PENDAL

Fund Manager Commentary

Month ended 30 June 2019

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Market Review

June was another positive month for the Australian equity market, with the S&P/ASX 300 Accumulation Index returning +3.6%. The same index had a strong second quarter, adding 8.1% to what was already a solid recovery in the previous quarter (+10.9%) following the market's decline in late 2018. Overall, the market returned +11.4% for FY19, with Resources (+15.0%) outperforming and Industrials (+10.5%) the laggard.

Domestically, sentiment improved somewhat following the Coalition's surprise win in the Federal election. Nevertheless, the 10-year bond yield is now at record lows, down 15bps in June and 132 basis points (bps) over the year, reflecting the subdued outlook for the economy, and the dovish stance of the Reserve Bank of Australia (RBA), which cut the cash rate to a record low of 1.25% in June. In that vein, gold is also fetching multi-year high prices, as investors make the rotation into the safe haven asset. Outside Australia, the reprieve achieved in the US-China trade issue is expected to allay concerns to a degree around the outlook for global economic growth, although this may prove temporary.

Australian iron ore miners continue to operate in their sweet spot, with the commodity now trading at around US$110/mt, despite Vale's latest announcement that the operation at its Brucutu mine in Brazil will resume within days, bringing an annual 20 million tonnes of iron ore supply back online. Inventory levels at China's ports are at a four-year low due to the previous underestimation of the Vale situation. Weather-related events, as well as disciplined capacity growth by the Aussie miners, could also see Australian iron ore export growth become negative this year. While we do not anticipate global iron ore prices to stay elevated at the US$110-120/mt level, it is also hard to see the commodity trade on the downside of $80/mt due to the supply constraints globally. The demand side of the equation is somewhat bifurcated: weak demand from automobile manufacturers is being offset by strong demand from infrastructure. Overall, the commodity still looks strong.

Ten of the 11 GICS sectors finished the month higher. Consumer Discretionary posted a loss of -1.5%. It was largely led by the negative market updates from Wesfarmers (WES, -2.4%) and Star Group (SGR, -7.8%). On its Strategy Day, WES downgraded its Discount Department Store (DDS) earnings (EBIT) guidance for FY19 to $515-565m, much lower than market expectations. The improved consumer sentiment following the Federal election is yet to be reflected in the retailer's sales figures; whereas the rising wage costs from new Enterprise Bargaining Agreements (EBAs) are also expected to hit future margins. Also reflecting the domestic economy weakness, casino operator SGR guided to $550-$560m earnings (EBITDA) for FY19, which at the mid-point was 2% lower than FY18 and 8% below market consensus. While management also outlined a cost reduction program of $40-50m that will be completed by the first quarter of FY20, investors are more wary of the subdued outlook for earnings growth from here.

On the other side of the tally board, Materials (+6.2%) finished the month the strongest, with the help of Metals & Mining (+7.7%). As mentioned above, rising commodity prices helped to lift the miners, with BHP (+9.0%), Fortescue Group (FMG, +12.0%), Newcrest Mining (NCM, +17.4%) and Northern Start (NST, +20.0%) leading the gainers. Rio Tinto (RIO, +3.4%) also advanced, yet lagged the cohort. RIO downgraded its Pilbara production guidance last week by around 10mt due to some "mine operational challenges" at its Greater Brockman complex. This is going to negatively impact on the grade of the miner's Pilbara blend and its subsequent price realisation.

Lastly, monthly performance amongst the big four banks was mixed, ranging from 0.9% (NAB) to 5.4% (CBA). While the RBA's rate cut is seen as limiting the downside risk from housing which is ultimately good for the banks, it also results in more pressure on margins and earnings for the core mortgage businesses. The issue is compounded by the reluctance of most banks to cut deposit rates due to the risk of losing flows.

Portfolio performance

The Pendal Australian Share Fund (formerly the BT Wholesale Core Australian Share Fund) returned 2.87% (post-fee, pre-tax) in June, underperforming its benchmark by 0.77%.

Contributors

Underweight Wesfarmers

On its strategy day, Wesfarmers (WES, -2.4%) downgraded its Discount Department Store (DDS) EBIT guidance for FY19 to $515-$565m, well below the market's expectation. The improved consumer sentiment following the Federal election is yet to be reflected in the retailer's sales figures, whereas rising wage costs from new Enterprise Bargaining Agreements (EBAs) are also expected to hit future margins for both Kmart and Target. We continue to be underweight the stock.

Underweight NAB

Performance amongst the big four banks is mixed, as noted earlier. We remain underweight in the banks on the basis of the current margin pressured environment, which contributed to performance this month.

Overweight Fortescue Metals

Australian iron ore miners continue to operate in their sweet spot, with the commodity now trading at around US$110/mt, despite Vale's latest announcement that the operations at its Brucutu mine in Brazil will soon resume. Overall, prospects for the iron ore price looks strong and as such, we continue to hold conviction in Fortescue Metals (FMG, +12.0%).

Detractors

Overweight Metcash

Metcash (MTS, -12.9%) weighed on portfolio performance, as its full year result was not well received in June. In terms of the reported earnings, NPAT for FY19 was only 3% below consensus, in a stark contrast to the share price reaction. The negative response was more ascribed to the forecast FY20 earnings downgrade. While this has been a known factor for earnings, the magnitude of the pullback was not fully appreciated by the market. Management is set to update the market in that regard at its AGM in August, and investors should welcome any sight of sales growth improvement, however slim.

Overweight Qantas

A stronger oil price and softer domestic environment has weighed on Qantas (QAN, -2.7%) in recent months. We believe that improved demand in the international sector should help offset a slowdown in domestic corporate travel. QAN has also been able to grow revenues off the back of less fare discounting, which should enable it to offset higher fuel costs for FY19.

Overweight Nine Entertainment

Nine Entertainment (NEC, -9.9%) gave back some of its recent strong gains in June, but remains one of the portfolio's better performers over the year to date. This reflects their resilience and ability to gain market share amid a poor market for free-to-are television advertising.

Strategy and outlook

Solid gains in June capped a strong first half to 2019, in which Australian equities have staged a rapid rebound from the sell-off in late 2018. The S&P/ASX 300 is up +3.6% for the month, +8.1% for the quarter and +19.8% for the first half.

At an economic level, we remain in an environment of muted growth. While the effect of interest rate cuts on broader economic activity is questionable, it does demonstrate that policy makers are actively working to avoid a housing-led economic downturn. The reduction in this threat has improved sentiment, however we believe that it is a case of removing downside risk, rather than expecting a meaningful pick-up in near-term economic growth. This is a view echoed in our meetings with domestic cyclical companies, who have noted that the environment remains challenging.

Corporate earnings look set to grow in the mid-single-digit range over the near term. There is considerable dispersion underneath this headline figure. Resource stocks — and in particular iron ore miners – remain in a sweet spot, as do the contracting companies which service them. The bank sector has seen some improvement in sentiment in line with progress in the housing sector, however, the already stiff headwinds for earnings are only exacerbated by rate cuts. Elsewhere, growth is present but patchy.

This underpins the benefits of being able to distinguish between those companies which can adapt to the current environment – and those which are more challenged – and allocate capital accordingly.

While elevated macro risk – primarily related to trade – dominates headlines, there are several positive factors for Australian equities, including high commodity prices, a depreciated currency and falling interest rates. As a result, we believe despite the market's strong run over the year to date, the outlook for equities remains reasonable.

The portfolio made decent absolute gains in June, with strong performance from the iron ore stocks. The bond-sensitives exposures via infrastructure stocks such as Transurban and Atlas Arteria also performed well. However, the Fund underperformed the Index given a weak month for Qantas, one of the Fund's largest positions, as well as a drag from Metcash, Nine Entertainment and Caltex. We retain the view that Qantas can offset a higher fuel bill via revenue growth. The oil price has also seen weaker volumes for fuel companies Viva Energy and Caltex Australia. Both are facing headwinds; however, they are largely cyclical rather than structural and we believe the market is under appreciating the value in both companies.

On the positive side, the iron ore exposure has worked well in Q2 2019. Iron ore miners are in a sweet spot, given a high US dollar price combined with a weaker dollar and a far lower cost base than has been the case in previous years. The infrastructure exposure has also worked well, as has the position in Telstra which has rebounded following the ACCC's decision to try and block the merger between TPG Telecom and Vodafone.

Growth exposure has been one of the more challenging areas over the last 12 months, given the relative scarcity of genuine growth opportunities in the Australian market and the high valuations that many of the stocks are subsequently pushed to. Nevertheless, our preferred growth stocks such as Xero and Aristocrat Leisure have performed well and we see them continuing to do so.

Pendal Smaller Companies Fund

Market review

There was again some performance divergence between the S&P/ASX Small Ordinaries Accumulation Index and its large cap counterpart, the S&P/ASX 100 Accumulation Index. The former finished June marginally higher (+0.9%), underperforming the latter by 3.1%. The small cap universe did not benefit as much from the boost of the iron ore miners; whilst weakness among some of the larger index-weights also detracted from relative performance.

Small Resources (+2.9%) outperformed with the help of the gold miners. The 10-year bond yield is now at record lows, down 15bps in June and 132bps over the year reflecting the subdued outlook for the economy and the dovish stance of the RBA and its central bank counterparts globally. In that vein, gold is also fetching multi-year high prices, as investors make the rotation into the safe haven asset.

Communication Services (-7.7%) was the worst performing GICS sector over the month, due to the losses posted by sector heavyweight Vocus Group (VOC, -28.8%). VOC retreated by more than it gained in the previous month, as two suitors, the Swedish investment firm EQT and later AGL both walked away from their proposed takeover bid. News Corp (NWS, +14.4%) helped to offset some of VOC's losses. Management noted that it is actively evaluating strategic options for the News America Marketing business (NAM) to optimise the company's portfolio and simplify its structure. NAM is currently a loss making business and the market responded positively to the announcement.

Consumer Staples (-2.4%) also finished June lower. Metcash (MTS, -12.9%) weighed on sector performance, as its full-year result was not well received. In terms of the reported earnings, net profit for FY19 was only 3% below consensus, in stark contrast to the share price reaction. The negative response was more ascribed to the FY20 earnings downgrade. In particular, the Food business' previous earnings fillip from the write-back back of an onerous lease provision is going to be significantly lower for FY20 compared to the reported $18m for FY19. While this has been a known factor for earnings, the magnitude of the pullback was not fully appreciated by the market. Outside of Food, Liquor continued to do well, whereas Hardware seemed to have run into a speed bump. Management indicated that sales for the first seven weeks of FY20 are lower than that period of FY19, reflecting the loss of a QLD customer and trade softness. That said, the company still expects additional cost savings to help mitigate the adverse impact from any slowdown in construction activities next year.

On the other side of the spectrum, Energy (+4.9%) recorded the largest sector gains; whereas Industrials (+4.6%) contributed the most to the headline index return. Waste processing company Bingo Industries (BIN, +22.5%) was the largest performance contributor within the Industrials sector. BIN held its investor day and site visits at Patons Lane and Eastern Creek. Whilst there was no trading update provided, Management is asking for 20-25% price increases across its NSW business to offset the new levies from QLD, as well as other rising costs. Integration for DADI has also been progressing well, with Management maintaining the $15m synergies target. Also updating the market, Emeco (EHL) gained by +14.7% after providing guidance for its FY19 operating EBITDA to come in the range of $211-213m, representing a 40% growth from the previous year. Management also delivered an upbeat outlook for FY20.

Lastly, index heavyweight Materials (+2.0%) advanced during June. It was largely lifted by the gold miners such as Regis Resources (RRL, +18.7%), Saracen Minerals (SAR, +15.0%) and St. Barbara (SBM, +14.8%), as the price of the precious metal continues to fetch higher. In addition, Ausdrill (ASL, +24.6%) also outperformed after announcing its subsidiary Barminco was awarded a five-year underground mining services contract, worth approximately $800m.

Portfolio performance

The Pendal Smaller Companies Fund returned 0.83% (post-fee, pre-tax) in June, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.09%.

Contributors

Underweight Vocus Communications

Vocus Communications fell as AGL Energy walked away from an indicative takeover offer following due diligence. In doing so, it followed several other private equity bidders in recent times. We see value in Vocus's infrastructure assets, however its subscriber book, which comprises just under half of its earnings, remains under intense pressure. We continue to avoid the stock at these levels and this helped performance in June.

Overweight Nanosonics

Nanosonics designs and manufactures 'Trophon', a specialised unit for cleaning ultra sound probes in hospitals. There has been no material news-flow since its most recent report in early April. However, the stock has continued to perform off the back of a good set of results. At this point Nanosonics continues to offer a product with a clear competitive edge over other approaches to cleaning probes. Sales of the Trophon units are augmented by a pipeline of 'consumables' used in the units, which offer a recurring revenue stream.

Detractors

Overweight AUB

Insurance services company AUB Group delivered weak earnings results which explains its recent underperformance. While the underlying insurance cycle remains supportive, some of this has been offset in the near term by changes in iCare (formerly WorkCoverNSW) which have led to a transitory slowdown in referrals. We expect a recovery in earnings for the relevant division in FY20. More broadly, the company raised ~$142m in November 2018 to position them to take advantage of M&A opportunities. In the near term the dilution from the capital raise has weighed on the stock. In the medium term we expect the company to continue to allocate capital efficiently into M&A, driving shareholder value.

Overweight Japara Healthcare

Sentiment towards the aged car sector, including Japara Health Care, remains poor in light of some of the serious incidents brought to light by the Royal Commission into aged care. This is likely to weigh on the sector in the near term. The Royal Commission's work in uncovering poor practices is critical in improving the quality of the sector. Longer-term we see this improved quality, combined with a structural shortage in aged care facilities, driving opportunities within the sector. Japara trades materially below the replacement cost of its assets and, given the significant operational challenges being experienced by many operators due to government funding cuts in recent years, we see a medium term industry-wide funding improvement as highly probable.

Outlook

A positive June capped a strong 2019 first half for the Australian small cap equity sector, which has staged a rapid rebound from the sell-off in late 2018. The S&P/ASX Small Ordinaries Index is up +0.9% for the month, +3.8% for the quarter and +16.8% for the half year.

Smaller companies have underperformed the larger end of the index over 2019 to date. This has been driven by strength in the iron ore sector, dominated by the big three of Rio Tinto, BHP and Fortescue Metals. At the same time, conclusion of the Banking Royal Commission, coupled with an improvement in sentiment towards the housing sector has seen the big four banks outperform.

Nevertheless, smaller companies have delivered strong absolute returns over the last half in aggregate, although performance has been mixed at a sector level. Information technology is up

+43.7% calendar year to date, led by software-as-a-service companies Wisetech and Appen. This high-profile growth cohort continues to perform well and this quarter Altium joined Xero and Afterpay in the ASX 100, leaving the Small Ordinaries.

Consumer staples, in contrast, are down -9.7% over the half. This reflects a combination of challenges including concern over the domestic supermarket sector (Metcash), uncertainty around Chinese growth (Blackmores) and company-specific issues at other companies such as Costa Group and Graincorp.

The portfolio performed broadly in line with the index in June. Insurance brokers AUB Group downgraded earnings on the back of weaker volumes and higher-than-expected costs of a new IT system, however this was offset by strong gains from Austal and Nanosonics. The latter two are good examples of the kind of niche growth opportunities available in the small cap universe. Austal builds and services specialised ships, with contracts with the US Navy. Nanosonics manufactures equipment to clean ultrasound probes in hospitals.

Austal has been a strong performer for some time, while auto dealership AP Eagers has also done well as it looks to merge with rival Automotive Holdings Group. However, this was offset by the drag from AUB Group and the underweight in NIB Holdings, the latter continuing to outperform following the Coalition's election victory which removes the probability of near term caps on health insurance premiums.

Looking forward, we continue to see a challenging environment in domestic cyclicals on the back of tighter bank lending and softer house prices, which is showing up in weaker new car sales, media advertising and general retail. That said, government efforts to stimulate demand should provide some degree of support.

Elsewhere in small caps, a weak Australian dollar is supporting offshore earnings and helping those companies with niche growth opportunities in technology, health care and education.

Lower interest rates in Australia and elsewhere is providing further fuel for the growth parts of the market. There are valid opportunities here with some valuation support, however there are also stocks where we believe valuation has run ahead of reasonable levels and the market is being less discerning over the quality of these companies. While several of the more popular technology stocks have now left the index, finding attractively-priced growth remains a challenge for small cap investors.

As always, we retain our valuation discipline and look to have a diverse range of ideas within the portfolio. Our favoured tech stock remains Technology One. Elsewhere, the Fund's largest positions also include mining services (Seven Group), logistics (Mainfreight) and quality stocks with defensive earnings such as InvoCare and Ryman Healthcare.

International Shares

Pendal Concentrated Global Share Fund

Market review

Most major indices recorded gains in June to rebound from May's weakness. Although trade tensions did not dissipate over the month, investors chose to take a more optimistic outlook following the outcome of the G20 meetings which took place in the last days of the month. While no definitive agreement was concluded, a resumption of US-China trade talks, the absence of additional tariff announcements and the resumption of US technology exports to Huawei appeared to be what markets were hoping for.

Global economic data remains subdued, and unsurprisingly the US Federal Reserve opted to leave US rates unchanged, with markets building expectations for an easing this year.

A Brexit agreement has yet to be concluded in the UK. The process is underway to appoint a new Prime Minister, with markets looking for a change in leadership as the catalyst to establish a consensus amongst the British Parliament and move forward with a Brexit agreement.

The US market was buoyed by expectations of gradual resolution to the US-China trade issue, together with signs the Fed will cut interest rates this year. The positive sentiment was most notable in the performance of growth oriented sectors, with materials, energy and tech stocks among the best performers. Pushing the energy sector higher was the oil price, which moved higher amid fears of escalating tensions with Iran which prompted concerns that conflict could disrupt energy supplies from the Middle East. At the month's close, the S&P500 registered a gain of 6.9%, while the NASDAQ declined by 7.4%.

European markets also registered a strong performance, supported by comments from ECB President, Mario Draghi, who indicated the board would consider easing monetary policy through a combination of interest rates and quantitative easing. Economic indicators showed some degree of resilience, with the Flash Eurozone Composite PMI indicator for the region registering its highest reading in seven months. In terms of market performance, the region's benchmark Euro Stoxx Index gained 5.9%, with gains across the region from Italy (+7.2%), Germany (+5.7%), France (+6.4%) and the UK (3.7%).

Asian equity markets took confidence from positive momentum in policy beyond their borders, with progress on the US-China trade issue remaining front and centre of considerations. Late in the month, a meeting between President Trump and President Xi at the G20 summit in Osaka, Japan concluded with an announcement that the two sides would resume negotiations while the US promised to temporarily halt a new 20% tariff on US$300b worth of Chinese imports and to lower some restrictions on Chinese technology giant Huawei. The region's best performing markets include Thailand (+6.8%), Singapore (+6.5%), Hong Kong (+6.1%) and Korea (+5.3%). India bucked the trend with a 0.8% decline.

The Australian dollar was relatively unchanged against the US dollar, euro and Japanese yen. In commodity markets the oil price held onto its strength being range bound to close the month at US$65 per barrel.

Portfolio performance

The Pendal Concentrated Global Share Fund returned 5.00% (post fee, pre-tax) in June, underperforming its benchmark by 0.27%.

Caixa succumbs to macro influences

Our holding in Caixa Bank (-9%) underperformed this month. Caixa Bank is the number one Spanish regional bank and has been represented in the Fund since its inception in August 2016. While the share price has retraced much of the gains made in 2018 and remains around 11% above our initial purchase price, the total shareholder return during that period has been closer to 27%, courtesy of an attractive 5% dividend yield.

Our initial investment was predicated on a view that the business was winning market share, seeing loan loss provisions decline and the leadership team was actively managing costs through the implementation of a multi-year restructure of the bank's bricks and mortar operations.

We felt these positive operating metrics were not being reflected in the share price, which was trading at a price to book value of less than one. We also saw European interest rates as being cyclically depressed, and whilst we did not have a view as to when rates would increase, we saw Caixa Bank's earnings as benefitting in this environment. We considered the compelling valuation, and 5% dividend yield supportive of taking a longer term view on the business.

The recent share price underperformance can be attributed to two factors: the European Central Bank (ECB) guiding for interest rates to be on hold at least until the first half of 2020; and increased political and regulatory intervention in the Spanish banking industry which is currently subject to court action. The outcome of this court action is unlikely to be known until the end of the year.

On the first factor, while interest rate increases would provide a nice fillip to earnings, they were never factored into our assumptions. On the second factor, similar to the rest of the global banking industry, regulators in Spain are taking a more pro-active approach to consumer protection when applied to financial services.

We are not in a position to predict the outcome of the industry-wide regulatory investigations taking place in Spain, but we would be surprised if they did not present negative shorter term implications for the industry, either by the way of mandatory changes in process or retrospective fines/class actions. However, we feel these risks are more than reflected in the share price, with Caixa Bank currently trading at 0.6x price to book and on a 2019 price to earnings of 9x, compared to Commonwealth Bank which trades on more than 2x price to book and a price to earnings ratio in excess of 15x.

Given the compelling valuation, our longer term perspective and the attractive dividend yield we remain invested.

Oracle's eyes remain on the cloud

Outperforming this month was our holding in software supplier Oracle (+13%), with the share price rising to a record high. The company reported their fourth-quarter results in June which exceeded market expectations. Operating margins of around 47% were the highest in five years, while licence revenue grew 15% over the year to record the highest level of growth since 2011.

Although the market has yet to give Oracle management the benefit of the doubt when it comes to transitioning the business from an on-premise to a cloud-based model, it is notable that margins for cloud services and support business increased modestly.

Management's confidence in their ability to execute was reflected in their 2020 guidance for revenue growth to exceed the 3% growth rate recorded in fiscal 2019. With the pace of share buy-backs expected to moderate in 2020, as investors we were encouraged by the growth and market share gains in the software applications businesses, which saw the recurring software as a service (SaaS) business growing above 25%.

Oracle has now gained the most market share of enterprise application SaaS vendors for three years running. The company appears to be gaining traction with their autonomous database product released last year which is also encouraging, with new customers as well as new workloads being added.

Strategic review spikes share price

Another outperformer for the Fund this month was our holding in real estate developer, Howard Hughes (HHC, +20%). The catalyst for the share price spike was the company's decision to hire an advisor to explore "strategic alternatives". We have no insight as to what these alternatives may be, however we have long thought that the company is being significantly undervalued by the market. HHC develops master plan communities (MPCs) in Las Vegas, Texas and Columbia. They also have assets in Hawaii and Chicago. The MPCs are large land parcels on which HHC manages the development of new entire communities over decades.

Management's strategy is to sell parcels of land to homebuilders, with the resultant cash flow being used to fund the development of office and retail assets within the MPC. Management take a long term view to managing the assets through the cycle and tightly control land sales in order to optimise pricing. Management's ability to execute is reflected in the growth in recurring net operating income, with the company becoming less reliant on land sales to fund new developments. At the very least we believe the strategic review will highlight to the market the inherent value reflected in the current share price.

Strategy and outlook

The Fund's cash weighting has reduced to around 6% from about 10% at the end of 2018. This allocation continues to reflect some concern that the earnings growth and margins implied by consensus estimates appears optimistic for the second half of the year. With a number of macro uncertainties clouding the outlook, we expect future volatility to present opportunities for the Fund, as it enables us to either add to existing positons or initiate new positions.

We believe the Fund is positioned to outperform over the longer term. Although markets reversed the losses of the prior month, there remains a high degree of uncertainty regarding the near term outlook.

Our focus remains on owning companies that are equipped with robust business models, have nimble management teams and dominant market shares. We buy these companies when valuations are compelling and when we have the confidence they are able to not only withstand but prosper, regardless of what the economic cycle may have to offer.

Our philosophical belief in owning a concentrated portfolio of businesses, rather than having indiscriminate broader market exposure, continues to reflect the way we manage the Fund and our approach to generating compelling returns over the long term while retaining a disciplined, yet opportunistic approach to identifying undervalued companies with the fundamental characteristics that will support its long term performance.

Pendal Core Global Share Fund

(managed by AQR Capital Management)

Market review

Most major indices recorded gains in June to rebound from May's weakness. Although trade tensions did not dissipate over the month, investors chose to take a more optimistic outlook following the outcome of the G20 meetings which took place in the last days of the month. While no definitive agreement was concluded, a resumption of US-China trade talks, the absence of additional tariff announcements and the resumption of US technology exports to Huawei appeared to be what markets were hoping for.

Global economic data remains subdued, and unsurprisingly the US Federal Reserve opted to leave US rates unchanged, with markets building expectations for an easing this year.

A Brexit agreement has yet to be concluded in the UK. The process is underway to appoint a new Prime Minister, with markets looking for a change in leadership as the catalyst to establish a consensus amongst the British Parliament and move forward with a Brexit agreement.

The US market was buoyed by expectations of gradual resolution to the US-China trade issue, together with signs the Fed will cut interest rates this year. The positive sentiment was most notable in the performance of growth oriented sectors, with materials, energy and tech stocks among the best performers. Pushing the energy sector higher was the oil price, which moved higher amid fears of escalating tensions with Iran which prompted concerns that conflict could disrupt energy supplies from the Middle East. At the month's close, the S&P500 registered a gain of 6.9%, while the NASDAQ declined by 7.4%.

European markets also registered a strong performance, supported by comments from ECB President, Mario Draghi, who indicated the board would consider easing monetary policy through a combination of interest rates and quantitative easing. Economic indicators showed some degree of resilience, with the Flash Eurozone Composite PMI indicator for the region registering its highest reading in seven months. In terms of market performance, the region's benchmark Euro Stoxx

Index gained 5.9%, with gains across the region from Italy (+7.2%), Germany (+5.7%), France (+6.4%) and the UK (3.7%).

Asian equity markets took confidence from positive momentum in policy beyond their borders, with progress on the US-China trade issue remaining front and centre of considerations. Late in the month, a meeting between President Trump and President Xi at the G20 summit in Osaka, Japan concluded with an announcement that the two sides would resume negotiations while the US promised to temporarily halt a new 20% tariff on US$300b worth of Chinese imports and to lower some restrictions on Chinese technology giant Huawei. The region's best performing markets include Thailand (+6.8%), Singapore (+6.5%), Hong Kong (+6.1%) and Korea (+5.3%). India bucked the trend with a 0.8% decline.

The Australian dollar was relatively unchanged against the US dollar, euro and Japanese yen. In commodity markets the oil price held onto its strength being range bound to close the month at US$65 per barrel.

Portfolio performance

The Pendal Core Global Share Fund returned 4.79% (post-fee, pre-tax) in June, underperforming its benchmark by 0.48%.

The Fund's underperformance in June was primarily sourced from Europe and North America, while developed Asia produced mild offsetting outperformance of its regional benchmark.

Thematically, Momentum was weak in all regions and primarily responsible for overall underperformance over the month. In Europe, underperformance was due to weakness in Sentiment and Momentum signals. In North America, Momentum drove underperformance, offset somewhat by positive returns to Sentiment and Value themes. In developed Asia, the outperformance was due to the strength of Value and Sentiment signals outweighing weakness in Quality over the month.

From a stock and industry attribution perspective, intra-industry stock selection drove underperformance, while industry tilts produced mild negative active returns over the month. Stock selection within industries was weakest within Health Care and Consumer Staples, which outweighed the outperformance of active positioning within Information Technology. At a sector level, the underweight in Materials and overweight in Utilities were the notable negative contributors, while an overweight in Information Technology was the largest positive offset.

At a stock level, the largest detractors from active returns over the month came from an overweight position in Deutsche Lufthansa AG (Lufthansa), a major European airline headquartered in Germany; an underweight position in Exxon Mobil Corporation, a US multinational oil and gas corporation; an underweight position in Bank of America Securities, a US multinational investment bank; an overweight in Swedish Match AB, a Swedish company based in Stockholm that makes tobacco-related products; and an underweight in AT&T, a US multinational conglomerate holding company trading primarily telecommunications products and services.

The largest positive contributors to active returns came from overweight positions in Applied Industrial Technologies, a US based company focused on the distribution of bearings, power transmission products and other industrial supplies; Hewlett Packard, a US multinational information technology company; Skyworks Solutions, a US manufacturer of semiconductors for use in radio frequency and mobile communications systems; Biogen Inc., a US multinational biotechnology company; and Xilinx, a US technology company that is primarily a supplier of programmable logic devices.

Strategy and outlook

Entering July, the largest sector tilts are overweights in Information Technology and Health Care and underweight positions in Financials and Energy.

Australian Fixed Income

Pendal Fixed Interest Fund

Market review

Australian bonds continued their rally in June as yields fell to new record lows. The decline in yields was shared by global counterparts alongside growing speculation of easing by major global central banks. The RBA delivered on expectations with a cut of 25bps to 1.25% during the month and messaging from the Board suggesting further easing ahead. This was evident in addresses by Assistant Governor Luci Ellis and Governor Philip Lowe, who both indicated that their estimate of the unemployment rate associated with full employment had fallen from 5% to 4.5%. Labour market data during the month illustrated the gap between the unemployment rate of 5.2% and full employment persisted. Meanwhile some leading economic indicators reflected signs of optimism in the wake of the surprise Coalition victory at the Federal Election. This included a bounce in the NAB Business Confidence survey from 0 to 7. However, business conditions and consumer confidence were weaker, as were the latest retail sales figures published for April month end. Turning to market movements, Australian 3 and 10 year yields dropped by -14bps and -13bps to 0.96% and 1.34% respectively. At the very front-end of the curve, 90 day BBSW fell by a sharper -21bps to 1.20% on the back of the RBA rate cut.

Portfolio performance

The Pendal Fixed Interest Fund returned 1.25% in June (post-fees, pre-tax), outperforming its benchmark by 0.21%.

The Fund outperformed its benchmark during June, which was driven by the alpha overlay. The Duration strategy was again the largest contributor from long duration exposures that continued to benefit from the large fall in yields. This included positions in the US, Australia, China and New Zealand. Meanwhile, the Yield Curve and FX strategies were roughly flat with USD vs EM positions in the latter. There were no positions held in the Cross-Market or Macro strategies. Finally, the credit and government components of the fund both added value.

Strategy and outlook

The Reserve Bank eased monetary policy further at its meeting in early July. Further easing is likely to occur, although we view a further rate cut occurring in August as being unlikely. Waiting until October, or as early as September, would afford the central bank more time to assess how data evolves in the more accommodative environment. In that respect, the labour market data remains key. The Reserve Bank sees the non-accelerating inflation rate of unemployment (NAIRU) as being 4.5%, well below the current unemployment rate of 5.2%.

Progress in getting the unemployment rate moving lower will require further stimulus, including via fiscal policy. Second quarter inflation data is also due to be released in late July. Inflation has been consistently under the Reserve Bank's target band for an extended period and only a significant undershoot would prompt any action from them in August.

Central banks globally have become more dovish recently, weighed down by slowing global trade and falling inflation expectations. The Reserve Bank's adjustment to monetary policy has to-date been in response to domestic factors. A deteriorating external environment would only add to the case for further monetary policy accommodation. As such, we expect further policy easing in the fourth quarter.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bonds continued their rally in June as yields fell alongside growing speculation of easing by major global central banks. Movements were dominated by expectations that the Federal Reserve would cut rates during the remainder of the year. During the month, roughly 1.00% of reductions were priced over the next twelve months. Such expectations were not dismissed by Fed Chairman Jerome Powell at the Fed's June meeting. Weaker data also built the case for easing with soft employment growth of 75K and a drop in the ISM manufacturing survey. Expectations for more accommodative policy were also evident elsewhere after ECB President Mario Draghi offered a more dovish than anticipated message at the central bank's gathering in Sintra, Portugal. Meanwhile, there were fewer trade war developments during June and as such they bore less influence over rates than previous months. For most of the month, traders were awaiting the outcome of a meeting between President Trump and Xi Jinping at the G20 summit in Osaka. Turning to market movements, US yields experienced similar declines of -17bps for the 2 year and -12bps for the 10 year to 1.76% and 2.01% respectively.

Portfolio performance

The Pendal Global Fixed Interest Fund returned 1.43% in June (post-fees, pre-tax), outperforming its benchmark by 0.16%.

Over the month, the Duration strategy was again the strongest performer, while the FX strategy detracted slightly and Yield Curve strategy was flat. The portfolio risk level started at 6 risk units and ended the month at 3 risk units.

The Duration strategy was the largest contributor over the month. Long duration positions were maintained through the month. The majority of the gains were from long duration positions in the US front end. We took profits on these positions by month end. Profits were also made from long duration positions in the front end of the yield curves in Australia and New Zealand. A tactical short duration position in the Italian BTPs was closed early in the month with a minor loss. In emerging markets we kept long duration position in the Korean long end and took profit on the long position in China mid-month.

The FX strategy detracted over the month. Pre-existing FX positions were all closed out at the beginning of the month. Gradually as the month progressed, long USD positions were added back against EM currencies in the month which were initially profitable, but a decline in the USD in the second half of month led to losses on these positions. We maintain our long USD bias against China and trade cycle proxies in EM.

The Yield Curve strategy was roughly flat over the month. Minor gains were from a new flattening position in the Australian front end of the curve, offsetting the losses from the flattening position in the US front end, which was closed earlier in the month.

There were no trades in Relative Value, Macro or Cross-Market strategies in the month.

Strategy and outlook

As long as the soothing suggestions of further monetary easing remain, the yield grab is back and deteriorating economic fundamentals effectively become a positive for risk. Moreover, the backdrop for risk has improved with a more optimistic (or complacent) perspective on the trade front. For these reasons, we have stayed away from shorts in global credit as this phenomenon may play out for a while longer. At the same time, the mounting expectations for stimulus continue to support the outlook for lower yields and our preference for long duration positions. However we also note this preference has become more popular in the market and suggests some patience is required to re-initiate positions.

Credit

Pendal Enhanced Credit Fund

Market review

Australian credit generated another positive return in June, driven by a fall in yields and healthy accruals. The drop in yields was alongside the RBA cut and growing expectations of further easing. Similarly mounting speculation of stimulus from global central banks including the Fed and ECB put further pressure on global yields.

Turning to issuance, NAB was the only issuer among the Big Four domestic banks to raise debt capital during the month with an $2.5b deal. Other financials accounted for the bulk of volume through the period including Macquarie ($2.25b), Standard Chartered ($1b), and Barclays ($800m). Corporate deals were relatively light with $400m from Vicinity and $200m from data service centre provider NextDC.

On market movements, the Australian iTraxx index (Series 31 contract) traded in a wide 18.5bp range finishing the month 14.5bps tighter to +63.5bps. Physical credit spreads narrowed 2bps over the month, with the best performing sectors being domestic banks, offshore banks and industrials all tightening 2bps each. The worst performing sector was resources which finished 7bps wider. Semi-government bonds performed well tightening 4bps to government bonds.

Portfolio performance

The Pendal Enhanced Credit Fund returned 0.83% in June (post-fees, pre-tax), underperforming the benchmark return by 0.01%.

A fall in underlying rates and accruals made a positive contribution. Positions in infrastructure and utilities, where the fund is overweight, underperformed the credit index. Portfolio purchases over the period included issuance from truck manufacturer Paccar and an RMBS originated by ANZ.

Strategy and outlook

Our overall credit view remains cautiously constructive. We are positive on corporate fundamentals, but are wary that appetite for credit has demonstrated varying sensitivity to geopolitical developments and the ongoing trade war.

From a bottom-up perspective, corporates in the US have demonstrated resilience with upside surprises to earnings growth in the Q1 reporting season. Similarly, domestic fundamentals remain relatively healthy as issuers have not increased balance sheet leverage materially over the past several years. The major Australian banks also have stronger capital ratios than previous years, which should support domestic financial stability. Moreover the weight of the Royal Commission has finally been lifted from their shoulders. That said, recent results from the majors have revealed challenges as a result of the Commission as well as slowing mortgage growth.

From a macro standpoint, volatility has quickly spiked then evaporated over the past year. Elevated levels during 2018 (particularly December), subsided in January and have been muted over the past month. This has been alongside shifting perspectives towards the trade war and central bank policy stance. While the more dovish tilt from central bankers is a significant positive, we are wary that attitudes towards these developments can shift quickly as the story evolves, particularly with geopolitical flare-ups.

Of further consideration is the softening of domestic economic growth, where there is likely further risk to the downside as weak wage growth and the house price correction threaten to dampen consumption. 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 bonds continued their rally in June as yields fell to new record lows. The decline in yields was shared by global counterparts alongside growing speculation of easing by major global central banks. The RBA delivered on expectations with a cut of 25bps to 1.25% during the month and messaging from the Board suggesting further easing ahead. This was evident in addresses by Assistant Governor Luci Ellis and Governor Philip Lowe, who both indicated that their estimate of the unemployment rate associated with full employment had fallen from 5% to 4.5%.

Labour market data during the month illustrated the gap between the unemployment rate of 5.2% and full employment persisted, which suggested the RBA has scope to reduce the cash rate further. By month-end the market was pricing an additional two cuts in 2019. Meanwhile some leading economic indicators reflected signs of optimism in the wake of the surprise Coalition victory at the Federal Election. This included a bounce in the NAB Business Confidence survey from 0 to 7. However, business conditions and consumer confidence were weaker, as were the latest retail sales figures published for April month end.

Offshore, bond movements were dominated by expectations that the Federal Reserve would cut rates during the remainder of the year. During the month, roughly 1.00% of reductions were priced over the next twelve months. Such expectations were not dismissed by Fed Chairman Jerome Powell at the Fed's June meeting. Weaker data also built the case for easing with soft employment growth of 75K and a drop in the ISM manufacturing survey. Expectations for more accommodative policy were also evident elsewhere after ECB President Mario Draghi offered a more dovish than anticipated message at the central bank's gathering in Sintra, Portugal.

Meanwhile, there were fewer trade war developments during June and as such they bore less influence over rates than previous months. For most of the month, traders were awaiting the outcome of a meeting between President Trump and Xi Jinping at the G20 summit in Osaka. This ultimately saw the US President withdraw his threat of additional tariffs on US$300b of Chinese imports and remove some restrictions on supplies to Huawei. In exchange Trump claimed that China would purchase large scale quantities of US agricultural produce, although this was not confirmed by the Chinese.

Turning to market movements, Australian 3 and 10 year yields dropped by -14bps and -13bps to 0.96% and 1.34% respectively. At the very front-end of the curve, 90 day BBSW fell by a sharper -21bps to 1.20% on the back of the RBA rate cut. US yields experienced similar declines of -17bps for the 2 year and -12bps for the 10 year to 1.76% and 2.01% respectively.

In credit markets, synthetic spreads for major indices tightened over the month amid a more supportive environment for risk assets. This was driven by both a more accommodative stance by central banks as well as the absence of negative trade war news.

The Australian iTraxx index (Series 31 contract) traded in a wide 18.5bp range finishing the month 14.5bps tighter to +63.5bps. Physical credit spreads narrowed 2bps over the month, with the best performing sectors being domestic banks, offshore banks and industrials all tightening 2bps each. The worst performing sector was resources which finished 7bps wider. Semi-government bonds performed well tightening 4bps to government bonds.

Portfolio performance

Managed Cash

The Pendal Managed Cash Fund returned 0.15% in June (post-fees, pre-tax), outperforming the benchmark by 0.02%.

The fund returned 17 basis points for the month, outperforming the benchmark by 3 basis points for the month and 16 basis points over the year. With a higher running yield than the index remains well positioned to outperform. Themes and credit exposure remain consistent with prior months, with the excess spread from A-1 rated issuers and security selection likely to be the main driver of outperformance. The yield curve has flattened significantly and consequently yield curve strategies are less likely to add to performance in the near term. The fund ended the month with a weighted average maturity of 65 days (maximum limit of 70 days). The weighted average maturity had consistently been longer than benchmark due to the higher yields available further out the curve with minimal risk of any monetary policy tightening from the Reserve Bank. With yields having rallied aggressively longer dated yields do not look as attractive unless monetary policy easing does occur - something we expect to happen. We remain wary of extending too far out the curve, particularly if the curve inverts.

Enhanced Cash

The Pendal Enhanced Cash Fund returned 0.21% in June (post-fees, pre-tax) outperforming the benchmark by 0.08%.

The portfolio outperformed the benchmark by 10bps in June. Positive performance came primarily from financials and industrials sectors. Activity during the month included investing in three new primary market deals, all from the financials sector. These were funded out of cash.

As at the end of the month, the portfolio had a credit spread of 58bps over bank bills, interest rate duration of 0.15 years and credit spread duration of 1.35 years.

Strategy and outlook

The Reserve Bank eased monetary policy at its meeting in early June. It is highly likely that further easing occurs in the coming months. There had been ample opportunity for the Reserve Bank to ease at the June meeting - inflation data disappointed in late April and economic growth weakened over the second half of 2018. Why didn't the Board cut? The labour data had shown strong employment growth over the past 12 months and was at odds with the weak household consumption in the national accounts. Business liaison also indicated some labour tightness emerging in some areas. However, the increase in the unemployment rate from 5% to 5.2% revealed a weaker picture and in turn was the last domino to fall. The Reserve Bank had been looking for increasing labour market tightness feeding into underlying inflation. The increase in the unemployment rate put that to bed - there is more than ample slack in the labour market that will not result in the wage inflation outcomes they are looking for. For their forecasts to be achieved further policy easing will be required and soon, the question is not whether they ease again but how many times it occurs. The labour data will again be key in determining when the next rate cut occurs.

Australian Property

Pendal Property Securities Fund

Market review

The ASX 300 AREIT index was up 4.2% in June, outperforming the broader market by 50bp, with the strongest performance coming from Goodman Group (+13.3%) and GPT Group (+9.1%). REITs were driven by the 10 year bond yield falling 15bp to an all-time low of 1.32% and a 25bp cash rate cut. US bond yields fell below 2% for the first time since 2016. On a rolling 12 months, AREITS are +19.3%, outperforming the broader market by 7.8%. Globally REITs were up 2.6% for the month, with year rolling performance up 10.8%. Australian REITs have been the best performing market, followed by the US (+16.8%) with the laggard being Europe -10.9%.

June saw another very strong month for capital raisings with $1.7b raised, bring YTD raisings to $3.7b, the largest since the re-capitalisations just after the GFC. Cromwell Property Group, Growthpoint Properties and National Storage took advantage of high stock prices to raise equity to fund future opportunities/developments. GPT raised $800m to fund a further 25% of Darling Park 1&2, Sydney and Charter Hall Long WALE raised capital to acquire three assets. Interestingly only $150m has been raised to fund retail assets. The other notable transaction during the period was Scentre Group’s sale of the three office towers above Westfield Sydney to Blackstone for $1.52b, a 4.4% cap rate and 13% premium to book value. Scentre Group will deploy $800m of the proceeds to buy back stock as the REIT is trading at a 12% discount to NTA.

Macro data continues to disappoint with weak global PMIs, particularly in manufacturing (now in contraction mode). Despite this, global markets performed well with the S&P500 +7% and Europe +6%, driven by falling bond yields and some optimism about a trade truce.

In Australia employment was solid +42,300 positions, with the unemployment rate flat at 5.2%. A soft first quarter GDP growth rate of 0.4% saw the RBA cut the cash rate by 25bp to 1.25%, the first cut since 2016. Retail sales disappointed, -0.1% and credit growth continued to be lacklustre at a six-year low of +3.6%.

Portfolio performance

The Pendal Property Securities Fund returned 5.53% in June (post-fee, pre-tax), outperforming its benchmark by 1.37%.

The portfolio outperformed for the month. Positive attribution came from underweight positions in Vicinity Centres, Unibail-Rodamco Westfield, Stockland Trust Group and Shopping Centres Australia and an overweight position in Precinct Properties NZ. An overweight position in Japara Healthcare, Arena REIT and Charter Hall Education Trust and underweight positions in GPT Group and Abacus Property Group detracted from performance.

Over the month we increased our overweight positions in Goodman Group, Charter Hall Long WALE and Centuria Industrial Trust and reduced our underweight position in Unibail-Rodamco Westfield, reduced our overweight in Charter Hall Retail REIT and moved from an overweight to underweight position in both National Storage REIT and GPT Group.

Strategy and outlook

The AREIT sector is now priced on an FY20 dividend yield of 4.7%, a PE ratio of 18.7 times and a 45% premium to NTA, well above its long-term average of 17%. Cap rates are unlikely to compress much further from current levels and asset valuation improvements will be dependent on income growth and tenancy retention. Non-dominant discretionary malls with high specialty occupancy costs are actually expected to fall in value in the short to medium term. Balance sheets are stable with sector gearing at 27%.

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 rebounded in June, posting a total return of 1.5%. Asia Pacific (+3.9%) was the strongest performer, followed by North America (+1.2%), while Europe (-0.6%) underperformed during the month. Within Asia Pacific, results were positive across the region. Singapore (+10.9%) posted the largest increase, followed by New Zealand (+8.1%), Hong Kong (+5.1%) and Japan (+1.4%). Results in Europe were largely positive, however the region underperformed due to weakness in Germany (-9.0%). Conversely, Israel (+12.3%), Finland (+8.7%) and Ireland (+7.6%) were notable positive performers. Within North America, the US and Canada returned 4.2% and 1.1%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund returned 0.51% in June (post-fee, pre-tax), underperforming the benchmark by 0.21%.

North America

The North American portfolio returned 1.10% in June before fees and taxes, trailing the FTSE EPRA Nareit North America Index by 13 basis points. Underperformance relative to the benchmark was driven by negative stock selection results, which were partially offset by positive sector allocation results. In terms of stock selection, results were weakest in the health care, industrial, and shopping center sectors and were strongest in the diversified, office, and apartment sectors. Regarding sector allocation, positive results were driven by the portfolio’s overweight to the outperforming industrial sector. Among the portfolio’s holdings, top individual contributors to relative performance included overweight positions in outperforming Howard Hughes (HHC), Rexford Industrial Realty (REXR), and Duke Realty (DRE). Detractors most notably included an underweight position in outperforming Prologis (PLD), lack of exposure to outperforming Ventas (VTR), and an overweight position in underperforming Healthcare Trust of America Class A (HTA).

Europe

The European portfolio returned -2.17% in June before fees and taxes, underperforming the regional EPRA benchmark by 148 basis points. Underperformance relative to the benchmark was driven by both negative stock selection and negative country allocation results. In terms of stock selection, results were weakest in Germany, Sweden, and Ireland and were strongest in the United Kingdom, France, and Netherlands. Regarding country allocation, negative results were largely attributable to the portfolio's lack of exposure to the outperforming Switzerland and Belgium, and an overweight position in the underperforming Germany. Conversely, the portfolio's overweight to the outperforming Sweden, Norway, and Ireland were notable positive contributors to relative performance. Among the portfolio's holdings, top contributors to relative performance included overweight positions in outperforming Segro PLC (United Kingdom), Gecina SA (France), and Kungsleden AB (Sweden). Detractors most notably included overweight positions in underperforming Deutsche Wohnen SE (Germany), Vonovia SE (Germany), and ADO Properties SA (Germany).

Asia

The Asian portfolio returned 3.57% in June before fees and taxes, trailing the regional EPRA benchmark by 28 basis points. Underperformance relative to the benchmark was attributable to both negative stock selection and negative country allocation results. In terms of stock selection, results were weakest in Japan and Hong Kong, while results in Singapore were neutral. Regarding country allocation, negative results were driven by the portfolio's underweight to the outperforming Singapore. The regional portfolio's small cash position was also a modest detractor to relative performance given the positive absolute performance of the regional benchmark. Among the portfolio's holdings, top contributors to relative performance included overweight positions in outperforming Frasers Centrepoint Trust (Singapore) and CapitaLand (Singapore), and an underweight position in underperforming Sumitomo Realty & Development (Japan). Detractors included a lack of exposure to outperforming Hang Lung Properties (Hong Kong), City Developments (Singapore), and CapitaLand Mall Trust (Singapore).

Strategy and outlook

North America – While there is some evidence that the economy slowed in the second quarter, wage growth has been solid but not strong enough to raise inflation concerns. The Fed has continued to back away from its tightening cycle and is now expected to cut the Federal Funds rate sooner, possibly as early as July. With inflation largely dormant, the Fed has the flexibility to make several cuts in the Federal Funds rate to shore up the economy if warranted. It also plans to stop reducing the size of its balance sheet by September or earlier. U.S. property market fundamentals continue to be strong with few signs of weakening outside of certain subsectors. With the exception of self-storage and some seniors housing segments, construction appears to be peaking in most sectors. On the other hand, malls and power centres continue to be hit by store closures and are the main areas of demand weakness, with most other sectors seeing demand that is sufficient to keep vacancy rates near recent cyclical lows. Overall, we continue to expect 5-6% growth in REIT cash flows in 2019 as leases roll and as rents continue to rise at a slowing but still positive pace. After quarter-end, REITs traded at a 4% premium to net asset value, unchanged from the end of March and in line with the historical average of a 2% premium. REIT dividend yields were only 28 basis points lower than BAA corporate bond yields, an attractive spread compared to the historical average of 119 basis points lower. Following the stock market's strong performance, REITs became slightly more attractive versus general equities. Overall, at the end of June, REITs traded at more attractive valuations compared to the prior quarter-end.

Europe – European property equities are expected to post an attractive relative performance in the current environment of low interest rates, reasonable economic growth, and positive inflation. New construction levels generally are low as bank financing for speculative development projects is difficult to obtain. This is a competitive advantage for the REITs, which generally have access to cheap financing given that the European REITs typically do not buy assets in the “hot” investment markets but instead develop assets in undersupplied markets. The main risks for the sector are European politics and the German regulatory environment. The United Kingdom will get a new prime minister, and neither leading candidate has ruled out a “hard Brexit”, while the UK Parliament continues to be against a hard Brexit. It is likely that uncertainty will persist in the near term. At quarter-end, European property equities were reasonably valued with European REITs trading at a 9% discount to net asset values and offering a cash flow yield of 5.5% and a dividend yield of 4.3%.

Asia – At the end of June, the Asia Pacific portfolio traded roughly around fair value and supported by strong fundamentals and lower interest rates in some markets. With the Federal Reserve turning more dovish and with rate cuts in Australia, we believe it will be a conducive environment for the property stocks. We continue to like the office markets across the region, which are driven by positive demand and supply dynamics. We are generally cautious on retail but we like the Hong Kong retail sector where demand is unthreatened by e-commerce, although we acknowledge that in the medium term, the ongoing protests and political environment will affect tourism.

Active Balanced

Pendal Active Balanced Fund

Markets review

June was another positive month for the Australian equity market, with the S&P/ASX 300 Accumulation Index returning +3.6%. The same index had a strong second quarter, adding 8.1% to what was already a solid recovery in the previous quarter (+10.9%) following the market’s decline in late 2018.

Domestically, sentiment improved somewhat following the Coalition’s surprise win in the Federal election. Nevertheless, the 10-year bond yield is now at record lows, down 15bps in June after the Reserve Bank of Australia (RBA) cut the cash rate to a record low of 1.25% in June. Ten of the 11 GICS sectors finished the month higher. Consumer Discretionary posted a loss of -1.5%, while at the other end, Materials (+6.2%) finished the month the strongest, with the help of Metals & Mining (+7.7%).

Most major indices recorded gains in June to rebound from May’s weakness. Although trade tensions did not dissipate over the month, investors chose to take a more optimistic outlook following the outcome of the G20 meetings which took place in the last days of the month. While no definitive agreement was concluded, a resumption of US-China trade talks, the absence of additional tariff announcements and the resumption of US technology exports to Huawei appeared to be what markets were hoping for.

Global economic data remains subdued, and unsurprisingly the US Federal Reserve opted to leave US rates unchanged, with markets building expectations for an easing this year.

A Brexit agreement has yet to be concluded in the UK. The process is underway to appoint a new Prime Minister, with markets looking for a change in leadership as the catalyst to establish a consensus amongst the British Parliament and move forward with a Brexit agreement.

The Australian dollar was relatively unchanged against the US dollar, euro and Japanese yen. In commodity markets the oil price held onto its strength being range bound to close the month at US$65 per barrel.

Australian bonds continued their rally in June as yields fell to new record lows. The decline in yields was shared by global counterparts alongside growing speculation of easing by major global central banks. The RBA delivered on expectations with a cut of 25bps to 1.25% during the month and messaging from the Board suggesting further easing ahead. This was evident in addresses by Assistant Governor Luci Ellis and Governor Philip Lowe, who both indicated that their estimate of the unemployment rate associated with full employment had fallen from 5% to 4.5%. Labour market data during the month illustrated the gap between the unemployment rate of 5.2% and full employment persisted.

Meanwhile some leading economic indicators reflected signs of optimism in the wake of the surprise Coalition victory at the Federal Election. This included a bounce in the NAB Business Confidence survey from 0 to 7. However, business conditions and consumer confidence were weaker, as were the latest retail sales figures published for April month end.

Turning to market movements, Australian 3 and 10 year yields dropped by -14bps and -13bps to 0.96% and 1.34% respectively. At the very front-end of the curve, 90 day BBSW fell by a sharper -21bps to 1.20% on the back of the RBA rate cut.

Global bonds continued their rally in June as yields fell alongside growing speculation of easing by major global central banks. Movements were dominated by expectations that the Federal Reserve would cut rates during the remainder of the year. During the month, roughly 1.00% of reductions were priced over the next twelve months. Such expectations were not dismissed by Fed Chairman Jerome Powell at the Fed's June meeting. Weaker data also built the case for easing with soft employment growth of 75K and a drop in the ISM manufacturing survey. Expectations for more accommodative policy were also evident elsewhere after ECB President Mario Draghi offered a more dovish than anticipated message at the central bank's gathering in Sintra, Portugal. Meanwhile, there were fewer trade war developments during June and as such they bore less influence over rates than previous months. For most of the month, traders were awaiting the outcome of a meeting between President Trump and Xi Jinping at the G20 summit in Osaka.

In terms of market movements, US yields experienced similar declines of -17bps for the 2 year and -12bps for the 10 year to 1.76% and 2.01% respectively.

Portfolio performance

The Pendal Active Balanced Fund returned 2.62% (post-fee, pre-tax) for the month of June, underperforming its benchmark by 0.34%.

The Fund's return for June was largely driven by its exposure to Australian and offshore equity and property markets which experienced positive returns. Overweight exposures to the best performing asset classes contributed to returns. The Australian and international fixed income made positive contributions to returns as markets delivered gains from easing pressure on bond yields.

Performance relative to the benchmark was primarily driven by our active asset allocation processes. Our tactical decisions saw the Fund's overweight exposure to global equities contribute to relative returns, while an underweight exposure to Australian fixed interest assets also generated a positive contribution.

The key factors influencing the alpha generated through active management were stock selection outcomes within Australian and international equities. Within the Australian equity strategy, overweight positions in Qantas, Nine Entertainment and Metcash detracted from performance while overweight positions in Fortescue Metals and underweight positions in NAB and Wesfarmers contributed to performance.

Within the global equities portfolio the Core, Concentrated and Emerging Markets strategies delivered gains however they underperformed their benchmarks (pre fees), while the European Value strategy outperformed.

The Alternatives strategy delivered a total return (before fees) of 0.64% versus a cash return of 0.13%. Within our Alternatives core portfolio the Managed Futures, Event Driven and Fixed Income Relative Value strategies contributed to returns but were offset by detractions from the Equity Market Neutral, Global Macro and Dedicated Short Bias strategies.

In relation to our tactical positioning within the Alternatives component of the Fund, contributions from positioning in bond markets were partially offset by detractions from positioning in equity markets and volatility strategies.

Since the end of June we have taken new active asset allocation decisions to establish long positions in gold and in Japan.

Strategy and outlook

The Australian market has in the main now move past some concerns from earlier in the year, mainly in relation to the Federal election, developments in the housing market and policy direction of the RBA. With economic monetary and fiscal policy now proceeding together towards stimulatory settings, growth assets like shares and property are well placed to benefit, albeit to a degree.

The labour market needs to be a key area of focus, considering the bearing it has on management of related pressures such as household debt, low inflation and benign wages growth. Further easing of monetary policy in conjunction with tax relief can play its role in shoring up a weakening economy. Expansionary settings employed in the past few economic cycles have generally had the desired effect, although the record low level of the cash rate and external factors relating to trade warrant a degree of caution for investors, particularly those with a greater reliance on cash-based yields.

The Fund’s performance exhibits the benefit of having a well-diversified and disciplined investment strategy that can smooth returns from underlying assets which tend to be more volatile in isolation. We also structure the Fund to adequately diversify on many levels to capture opportunities for generating long term gains within a tightly controlled risk management framework.

Regardless of short term market developments, we are always focused on continual improvement through a rigorous, research-based approach and are focused on ensuring our funds are well positioned to achieve their long term objectives.

We remain confident that our tried and tested investment philosophy and asset allocation processes will continue to deliver favourable investment outcomes over the long term. We continue to employ an active approach to modelling scenarios and assessing market technical factors to identify opportunities and limit risks for our investors.

Performance as at 30 June 2019

(%)	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)	2.87	6.80	18.53	7.87	7.87	11.30	12.77	8.77	10.01
Total Return (pre-fee, pre-tax)	2.94	7.02	19.01	8.74	8.74	12.20	13.67	9.63	11.00
Benchmark	3.64	8.05	19.84	11.42	11.42	12.33	12.82	8.88	10.08
Pendal Imputation Fund								APIR -	RFA0103AU
Total Return (post-fee, pre-tax)	2.66	6.65	17.02	8.77	8.77	11.11	12.43	7.86	9.62
Total Return (pre-fee, pre-tax)	2.74	6.89	17.54	9.75	9.75	12.11	13.44	8.83	10.63
Benchmark	3.64	8.05	19.84	11.42	11.42	12.33	12.82	8.88	8.95
Pendal Focus Australian Share Fund								APIR -	RFA0059AU
Total Return (post-fee, pre-tax)	2.51	8.11	20.42	8.72	8.72	12.26	14.61	10.47	9.50
Total Return (pre-fee, pre-tax)	2.57	8.31	20.87	9.54	9.54	13.32	15.86	11.59	10.60
Benchmark	3.64	8.05	19.84	11.42	11.42	12.33	12.82	8.88	7.94
Pendal Ethical Share Fund								APIR -	RFA0025AU
Total Return (post-fee, pre-tax)	2.82	6.34	18.79	7.84	7.84	10.84	12.49	8.96	8.66
Total Return (pre-fee, pre-tax)	2.90	6.59	19.34	8.87	8.87	11.89	13.56	10.00	9.72
Benchmark	3.64	8.05	19.84	11.42	11.42	12.33	12.82	8.88	8.38
Australian Shares - Mid Cap									
Pendal MidCap Fund								APIR -	BTA0313AU
Total Return (post-fee, pre-tax)	0.24	4.00	12.38	-1.77	-1.77	10.01	12.04	12.18	9.93
Total Return (pre-fee, pre-tax)	0.31	4.23	12.88	-0.88	-0.88	11.42	13.34	13.55	12.05
Benchmark	1.99	3.81	14.95	2.88	2.88	10.04	11.67	12.02	5.93
Australian Shares - Small Cap									
Pendal Smaller Companies Fund								APIR -	RFA0819AU
Total Return (post-fee, pre-tax)	0.83	1.77	12.35	-3.53	-3.53	9.89	8.42	9.19	12.75
Total Return (pre-fee, pre-tax)	0.93	2.09	13.04	-2.32	-2.32	11.26	9.77	10.56	14.04
Benchmark	0.92	3.75	16.81	1.92	1.92	12.53	10.66	9.26	7.76
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund								APIR -	RFA0061AU
Total Return (post-fee, pre-tax)	0.16	3.35	17.68	7.77	7.77	13.61	14.20	16.72	17.70
Total Return (pre-fee, pre-tax)	0.12	3.51	18.67	9.50	9.50	15.21	16.44	19.97	22.61
Benchmark	0.92	3.75	16.81	1.92	1.92	12.53	10.66	9.26	3.47
International Shares									
Pendal Core Global Share Fund								APIR -	RFA0821AU
Total Return (post-fee, pre-tax)	4.79	2.08	13.05	3.12	3.12	8.40	10.85	10.73	5.81
Total Return (pre-fee, pre-tax)	4.85	2.29	13.55	4.08	4.08	9.42	11.90	11.79	6.97
Benchmark	5.27	5.19	17.29	11.95	11.95	13.66	14.01	13.25	7.57
Pendal Global Emerging Markets Opportunities Fund - WS								APIR -	BTA0419AU
Total Return (post-fee, pre-tax)	4.49	2.44	12.38	6.82	6.82	9.50	13.24	10.04	10.64
Total Return (pre-fee, pre-tax)	4.59	2.79	13.13	8.30	8.30	11.02	14.81	11.61	12.76
Benchmark	4.89	1.84	10.95	6.56	6.56	9.41	12.87	8.75	9.98
Pendal Concentrated Global Share Fund								APIR -	BTA0503AU
Total Return (post-fee, pre-tax)	5.00	3.54	13.60	9.75	9.75	13.45	N/A	N/A	14.23
Total Return (pre-fee, pre-tax)	5.09	3.82	14.22	10.86	10.86	14.67	N/A	N/A	15.52
Benchmark	5.27	5.19	17.29	11.95	11.95	13.66	N/A	N/A	13.68
Property									
Pendal Property Securities Fund								APIR -	BTA0061AU
Total Return (post-fee, pre-tax)	5.53	5.79	22.50	23.61	23.61	17.72	9.69	14.35	8.27
Total Return (pre-fee, pre-tax)	5.59	5.96	22.89	24.41	24.41	18.48	10.40	15.10	9.08
Benchmark	4.16	4.12	19.10	19.39	19.39	16.25	8.44	13.81	8.00
Pendal Global Property Securities Fund								APIR -	RFA0051AU
Total Return (post-fee, pre-tax)	0.51	-0.46	13.62	7.62	7.62	7.18	5.61	7.46	9.14
Total Return (pre-fee, pre-tax)	0.57	-0.24	14.14	8.61	8.61	8.16	6.59	8.46	10.14
Benchmark	0.72	-0.70	13.72	7.07	7.07	6.58	5.32	7.46	8.84
Fixed Interest									
Pendal Fixed Interest Fund								APIR -	RFA0813AU
Total Return (post-fee, pre-tax)	1.25	3.32	6.29	7.71	7.71	5.53	3.35	4.47	6.45
Total Return (pre-fee, pre-tax)	1.29	3.45	6.55	8.25	8.25	6.06	3.87	4.99	7.01
Benchmark	1.04	3.05	6.59	9.57	9.57	6.28	4.23	5.06	6.72
Pendal Global Fixed Interest Fund								APIR -	RFA0032AU
Total Return (post-fee, pre-tax)	1.43	2.99	5.22	5.72	5.72	3.77	1.68	4.22	5.96
Total Return (pre-fee, pre-tax)	1.48	3.13	5.50	6.28	6.28	4.32	2.22	4.77	6.54
Benchmark	1.27	2.89	5.47	7.34	7.34	4.69	2.66	5.00	6.89
Pendal Enhanced Credit Fund								APIR -	RFA0100AU
Total Return (post-fee, pre-tax)	0.83	2.46	5.17	7.41	7.41	5.35	4.30	4.67	5.80
Total Return (pre-fee, pre-tax)	0.86	2.57	5.40	7.89	7.89	5.83	4.77	5.14	6.32
Benchmark	0.84	2.46	5.18	7.56	7.56	5.44	4.34	4.75	5.91
Cash & Income									
Pendal Enhanced Cash Fund								APIR -	WFS0377AU
Total Return (post-fee, pre-tax)	0.21	0.65	1.39	2.46	2.46	2.58	2.74	2.67	4.82
Total Return (pre-fee, pre-tax)	0.23	0.71	1.52	2.71	2.71	2.84	2.99	2.92	5.16
Benchmark	0.13	0.45	0.97	1.97	1.97	1.88	1.86	2.08	4.75
Pendal Managed Cash Fund								APIR -	WFS0245AU
Total Return (post-fee, pre-tax)	0.15	0.46	0.94	1.91	1.91	1.85	1.86	2.06	6.28
Total Return (pre-fee, pre-tax)	0.17	0.52	1.05	2.14	2.14	2.07	2.08	2.28	6.58
Benchmark	0.13	0.45	0.97	1.97	1.97	1.88	1.86	2.08	6.36
Pendal Monthly Income Plus Fund								APIR -	BTA0318AU
Total Return (post-fee, pre-tax)	1.16	3.15	6.17	6.33	6.33	5.68	4.83	4.87	5.58
Total Return (pre-fee, pre-tax)	1.22	3.32	6.52	7.03	7.03	6.37	5.52	5.55	6.25
Benchmark	0.11	0.36	0.73	1.49	1.49	1.50	1.51	1.78	2.76
Diversified									
Pendal Active Balanced Fund								APIR -	RFA0815AU
Total Return (post-fee, pre-tax)	2.62	3.32	10.67	4.46	4.46	7.12	7.87	7.27	7.59
Total Return (pre-fee, pre-tax)	2.70	3.57	11.19	5.46	5.46	8.15	8.90	8.29	8.66
Benchmark	2.96	4.62	12.80	9.34	9.34	9.51	9.24	8.18	7.60

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PENDAL

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

Pendal is the issuer of the following products:

Pendal Australian Share Fund ARSN 089 935 964

Pendal Smaller Companies Fund ARSN 089 939 328

Pendal Concentrated Global Share Fund ARSN 613 608 085

Pendal Core Global Share Fund ARSN 089 938 492 #

Pendal Global Fixed Interest Fund ARSN 099 567 558

Pendal Enhanced Credit Fund ARSN 089 937 815

Pendal Fixed Interest Fund ARSN 089 939 542

Pendal Property Securities Fund ARSN 089 939 819

Pendal Global Property Securities Fund ARSN 108 227 005

Pendal Managed Cash Fund ARSN 088 832 491

Pendal Enhanced Cash Fund ARSN 088 863 469

Pendal Active Balanced Fund ARSN 088 251 496

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

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