headline index, despite recording a loss-making quarter include Materials (-6.1%) and Consumer Staples (-6.6%); whilst the performance of Financials (-13.7%) was in line with the index. Within Materials, the outstanding performance of the gold miners contributed the most in line with the risk-off sentiment which typically leads a revival of the gold price. The precious metal was trading at US\$1284.7/oz at December end, compared to the \$1196.2/oz it was trading at the quarter beginning. This helped to support the share price of gold miners in general, including the likes of Saracen Mineral (SAR, +57.1%), St. Barbara (SBM, +34.7%), and Regis Resources (RRL, +29.8%). SAR in particular reached a record quarterly production during its third quarter, although guidance for the full financial year was maintained. Offsetting some of these gains, lithium miner Pilbara Minerals (PLS, -30.6%) posted double-digit losses over the quarter, where most of it was incurred in December. Peer miner Galaxy Resources (GXY, -12.9%) reported lower pricing in the December quarter, attributed to weakening market conditions in China which clearly weighed on PLS.

Stock performance within Consumer Staples was also mixed over the quarter, with Graincorp (GNC, +17.3%) and Asaleo (AHY, +26.2%) both recording strong gains on the back of potential corporate actions: Asaleo managed to lock in a deal to sell its loss-making Australian Consumer Tissue business at a price that exceeded market expectations. Management noted 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 GNC came from a non-binding indicative acquisition proposal from Long-Term Asset Partners, at \$10.42/share. On the other side of the tally board, BWX (-56.1%) was the worst performing stock within the sector. Management now expects FY19 normalised earnings (EBITDA) to be in the range of \$27 - 32m, representing a 27% downgrade from that of FY18 and management's previous guidance. A combination of soft market conditions in China and a loss of sales momentum in the US was cited as the culprit.

Lastly, Energy (-28.9%) was the worst performing sector over the quarter in both absolute terms and as a performance detractor for the headline index. Whilst a plunging oil price, which traded 38% lower over the last quarter clearly weighed on Beach Energy (BPT, -37.1%); Engineering company WorleyParsons (WOR, -44.5%) was the largest detractor from sector performance. The company raised capital to fund the purchase of Jacobs Engineering Group's Energy, Chemical and Resources division, which was not well received by the market.

Portfolio performance

The Pandal Smaller Companies Fund (formerly the BT Wholesale Smaller Companies Fund) returned -15.30% (post-fee, pre-tax) for the quarter, underperforming its benchmark by 1.60%.

Contributors

Overweight Technology One

Software and technology service company Technology One (TNE, +11.1%) posted solid FY18 results which beat consensus expectations. Net profit grew 15% while margins also increased, helped by demand for its cloud-based services from both new and existing customers. The company's UK business continues to lose money, but improving trends in the second half of FY18 underpin management's expectations that it will break even in FY19.

Underweight WorleyParsons

Engineering company WorleyParsons (WOR, -43.4%) 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 particularly well received as the market expressed concern over the long-term return to be earned from the deal.

Detractors

Overweight RCR Tomlinson

The position in RCR Tomlinson (RCR, -19.1%) was initiated in May 2017 as part of our interest in lifting exposure to domestic infrastructure, renewable energy and resources investments. We invested in RCR because it had strong engineering, procurement and construction (EPC) credentials across infrastructure, energy and renewables. Our due diligence, which included meeting with solar developers, corroborated our view that RCR is one of the higher quality EPC companies in this space. The subsequent failing of the company is nothing but disappointing. The administrators have advised us that the businesses continue operation and they expect to commence an asset sale process imminently, which will ultimately determine if any recoverable amounts are available for ordinary equity holders. However, it is too early to ascertain what the outcome will be at this stage and we have written the value of this holding to zero.

Overweight Seven Group

Seven Group (SVW, -37.3%) 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 December month and quarter 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 of interest 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 and 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. In our view, the key takeaway is investors must remain mindful of a higher 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 growth stocks which had done well earlier in the year. This is evident in the small companies market through the underperformance of previous market darlings such as Afterpay Touch (APT). At the same time, a weaker oil price and 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 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, particularly in areas such as agriculture, tourism, education and mining services. Given this view, the sentiment driven 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 valuations given the 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. Even as we counsel some caution on the broad market in the 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 saw the return of more volatile conditions during the December quarter, after the positive sentiment that has held markets afloat this year dissipated. Volatility spiked in October as some of the US mega tech stocks that have driven the market higher through the year dampened investor expectations. The trade tensions between China and the US simmered after Presidents Trump and Jinping came together to formalise intentions, while concerns over monetary over-tightening in the US added to the cautious tone in markets.

The US share market felt the supports being pulled away after some unexpected reporting results from Amazon, Google's parent entity Alphabet, and Apple. The latter spooked the market with its decision to cease reporting unit sales, while Alphabet reported lower than expected revenues and Amazon alerted the market to expectations of lower sales volumes through the holiday trading period. November saw a temporary reprieve before Trump's comments on Chairman Powell's impending actions to tighten monetary policy suggest the move will stifle the economy's growth.

The market fell into correction territory for the quarter after the S&P500 lost 14.3% while the NASDAQ fell 17.4%.

European share markets were uniformly lower as investors reacted to both offshore developments and regional concerns. Italy came into the spotlight after the European Union rejected its latest budget proposal. Subsequent reports emerged that Italy would target lower budget deficits for 2019 and 2020, although ratings agency Moody's proceeded to announce a downgrade to Italy's sovereign debt rating to Baa3 - one notch above junk bond status. Elsewhere, markets were impacted by lower oil prices and growing uncertainty over the shape and form of Brexit as the target date draws near. Considering the implications for the broader economy in such a scenario, the Bank of England kept its official cash rate unchanged at 0.75%. Social unrest in Paris also contributed to declines on France's stock exchange, leading to a quarterly return of -14.1%, while the FTSE 100 lost 10.2% and Germany's DAX fell by 14.4%.

Most of Asia's equity markets also moved into correction mode, responding to issues surrounding the US and China. China's economic growth eased to 6.5%, signalling a slowing of expansion, while weakness in technology stocks offshore transpired to weakness among Asia's technology sector. A strengthening yen and imposition of tariffs on China weighed on Japan's performance (-17.5%). China's Shanghai Composite (-11.6%) reflected weakness in the mainland, while Hong Kong (-7.0%) fared little better, while the performance of Singapore (-5.7%), Korea (-13.0%), Taiwan (-12.0%) 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 fell 2.4% against the US dollar and 1.5% against the euro but devalued by 6.1% against the Japanese yen and 3.6% against the British pound. Commodity markets witnessed a strong correction as the crude oil price fell by 40% to close at US\$45.40 per barrel and the Trade-Weighted Index (TWI) declined 2.4%. The Gold price naturally rose to an 8% gain, closing at US\$1282.45.

Portfolio performance

The Pandal Concentrated Global Share Fund (formerly the BT Concentrated Global Share Fund) returned -7.14% (post-fee, pre-tax) for the quarter, outperforming its benchmark by 3.96%.

US-China trade wars, Brexit uncertainty and Trump tweets had seemingly little impact on US markets in the September quarter, however the later part of the December quarter saw the US 'shoe finally drop', and US markets underperformed most other global markets in December. In January 2018 the VIX index (measure of volatility) hit a record low of 9, HK warrant turnover (a gauge of retail enthusiasm) hit a decade high and MSCI Europe moved ahead of the 2014 peak. Eleven months later global equity markets are experiencing their worst fourth quarter since 2008, the VIX index is up 176%, HK warrant volume is down, and MSCI Europe has finished the year at the lows. All major asset classes have underperformed US inflation for the first time since 1992.

Outperformance for the fund this quarter was a result of our underweight in 'FAANG' stocks, underweight in emerging markets, increased cash levels and the continued outperformance of our healthcare names.

After nine US interest rate increases since the fund's inception, and what appears to be a slowing in the pace of increase we did make some changes to the fund this quarter. BB&T has outperformed in 2018 and became the most expensive bank we owned, trading on 1.3x price to book, with valuation looking even less appealing if we were to take into account the large amount of goodwill on the balance sheet as a result of being a serial acquirer. At their recent investor day, management highlighted that the acquisition strategy of the past will not translate to the future given that digital trends in financial services are reducing the benefits traditionally resulting from acquisitions. As a result the bank will become more reliant on loan growth in order to achieve earnings growth. Our stock exchanges also outperformed in 2018, however we sold our holding in Intercontinental Exchange (ICE) in early December. ICE was trading at near all-time highs, having

benefited from a rising interest rate environment, rising volumes and rising volatility over the last two years. Consensus has begun to factor in peak margins and long term annual EPS growth of around 12%. While we believe the company will continue to benefit from an improvement in volumes and increased volatility, we feel this has now been adequately reflected at current multiples.

Utilising the funds from the above sales we added to our cash position in December, closing the year with our highest cash since inception at 14%. We also initiated a new position in Procter and Gamble (PG), added to Colgate Palmolive, the other company in the home and personal care sector in which we initiated a position this year. PG is a leading home and personal care company that has underperformed the S&P 500 and peers over three and five years. Given the longer term underperformance we believe the market has underestimated the benefits of recent strategic initiatives, including a \$10b cost saving programme. Organic top line growth since 2012 has struggled to rise above 1-2%, however we believe share gains in the US, as result of a recent brand reinvestment strategy will propel top-line growth, while margins should improve with recently announced price increases in both the US and emerging markets.

Strategy and outlook

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 positions, 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

Market review

Global equity markets saw the return of more volatile conditions during the December quarter, after the positive sentiment that has held markets afloat this year dissipated. Volatility spiked in October as some of the US mega tech stocks that have driven the market higher through the year dampened investor expectations. Trade tensions between China and the US simmered after Presidents Trump and Jinping came together to formalise intentions, while concerns over monetary over-tightening in the US added to the cautious tone in markets.

The US share market felt the supports being pulled away after some unexpected reporting results from Amazon, Google's parent entity Alphabet, and Apple. The latter spooked the market with its decision to cease reporting unit sales, while Alphabet reported lower than expected revenues and Amazon alerted the market to expectations of lower sales volumes through the holiday trading period. November saw a temporary reprieve before Trump's comments on Chairman Powell's impending actions to tighten monetary policy suggest the move will stifle the economy's growth. The market fell into correction territory for the quarter after the S&P500 lost 14.3% while the NASDAQ fell 17.4%.

European share markets were uniformly lower as investors reacted to both offshore developments and regional concerns. Italy came into the spotlight after the European Union rejected its latest budget proposal. Subsequent reports emerged that Italy would target lower budget deficits for 2019 and 2020, although ratings agency Moody's proceeded to announce a downgrade to Italy's sovereign debt rating to Baa3 - one notch above junk bond status. Elsewhere, markets were impacted by lower oil prices and growing uncertainty over the shape and form of Brexit as the target date draws near. Considering the implications for the broader economy in such a scenario, the Bank of England kept its official cash rate unchanged at 0.75%. Social unrest in Paris also contributed to declines on France's stock exchange, leading to a quarterly return of -14.1%, while the FTSE 100 lost 10.2% and Germany's DAX fell by 14.4%.

Most of Asia's equity markets also moved into correction mode, responding to issues surrounding the US and China. China's economic growth eased to 6.5%, signalling a slowing of expansion, while weakness in technology stocks offshore transpired to weakness among Asia's technology sector. A strengthening yen and imposition of tariffs on China weighed on Japan's performance (-17.5%). China's Shanghai Composite (-11.6%) reflected weakness in the mainland, while Hong Kong (-7.0%) fared little better, while the performance of Singapore (-5.7%), Korea (-13.0%), Taiwan (-12.0%) 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 fell 2.4% against the US dollar and 1.5% against the euro but devalued by 6.1% against the Japanese yen and 3.6% against the British pound. Commodity markets witnessed a strong correction as the crude oil price fell by 40% to close at US\$45.40 per barrel and the Trade-Weighted Index (TWI) declined 2.4%. The Gold price naturally rose to an 8% gain, closing at US\$1282.45.

Portfolio performance

The Pandal Core Global Share Fund (formerly the BT Wholesale Core Global Share Fund) returned -13.90% (post-fee, pre-tax) for the quarter, underperforming its benchmark by 2.80%.

Underperformance in North America was due to negative returns to momentum, both for stock and industry selection, together with investor sentiment themes. Value and stability themes provided some positive offset over the quarter. Momentum and investor sentiment themes were similarly weak in Europe, although management signalling and earnings quality were the best performing stock selection themes over the quarter. In developed Asia, investor sentiment and industry momentum were the notable underperformers, outweighing positive returns to value signals.

From a stock and industry attribution perspective, both industry selection and intra-industry stock selection produced negative returns over the quarter. At a sector level, the overweight to Energy and underweight to Utilities were the largest detractors, with the overweight to Health Care the largest positive offset. Stock selection within industries was weakest within Consumer Discretionary, Materials and Health Care, offset slightly by positive active returns within Financials and Health Care.

At a stock level, the largest contributors to active returns came from underweight positions in: Nvidia Corporation, a US technology company headquartered in California which specialises in graphics processing units for the mobile computing and automotive industries; Citigroup, Inc., a US multinational investment bank and financial services corporation; Netflix Inc., a US-headquartered global media services provider; Exxon Mobil Corporation, a US-headquartered multinational oil and gas corporation; and J.P Morgan Chase & Co., a US-headquartered multinational investment bank and financial services company. The largest detractors from active returns over the month came from overweight positions in: Covestro AG, a producer of high tech polymers and adhesives, based in Germany; Michael Kors Holdings Ltd., a US fashion company; Valero Energy Corporation, a US headquartered international manufacturer and marketer of transportation fuels; Best Buy Co, Inc., a US-headquartered consumer electronics retailer operating in North America; and HollyFrontier Corporation, a US petroleum refiner and distributor of petroleum products.

Strategy and outlook

Moving into 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 20bps and 31bps to 1.84% and 2.33%, respectively, while the 90-day BBSW rose 18bps to 2.09%.

Portfolio performance

The Pendal Fixed Interest Fund (formerly the BT Wholesale Fixed Interest Fund) returned 1.14% for the quarter (post-fees, pre-tax), underperforming its benchmark by 0.79%.

The portfolio underperformed its benchmark in the December quarter. In the alpha overlay, the largest detractor was the FX strategy. Losses were tied to a range of positions including EUR shorts with a EUR/USD position stopped out in December. The Yield Curve strategy also detracted due primarily to a Euro curve flattener. Smaller losses were experienced in the Duration and Cross-Market strategies as the former lost on a short duration Japan position and the latter on an Australia versus New Zealand trade. The Macro strategy recovered most of its losses after credit spreads widened into year-end and benefited short CDS exposures including US and European investment grade.

The Government bond component also underperformed over the quarter. The Duration and Yield Curve strategies generated losses on positions on the 3- and 10-year parts of the Australian curve. Meanwhile the Relative Value strategy was positive for the quarter through a 3 year EFP widener.

Finally the credit component outperformed with overweights in cash, infrastructure and utilities and an underweight exposure to supranationals.

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 during the quarter 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 with another two hikes projected for 2019. Data-wise, payrolls revealed softer-than-expected additions for September and November. Meanwhile, the annual rate for Core PCE slipped back below 2.0% to 1.9%. Leading indicators were more encouraging, including continued strength in the ISM Manufacturing survey data. Elsewhere, some progress was made on policy issues in Europe, including the Italian budget and UK Prime Minister, Theresa May, survived a leadership challenge. In Asia, weaker Chinese data added to investors' woes as the NBS gauge of manufacturing activity fell to 49.4, firmly into contractionary territory. Finally, the US 2-year and 10-year rates fell by 38bps and 46bps to 2.49% and 2.69%, respectively.

Portfolio performance

The Pendal Global Fixed Interest Fund (formerly the BT Wholesale Global Fixed Interest Fund) returned 1.96% for the December quarter (post-fees, pre-tax), underperforming its benchmark by 0.48%.

The Duration strategy experienced losses for the quarter. This was driven by a sharp fall in yields during December, which hurt a short Japanese long-end position. An Italian BTP short also detracted over the period. Meanwhile, performance on Australian positions was flat.

The FX strategy finished negative, which stemmed from a range of positions including short EUR exposure against USD, JPY and NOK. These suffered as the euro recovered on optimism that

issues facing Italy were on the path to resolution, as well as the market discounting a deterioration in broader eurozone data.

Similar sentiment hurt a EUR curve flattener position in the Yield Curve strategy during October and November. Positioning elsewhere was more mixed, with gains on a JPY long-end steepener early in the quarter, losses on an NZD steepener later in the period and flat performance from Australian curve positioning in December.

The Cross-Market strategy was relatively flat, with gains on a Bund-BTP spread trade offset by losses on an Australia vs New Zealand position, as well as a long Europe vs short Japan trade.

In the Macro strategy, strong returns were generated in December that partly offset losses earlier in the quarter. The gains occurred on the back of a sharp rise in credit spreads that benefited short CDS exposures in European and US investment grade credit. Most individual emerging market CDS positions were cut in October, excluding Korea and Turkey.

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

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 quarterly return. This was driven by a fall in underlying yields, which 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.

Turning to market activity, issuance was light in October before a large volume of deals in November as three of the four major banks issued debt capital. NAB, WBC and ANZ tapped the market for \$1b, \$4.25b, and \$3.25b respectively. Later, in December amid an increasingly risk-off environment, primary issuance in Australia was almost 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.

The Australian iTraxx index (Series 30 contract) traded in a wide 25bp range finishing the quarter 20bps wider to 95bps. Physical credit spreads were on average 10bps wider with the worst

performing sectors being industrials and REITs, which widened 15 and 14bps respectively. The best performing sector was supranationals only widening 4bps. Semi-government bonds also underperformed widening 7bps to government bonds over the quarter.

Portfolio performance

The Pendal Enhanced Credit Fund (formerly the BT Wholesale Enhanced Credit Fund) returned 1.43% for the December quarter (post-fees, pre-tax), underperforming the benchmark return by 0.05%.

The positive return was driven by a fall in underlying swap rates as well as strong accruals. These more than offset a widening in credit spreads over the period. Overweights in the infrastructure and utilities sectors did not perform as strongly as previous quarters relative to other sectors.

Purchases over the quarter were relatively light, given a more cautious tone in credit markets. Activity during the period included purchases of Lonsdale Financial Corp, ANZ and Airport Motorway.

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 quarter. Their sizeable fall was tied to broad risk-off sentiment and a significant sell-off in equities, particularly in

December which drove investors to safe-haven assets. A number of causes were cited 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 fairly uneventful with the RBA leaving the cash rate unchanged at 1.50% through the quarter. Communication over the quarter continued to suggest that the Board's bias was towards an eventual hike rather than a cut. Nonetheless, market pricing shifted during the quarter 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 into year-end fuelled a similar increase in its domestic BBSW-OIS cousin.

In terms of domestic data the RBA's preferred measure of CPI, the trimmed mean, rose 0.4% quarter-on-quarter which brought the annual rate to 1.8% - still well-below the board's 2-3% target band. Wage inflation was stronger at 0.6% for the quarter and 2.3% for the year, however this reflected temporary effects like a one-off increase in the minimum wage. Meanwhile, a disappointing third quarter GDP figure revealed 0.3% growth over the quarter and an annual rate of 2.8%. Employment figures were more mixed with reasonable job additions, however the unemployment rate ticked higher 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 into the end of the quarter.

In the US, there were a number of headlines that guided investors over the final three months of the year. After a series of tit-for-tat trade war developments and intense speculation, a 90 day truce was settled at the outset of December. However, fears of an escalation were reignited after Huawei's CFO was arrested on charges of breaching sanctions against Iran. Market concerns were later compounded by a disagreement between Trump and House Democrats on US border protection funding, which eventuated in a partial US Government shutdown.

Also in the US, Fed communication over the quarter appeared to swing between dovish and hawkish messaging, which also generated shifts in market sentiment. Although well-broadcast in advance, an eventual 25bps rate increase in December was poorly-received by markets. 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 quarter with payrolls revealing softer-than-expected additions for September and November. The annual rate for Core PCE also slipped back below 2.0% to 1.9%. Leading indicators were more encouraging, including continued strength in the ISM Manufacturing survey data.

Looking elsewhere, progress was made on the surface of some political issues in Europe. Italian policymakers eventually 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 to 51.3 and consumer confidence fell 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 to 49.4. The survey figure suffered four consecutive declines which brought it into contractionary territory and its lowest level since February 2016. Industrial production, exports and retail sales also weakened over the period.

Finally on market movements, Australian 3 and 10 year yields fell by 20bps and 31bps to 1.84% and 2.33% respectively. In contrast, 90 day BBSW rose 18bps to 2.09%. In the US, the 2 year and 10 year rates fell by 38bps and 46bps to 2.49% and 2.69% respectively. Meanwhile the Australian Dollar ended the quarter roughly flat.

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 fell out-of-favour as GE revealed a raft of issues, GM announced mass closures and Johnson & Johnson was accused of tainted baby powder.

The Australian iTraxx index (Series 30 contract) traded in a wide 25bp range finishing the quarter 20bps wider to 95bps. Physical credit spreads were on average 10bps wider with the worst performing sectors being industrials and REITs, which widened 15 and 14bps respectively. The best performing sector was supranationals only widening 4bps. Semi-government bonds also underperformed widening 7bps to government bonds over the quarter.

Portfolio performance

Managed Cash

The Pandal Managed Cash Fund (formerly the BT Wholesale Managed Cash Fund) returned 0.48% for the December quarter (post-fees, pre-tax), matching the benchmark return.

The positive accrual of the portfolio was offset by widening credit spreads. Positive performance came from industrials and financials sectors whilst the long iTraxx position and infrastructure sector detracted. The portfolio has outperformed its benchmark by over the past 12 months.

We reduced credit exposure during the quarter given our cautious outlook. Activity included closing the long Australia iTraxx position in October. In November and December we reduced exposure to financials, industrials and infrastructure whilst increasing our cash weighting.

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

Enhanced Cash

The Pandal Enhanced Cash Fund (formerly the BT Wholesale Enhanced Cash Fund) returned 0.41% for the December quarter (post-fees, pre-tax), underperforming the benchmark by 0.07%

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 74bps over bank bills, interest rate duration of 0.07 years and credit spread duration of 2.37 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 AREIT sector generated a total return of -1.7% for the December 2018 quarter, outperforming the broader Australian share market which was declined by -8.4%. Globally, REITs were down 5.5% (USD) for the quarter, with New Zealand the strongest REIT market (flat in local currency) and the UK the worst performer -9.3% (local currency).

The best performing AREIT over the quarter was SCA Property Group (+9.2%), reflecting the accretive \$573m acquisition of the Vicinity Centre non-core portfolio (lifting FY19 earnings by 5%). Other performers were Charter Hall Retail REIT (+8.9%) with supermarket sales remaining resilient and BWP Trust (+8.3%). Underperformers over the quarter included Unibail Rodamco Westfield (-24%), which has been hampered by high leverage, low liquidity and integration issues, Stockland Group (-12%) hampered by a slowing housing market and softer sales across its secondary retail assets and Cromwell Group (-5.2%), impacted by lower distribution guidance and recent capital raising.

It was a terrible quarter for equity markets, with the S&P500 down 14% as investors raised concerns over a slowdown in activity caused by Chinese trade tensions, weaker economic data in China and Europe 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 the market jitters, the Federal Reserve lifted the Fed Fund rate in December to 2.25%. While the Fed has flagged it expects a further two rate hikes in 2019 (although any further hikes will be data dependent), the market has now discounted this outcome to virtually nil. The US unemployment rate lifted slightly to 3.9% and core retail sales +0.7%, slightly ahead of market expectations.

It was a busy quarter for AREITs with a number of capital raisings from Shopping Centres Australia, Charter Hall Long WALE, Centuria Metropolitan Trust, Centuria Industrial Trust, Growthpoint Properties and Cromwell Property Group. M&A activity also supported the sector with Oxford Properties successful in its \$5.60 cash takeover of Investa Office Fund and Propertylink directors recommending the \$1.20 cash offer from Asian fund manager ESR. Buybacks continued throughout the quarter, and asset valuations continued to firm for office and industrial assets, although appear to have largely stalled for retail assets.

Portfolio performance

The Pendal Property Securities Fund (formerly the BT Wholesale Property Securities Fund) returned -2.07% for the December quarter (post-fee, pre-tax), underperforming its benchmark by 0.30%.

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, 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.

Strategy and outlook

The AREIT sector is now priced on an FY19 dividend yield of 5.5%, a P/E ratio of 16.6 times, well ahead of its 27 year average of 13.4x, but in line with its long term average relative to Industrials (0.97x). Office and industrial cap rates will likely compress further in the next reporting period (on the back of recent transaction evidence), but asset valuation uplift thereafter will depend on income growth and tenancy retention. We expect to see cap rates soften for retail assets, especially lower quality malls in the next 6-12 months. Balance sheets are stable with sector gearing at 28%.

International Property

Pendal Global Property Securities Fund

Market review (in US\$)

For the December quarter, 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 -5.77% for the December quarter (post-fee, pre-tax), outperforming the benchmark by 0.26%.

North America

For the December 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 December 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 Fabege 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 December 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 S&P/ASX 300 Price Index pulled back by 9.2% (-8.4% for the Accumulation Index) over the course of the December quarter, marking the first negative year of the domestic equity market since 2011. The same index was 7.1% lower over the past 12 months, or -3.1% after accounting for dividends, as a result of market de-rating. The change in market sentiment overshadows the positive earnings change posted by companies, particularly in relation to resource companies, which have been benefiting from an elevated level of commodity prices. In contrast, Financials have been a large drag on all fronts over the year. Revelations from the Royal Commission saw investor confidence for the sector plunge to historical lows; whereas the earnings outlook also remains subdued due to limited mortgage growth and higher funding costs for banks. Looking at sector performance more closely, all of the 11 GICS sectors finished the quarter lower, although some recorded smaller losses than others. Utilities (-3.1%) was the best performing sector, driven by AGL's (+5.6%) strong performance; whilst Energy (-21.6%) was the worst. 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.

Global equity markets saw the return of more volatile conditions during the December quarter, after the positive sentiment that has held markets afloat this year dissipated. Volatility spiked in October as some of the US mega tech stocks that have driven the market higher through the year dampened investor expectations. The trade tensions between China and the US simmered after Presidents Trump and Jinping came together to formalise intentions, while concerns over monetary over-tightening in the US added to the cautious tone in markets.

The US share market felt the supports being pulled away after some unexpected reporting results from Amazon, Google's parent entity Alphabet, and Apple. The latter spooked the market with its decision to cease reporting unit sales, while Alphabet reported lower than expected revenues and Amazon alerted the market to expectations of lower sales volumes through the holiday trading period. November saw a temporary reprieve before Trump's comments on Chairman Powell's impending actions to tighten monetary policy suggest the move will stifle the economy's growth. The market fell into correction territory for the quarter after the S&P500 lost 14.3% while the NASDAQ fell 17.4%.

European share markets were uniformly lower as investors reacted to both offshore developments and regional concerns. Italy came into the spotlight after the European Union rejected its latest budget proposal. Subsequent reports emerged that Italy would target lower budget deficits for 2019 and 2020, although ratings agency Moody's proceeded to announce a downgrade to Italy's sovereign debt rating to Baa3 - one notch above junk bond status. Elsewhere, markets were impacted by lower oil prices and growing uncertainty over the shape and form of Brexit as the target date draws near. Considering the implications for the broader economy in such a scenario, the Bank of England kept its official cash rate unchanged at 0.75%. Social unrest in Paris also contributed to declines on France's stock exchange, leading to a quarterly return of -14.1%, while the FTSE 100 lost 10.2% and Germany's DAX fell by 14.4%.

Most of Asia's equity markets also moved into correction mode, responding to issues surrounding the US and China. China's economic growth eased to 6.5%, signalling a slowing of expansion, while weakness in technology stocks offshore transpired to weakness among Asia's technology sector. A strengthening yen and imposition of tariffs on China weighed on Japan's performance (-17.5%). China's Shanghai Composite (-11.6%) reflected weakness in the mainland, while Hong Kong (-7.0%) fared little better, while the performance of Singapore (-5.7%), Korea (-13.0%), Taiwan (-12.0%) 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 fell 2.4% against the US dollar and 1.5% against the euro but devalued by 6.1% against the Japanese yen and 3.6% against the British pound. Commodity markets witnessed a strong correction as the crude oil price fell by 40% to close at US\$45.40 per barrel and the Trade-Weighted Index (TWI) declined 2.4%. The Gold price naturally rose to an 8% 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 20bps and 31bps to 1.84% and 2.33% respectively, while 90 day BBSW rose 18bps to 2.09%.

Global bond yields sank during the quarter 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 with another two hikes projected for 2019. Data-wise, payrolls revealed softer-than-expected additions for September and November. Meanwhile, the annual rate for Core PCE slipped back below 2.0% to 1.9%. Leading indicators were more encouraging, including continued strength in the ISM Manufacturing survey data. Elsewhere, 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 to 49.4, firmly into contractionary territory. Finally the US 2 year and 10 year rates fell by 38bps and 46bps to 2.49% and 2.69% respectively.

Portfolio performance

The Pandal Active Balanced Fund (formerly the BT Wholesale Active Balanced Fund) returned -7.00% (post-fee, pre-tax) for the December quarter, underperforming its benchmark by 1.75%.

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 quarter. 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 which was most prevalent in Australian equities, the core global equity strategy, 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 Qantas, Ramsay Health Care and Evolution Mining, plus holding no exposure to Woodside Petroleum contributed to returns. These contributions were more than offset by overweight positions in CYBG, Santos and Nine Entertainment together with an underweight to Woolworths.

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 quarter. Through the quarter, six of the eight sub-strategies delivered negative returns, while one had a positive impact and the remaining strategy was neutral in impact. The Alternatives strategy delivered a total return (before fees) of -2.33% versus a cash return of 0.48%.

The Managed Futures, Long-Short Equity and Global Macro strategies generated negative returns this quarter after being impacted by long positions in commodity markets, notably energy contracts. Positioning within currency & fixed income markets also detracted from performance. The sole positive contributor over the quarter was Event Driven (+0.3%). Nearly 80% of the merger deals made gains over the quarter, on the back of a high percentage of successful completions vs cancellations.

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									
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	1.49	5.25	1.49	9.16	9.05	7.71	7.98	7.69
Total Return (pre-fee, pre-tax)	-0.61	1.73	5.75	1.73	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 Australian Share Fund ARSN 089 935 964

Pendal Smaller Companies Fund ARSN 089 939 328

Pendal Concentrated Global Share Fund ARSN 613 608 085

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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

Pendal Property Securities Fund ARSN 089 939 819

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