Fund Manager Commentary

Month ended 31 August 2019

Table of Contents

Australian Shares

Pendal Australian Share Fund

Market Review

Australian stocks (S&P/ASX 300 Accumulation Index) fell 2.3% in August. With the sudden escalation in the Sino-US trade dispute and a mixed reporting season, six out of the 11 GICS sector ended the month with a negative return. Defensive sectors such as Health Care (+3.4%) and Real Estate (+2.4%) were the best performers in August. Real Estate was aided by signs of some recovery in the housing market as the RBA cut the cash rate to 1%; while the respective 52/30 basis points (bp) decline in the US/AU 10-year bond yield also generally supported the bond sensitives. Amongst all, Lend Lease (LLC, +19.4%) led the sector with some attribution to the recovering Sydney and Melbourne property markets rebound. The company managed to close a large number of their apartment sales around Australia, particularly in Sydney's Barangaroo, which investors had been worried about. Management also made comments around the bottoming out of the Australian residential market, which coincided with similar comments from other companies that the property market is seeing some early signs of stabilisation. In addition, the absence of any new news from LLC’s engineering business which had a catastrophic outcome last year, supported investor sentiment in general.

Within Health Care, CSL Limited (CSL, +4.9%) experienced strong growth in FY19, driven by high product volume. Despite some initial approval issues in China, CSL managed to substantially improve the country’s albumin sales in the second half of FY19. On the flipside, Ramsay Health Care (RHC, -9.8%) disappointed markets after its earnings per share (EPS) growth fell short of market expectations.

Elsewhere, Consumer Staples (+0.1%) made reasonable gains. Within the sector, Treasury Wine Estates (TWE, +5.9%) reported strong organic sales growth and an earnings to cash conversion rate that were in line with market expectations. These helped to reverse some prior doubtful sentiments. Other stocks such as A2 Milk (A2M, -20.8%) disappointed the market after revealing a set of underwhelming earnings results, with management reporting an FY19 earnings (EBITDA) margin of 28.2%, which was 12% below market consensus.

Lastly, some growth stocks performed well during the month. One of the market's favourites – Afterpay (APT, +15.9%) – reached a record high in August after a release of encouraging company news. With strong growth in sales metrics, a solid US network and a positive UK market entry, Afterpay continued to impress the market with its rapid expansion. Domino’s Pizza (DMP, +12.3%) has also recouped some losses since its share price reached a two-year low. While we did see a decrease in EBIT (compared to last year’s figure) for the Australia-New Zealand and Europe regions, the market was already aware of the sluggish sales growth and stores rollouts.

On the other side of the tally board, Energy (-5.6%) and Materials (-7.3%) were the sector laggards. Metals & Mining (-8.0%) declined in response to the falls in commodity prices, including copper and iron ore. A notable drop in the iron ore price (-28.3%) was largely attributed to the sudden escalation in the Sino-US trade dispute as well as the restart of production at Brazil's Vale mining operations. As a result, despite reporting some strong results in the first half of FY19, with 24% revenue growth and higher than expected dividend growth, the Rio Tinto (RIO, -8.4%) share price still declined over the month. A large boost to RIO’s earnings was due to the high commodity prices, and with the recent price decreases the main concern is whether the miner can sustain its growth. Similarly, BHP (-11.0%) and Fortescue Metals Group (FMG, -4.0%) both retreated. Offsetting some of these losses were gold miners such as Newcrest (NCM, +4.6%) and Evolution Mining (EVN, +4.4%) which fared better in August. The rising gold price on the back of heightened geopolitical uncertainties and a low interest rate environment remains supportive to the cohort.

The Financials sector (-2.6%) also underperformed marginally over the month, as the share price of all big four banks declined in the range of -1.1% (CBA) to -4.2% (ANZ). CBA experienced softer earnings and overall profits, with a 12% decrease in retail banking profitability when compared to last year. Management has stated the rate cuts have put pressure on their profit margins as they cannot pass on the decrease in rates onto their deposit accounts (worth $160 billion). For Diversified Financials, the share prices of both Magellan (MFG, -16.2%) and AMP (-5.3%) decreased amid capital raising plans. The former raised $275 million to primarily fund their new High Conviction Trust IPO; whereas the latter issued a heavily discounted capital raising of $650 million to help fund the restructuring of their wealth management arm.

Portfolio performance

Contributors

Overweight Qantas

Qantas (QAN, +7.0%) delivered a decent result, despite the headwind of higher fuel costs and softer demand in the domestic market. The company also dialled-up its capital return by $100m to $600m per half year, which was well received by the market. There was also a positive read on the implications of Virgin Australia's (VAH) poor earnings result. VAH's announcement that it is looking to cut unprofitable routes, plus the increased gearing that comes with its US$-denominated debt, had some investors questioning its ability to survive. We believe that it does; however, VAH is in no position to start aggressively discounting fares, while fewer routes means less capacity in the domestic Australian market. Both situations are good for QAN.

Overweight CSL

CSL (+4.9%) posted a strong set of results for FY19. The company continued to deliver strong top-line growth, predominantly driven by product volume. In particular, there was a significant improvement in albumin sales into China in the second half after a disrupted first half due to approval issues. The result provided investors with a good level of assurance in a down market and was well received.

Overweight James Hardie

James Hardie (JHX, +13.4%) posted a double-digit gain in August on the back of a surprisingly good result. While US housing remains soft, JHX's share of fibre cement is showing signs of growing and the fibre cement category itself is growing in usage, so two out of the three tenets of their story are now better placed. Pulp prices are also falling which is also supportive for JHX.

Detractors

Overweight Viva Energy

Viva Energy (VEA, -18.1%) retreated following a weak print of first-half results. While refining margins have improved more recently, the retail fuel margin came in lower than expected for the period and management has guided for the second-half to be in line with the first if the weakness in retail margin persists. We think this could be attributed to some aggressive competition from EG Group, which bought the Woolworths fuel business in April. The market has quickly priced in an expectation that currently weak margins will persist, weighing not only on Viva but also on Caltex (CTX, -11.3%). We remain mindful that retail fuel margins have historically been volatile and can reverse swiftly. The current margin levels also imply a material proportion of petrol stations are currently unprofitable, which is not sustainable.

Woolworths - not held

Woolworths (WOW, +6.0%) outperformed after releasing its FY19 results. While its latest earnings result was largely in line with market expectations, its Australian Foods business was the standout and management noted there was lower discounting in long-life (i.e, packaged) goods. We do not hold Woolworths and our preference in the sector is Metcash (MTS, +2.8%). We believe the commentary from WOW is yet another sign that grocery deflation may have bottomed after several years which being the case would be a tailwind for MTS that is not reflected in its current valuation.

Overweight Caltex

Caltex Australia (CTX, -11.3%) experienced a weakening share price post reporting of its latest results. FY19 was weighed down by weak refining margins. However, margins have been improving towards the end of the year and was well known. That said, there has also been unexpected weakness in its retail fuel margins, possibly due to some aggressive competition from EG Group after its purchase of the Woolworths fuel business in April. The market has quickly moved to price in an expectation that currently weak margins will persist, weighing not just on CTX but also on Viva Energy (VEA, -18.1%). We remain mindful of the fact retail fuel margins have historically been volatile and can reverse in short spaces of time. As mentioned earlier, the current levels imply a material proportion of petrol stations are currently unprofitable, which is not sustainable.

Strategy and outlook

August's reporting season certainly reflected the fact that economic growth and consumer demand has slowed over the past 12 months. However, it was not as bad as many feared. While the overall market declined, this was driven more by macro uncertainty over the US-China trade dispute rather than an overly negative reporting season, evidenced by the MSCI World Index's 2.3% return in August.

Around 42% of companies which reported downgraded their earnings guidance for the next 12 months, versus an historical average of just over 30%. Conversely, only 10% upgraded compared to the historical average of just under 20%. The greatest pressure came in areas such as steel, which saw earnings estimates for the next 12 months fall 15%. Media (-13%) and telcos (-10%) were also part of this cohort. Very few sectors of the market saw aggregate upgrades and where they occurred, upgrades were small. Examples include Consumer Discretionary (+1%) and Health Care (+1%).

In aggregate, earnings expectations for the ASX200 for the next 12 months fell 3%, which reflects an environment in which housing construction has slowed and where weaker house prices have weighed on consumer demand.

That said, price action tended to reflect the view that broad outcomes were not as bad as some had feared. There is also a general expectation that stimulus – in the form of cuts to interest rates and taxes as well as the possibility of more fiscal spending – could help underpin demand and prevent further falls. Signs of improvement in the housing market are helping in this regard.

Hence, media and steel – the two sectors with the largest downgrades – both outperformed the market and posted positive gains in August. Likewise, Building Materials advanced in spite of downward revisions. Discretionary stocks also did very well as companies like JB Hi-Fi noted in their outlook that demand and sales had started to rise again in recent weeks.

All in all, growth remains muted although further signs of an uptick in the domestic economy could drive stock-specific opportunities, given how cheap many domestic industrial cyclicals have become. We retain our exposure to cyclicals via positions in Qantas and Nine Entertainment among others.

We are mindful that both growth and defensive yield stocks have had a strong 12-month run on the back of falling bond yields. Yields are likely to remain depressed for a period but now is not the time to go aggressively underweight. However, these stocks are unlikely to replicate the same degree of outperformance over the coming year unless Australian bond yields move closer to zero. Our preferred growth stocks include CSL and Xero, while we continue to like Transurban and Atlas Arteria among the defensive yield stocks.

Pendal Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation index fell -3.9% in August, underperforming its larger cap ASX 100 counterpart (-2.1%). Eight out of the 11 GICS sector finished the month in the red, with Energy (-10.4%) experiencing the largest loss. Amongst all, Viva Energy (VEA, -18.1%) retreated following a weak print of 1H19 results. While refining margin has improved more recently, Retail fuel margin came in lower than expected for the period and management guided 2H19 to be in line with 1H19 if the weakness in retail margin persists. The market has quickly priced in an expectation that currently weak margins will persist, weighing not just on Viva but also on Caltex.

Following Energy, Information Technology (-8.3%) also retreated after posting a 40.8% gain for the calendar year to August. Wisetech Global (WTC, +15.6%) advanced after being included in the ASX 100 index. The company also reported strong earnings, with total revenue increasing by 57% to $348.3 million for FY19. Management guided revenue to be in the range of A$440-460m for FY20; and EBITDA at A$145-153m. In contrast, Appen (APX, -15.6%) was sold off although the underlying EBITDA for 1H19 was up +81% compared to 1H18. Figure Eight had a slow start for the financial year, with Annualised Recurring Revenue (ARR) guidance being revised down to $30-35m from $40-43m. Management cited challenges from first year integration disruptions, but retained profit and synergy outlook.

Consumer Staples (-8.0%) lagged as companies including Blackmores (BKL,-18.8%), Bellamy’s Australia (BAL, -25.7%) and Inghams Group (ING, -21.9%) reported softer earnings. Ingham’s weaker financial outlook was due to the higher input costs and production inefficiencies. In addition to reporting a FY19 EBITDA below market consensus, management stated that EBITDA will likely decline further in FY20. Production inefficiency also affected Blackmores’ price, as margins have continued to degrade despite management’s attempts to adjust the cost base. Bellamy’s EBIT decreased 19% (when compared to the prior year) and management stated that the main factors that impacted profitability were new e-commerce regulations and increased competition in the Chinese market. Partially offsetting some of the losses, sector heavyweight Metcash (MTS, +2.8%) reaffirmed full year guidance while flagging weaker performance in their hardware business. Nevertheless, the company had a positive read-through from Woolworths, where management noted that there was lower discounting in long-life (ie packaged) goods. It is another sign that grocery deflation may have bottomed after several years which, if so, would be a tailwind to MTS.

On the other side of the tally board, Real Estate (+4.4%) was the largest contributor to headline index performance. The global environment of decreasing bond yields continues to support bond proxy stocks, particularly as market turns risk-off. Charter Hall Long WALE REIT (CLW, +14%) was the standout after recently acquiring Telstra’s Melbourne Headquarters for $830m. On top of Woolworth’s renewed 5 years lease, Charter Hall has a wide and long-term portfolio that aims to provide investors with steady earnings. Similarly, Aveo Group (AOG, +3.4%) gained after news on corporate action broke out – Aveo entered into a Scheme Implementation Deed with Brookfield, for it to be acquired at $1.3b. The cash offer price was 7% above AOG’s then closing price; however was below the company’s last stated Net Tangible Assets (NTA).

Lastly, Utilities (+28.6%) was the best performing sector in August. Amongst all, ERM Power Limited (EPW, +34.4%) reported a FY19 $123.1 million net profit, a turnaround from its $80.5 million loss last year. Adding onto ERM’s success, it has been recently acquired by Shell Australia –

as Shell plans to make ERM its core “power and energy solutions platform”. Infigen Energy (IFN, +24.2%) reported an 11% increase in EBITDA and resumed payment of dividends ($0.01/share) for the first time since 2011 (the company halted dividend payments to repay debt). Infigen has also recently acquired a gas power plant and back-up diesel generators, helping to upgrade power output and generate higher quality earnings.

Portfolio performance

The Pendal Smaller Companies Fund returned -4.03% (post-fee, pre-tax) in August, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.18%.

Contributors

Overweight Credit Corp (CCP)

CCP announced the acquisition of competitor Baycorp in August, removing a well-established competitor. This move led management to upgrade net profit after tax (NPAT) growth guidance for FY20 from 15% to 18%. The acquisition was funded from existing debt facilities. This news came on top of 9% growth in NPAT in FY19 and the industry’s consolidation augments several other near term tailwinds for the company.

Overweight Smartgroup Corporation (SIQ)

Salary packaging and fleet-management company Smartgroup saw widespread upgrades to consensus earnings forecasts following its FY19 earnings. The market had been wary of softer auto finance approval rates and new car sales. However, its result demonstrated a resilience that generally surprised the market and reduced the perception of risk to near-term earnings.

Detractors

Overweight Saracen Mineral (SAR)

The gold price eased mid-month as sentiment on US-China trade took a more positive turn, weighing on gold miners such as Saracen. Yet another twist in rhetoric saw the gold price recover later in the month. SAR also started to climb again, but finished the month lower. During August it reported a 22% increase in profits for FY19 - helped by strength in the gold price – and announced the implementation of a dividend. The portfolio currently has a~6% exposure to gold miners, with Saracen among our preferred companies.

Overweight Ooh Media (OML)

OML downgraded 1H19 earnings guidance ahead of their results, driven largely by weakness in advertising spending in the domestic economy. When reporting, they noted that there were some recent signs of improvement in advertising and also stated that opex and capex are both likely to be towards the lower end of expectations. We continue to monitor the near-term domestic environment, mindful of the potential for interest rate cuts and fiscal stimulus to help stabilise recent weakness. We also continue to like the structural tailwinds supporting OML.

Outlook

The underweight in real estate detracted from relative performance as investors sought more defensive, bond-sensitive pockets in a volatile month. The position in gold miners also gave back some of its recent gains after a very strong run. However, this was largely offset by strong gains from Credit Corp (CCP), Smartgroup (SIQ), specialist medical device maker Nanosonics (NAN) and car dealership group AP Eagers (APE).

Reporting season broadly reflected the effect of a weaker domestic demand environment. The number of companies which downgraded earnings was roughly double the amount that upgraded. However it was interesting to note that in many instances there was a muted price reaction to downgrades, suggesting that the market had already priced in a weaker environment.

In this vein, there were several examples of market segments where trends were actually not as poor as many had feared. Some larger retailers such as Super Retail (SUL) and Harvey Norman (HVN) saw relief rallies post reporting. Several management teams called out signs of improving trends in discretionary spending, helped by the Reserve Bank cutting rates, tax cuts and signs of stabilisation in property prices. Nevertheless, domestic economic growth remains very patchy and our retail exposure tends to be more defensive areas or with global opportunities.

Several of the Fund's largest holdings delivered strong results. Seven Group (SVW) posted a 49% gain in annual profit as its WesTrac business benefited from an increase in sales of new equipment as miners looks to replace aging fleets. The company remains well placed to benefit from this trend as well as east coast infrastructure spending.

Ship-builder Austal's (ASB) 64% increase in profit came in ahead of consensus. Its US operations continued to drive strong revenue growth. Meanwhile Nanosonics (NAN), which makes specialised hospital equipment to disinfect ultrasound probes, delivered 201% growth in operating profits before tax. It continues to see strong growth in its European, Australian and North American markets, while management also announced that is 'Trophon2' system has been granted approval in Japan.

Looking forward, we continue to seek and find attractive niches within the small cap universe. We have a good mix of exposures within the portfolio, including areas with attractive organic earnings growth (eg mining services, Mainfreight (MFT), with strong free cash flow generation (eg AUB Group (AUB), Bapcor (BAP)), leveraging disruptive forces (eg. Nanosonics (NAN), Technology One (TNE)) or where management strategy is improving the quality of the franchise (eg Austal (ASB), Invocare (IVC)).

International Shares

Pendal Concentrated Global Share Fund

Market review

The major equity markets retreated during August amid waning sentiment on the likelihood of resolution to the US-China trade issue, a persistent impasse on the Brexit issue and a more recent issue affecting bond markets. In terms of the latter, August saw an inversion of the US and UK yield curves, whereby the shorter dated yields have inverted to be higher than their 10-year counterparts. Such a development has been associated in the past as a predictor of a recession. Exacerbating the general uncertainty was a historic one-day market drop in Argentina, together with mixed global economic data. These developments, coupled with the latest instalment in the tariff saga with China announcing it would apply tariffs of 5-10% on US$75b worth of US imports from September, contributed to further caution on equity markets.

The US equity market adopted the trade rhetoric with an unsurprising negative tone, with a number of flat-to-down days characterising the month. Acceptance of the continued growth mantra that has supported the market appeared fragile, as evidenced by news that US economic growth decelerated in the second quarter by more than initially reported. Investors promptly drew conclusions about the growing impact of Trump's tariffs on the country's economic expansion. The US second-quarter reporting season also drew to a close, with numbers on the whole better than consensus. That said, in aggregate the market has recorded a second consecutive quarter of negative earnings growth. At the month's close, the S&P500 registered a decline of 1.8%, while the NASDAQ fell by 2.6%.

The major European markets were uniformly down in August. Negative sentiment emanating from the global economy's health was exacerbated by further complications with the UK's uncertain Brexit path, together with the UK debt yield curve inversion – being the first such instance since 2008. UK economic data released during the month revealed a slowdown in economic growth through the first half of 2019, largely explained by weaker business investment and slowing global economic growth. Elsewhere in Europe, earlier weakness was recouped to a degree by month end, although a definite bias emerged towards defensive sectors such as Consumer Staples, Utilities and Health Care and away from the cyclically oriented Financials, Information Technology and Energy sectors was evident. In terms of market performance, the region's benchmark Euro Stoxx Index declined by 1.2%, with the UK (-5.0%), Germany (-2.1%) and Spain (-1.8%) leading the region lower.

Asian equity markets were far from a place of refuge for investors during August. Social unrest in Hong Kong continued while the Chinese yuan was allowed to fall through a key threshold to an 11-year low, attracting accusations of currency manipulation by Trump. China's economic data provided little comfort, with industrial production slowing to a lower-than-expected 4.8% year-on-year growth in July, while fixed asset investment rose 5.7% over the first seven months of the year. The manufacturing purchasing managers' index (PMI) slipped further into contractionary territory to a reading of 49.5 in August compared with 49.7 in July. Hong Kong (-7.4%) bore the brunt of selling, followed by Singapore (-5.9%), Japan (-3.4%) and Thailand (-3.3%).

The Australian dollar weakened against all major currencies, headlined by falls of 3.9% against the yen, 1.6% against the US dollar and British pound, and 0.8% against the euro. Commodity markets trended lower, led by a 6% fall in the oil price. Weaker iron ore prices also contributed to the Australian trade weighted index being down by 1%.

Portfolio performance

The Pendal Concentrated Global Share Fund returned -0.86% (post fee, pre-tax) in August, underperforming its benchmark by 1.13%.

Rio Tinto takes a step down on earnings while posting record dividend

Underperforming this month was our holding in Rio Tinto (-11.7%). The company reported its half-yearly results at the beginning of August, causing some of the share price decline. The results were in line with consensus estimates, with the 11% year on year rise in earnings (EBITDA) being driven by iron ore operations in the Pilbara. The iron ore division benefitted from a 31% increase in prices, which more than offset the 8% decline in volumes resulting from maintenance and weather related issues. The company remains committed to returning excess cash to shareholders, demonstrated by the record A$3.5b first-half dividend, (including a A$1b special dividend), which reflect 90% of free cash flow being returned to shareholders.

The disappointment reflected in the share price stemmed from operational issues being experienced in the Pilbara, as well as the A$0.8b impairment taken on RIO's share of the Oyu Tolgoi (OT) copper project in Mongolia.

A technical review is currently underway at OT, with expectations that a new estimate for development capital spend and production timeline will be released in the second half of 2020. Project delays are not ideal; however, given the complex geological challenges of an underground mine we would prefer operators to protect the long-term value of the asset if unforeseen technical difficulties arise, by ensuring thorough due diligence is completed before proceeding.

We will assess the new production timeline and cost update when this is announced. While being of strategical importance, OT represents less than 5% of the net present value of Rio Tinto and in our view, the share price underperformance this month is more directly associated to the 20%-plus fall in the iron ore price. Despite the fall, iron ore prices remain over 25% higher for the year to date. Around 70% of RIO's earnings are derived from iron ore, cash flow generation is significant and the balance sheet is strong. If iron ore prices were to fall further, we are comfortable that the company can remain profitable through the cycle, given their industry-leading margins. As shareholders, we are also happy to continue to benefit from those profits being distributed back to shareholders, with the company currently trading on a dividend yield of around 10%.

Las Vegas Sands delivers on earnings

Our holding in integrated resort operator, Las Vegas Sands (LVS, -8.2%), also underperformed this month. With almost 60% of LVS' consolidated earnings being derived from their Macau operations, the share price has been caught in the cross-hairs of the US/China trade conflict. However, the second-quarter results did not reflect these negative headlines. Macau earnings grew 2% year on year, but more significantly, mainland Chinese visitation was up 12% over the period, with mass market table wins growing by 5.2%—a second-quarter record. The LVS strategy in Macau has been to focus primarily on the mass market, with a view that the infrastructure build-out within both Macau and in mainland China would allow visitors to travel further and to stay longer in Macau.

With over 12,000 hotel rooms, 1.9m square feet of retail space and more entertainment venues than any other operator, the company is uniquely positioned to cater to the mainland Chinese market. While we acknowledge the risks associated with deteriorating relations between the US and China, particularly in light of the upcoming concession renewals in 2022, we believe company management are doing everything to mitigate those risks by working closely with the Macau Government and supporting non-gaming development initiatives.

As Macau's largest employer they are an integral part of Macau's economic prosperity. We expect the volatility to continue; however, considering LVS' underlying business strength and the share price trading on a 6% dividend yield, we are happy to retain our position.

CME finds its NEXus

Outperforming for the Fund this month was our holding in the world's largest financial exchange company, CME Group (+11.8%). The strong performance followed the release of its second-quarter earnings result. While volume growth remains unsurprisingly muted, management are focused on the metrics they can control. They lowered operating expense guidance for 2019, de-leveraging post the NEX Group acquisition and are focused on maintaining operating margins at around 65%. We remain of the view that the market is yet to appreciate the extent of the benefits that will flow from the NEX acquisition, which closed in the fourth quarter of 2018.

NEX operates a leading electronic foreign exchange and fixed income cash execution platform as well as OTC post-trade services. While the full extent of revenue synergies will not be realised until 2020/21, we remain confident the strategic rationale of the NEX deal will prove well-founded. In the interim, the company trades on a dividend yield of 3%.

Strategy and outlook

During August the markets retraced the highs recorded in July. Economic data remains mixed, macro conditions are uncertain and we continue to believe that near-term earnings expectations appear optimistic. We also expect market volatility to increase. Our current cash position continues to reflect some concern that second-half earnings growth expectations for a number of companies appears optimistic.

We believe the Fund is positioned to outperform over the longer term. 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. We believe owning a concentrated portfolio of businesses rather than having indiscriminate broader market exposure is the best way to optimise investment performance.

Pendal Core Global Share Fund

(managed by AQR Capital Management)

Market review

The major equity markets retreated during August amid waning sentiment on the likelihood of resolution to the US-China trade issue, a persistent impasse on the Brexit issue and a more recent issue affecting bond markets. In terms of the latter, August saw an inversion of the US and UK yield curves, whereby the shorter dated yields have inverted to be higher than their 10-year counterparts. Such a development has been associated in the past as a predictor of a recession. Exacerbating the general uncertainty was a historic one-day market drop in Argentina, together with mixed global economic data. These developments, coupled with the latest instalment in the tariff saga with China announcing it would apply tariffs of 5-10% on US$75b worth of US imports from September, contributed to further caution on equity markets.

The US equity market adopted the trade rhetoric with an unsurprising negative tone, with a number of flat-to-down days characterising the month. Acceptance of the continued growth mantra that has supported the market appeared fragile, as evidenced by news that US economic growth decelerated in the second quarter by more than initially reported. Investors promptly drew conclusions about the growing impact of Trump's tariffs on the country's economic expansion. The US second-quarter reporting season also drew to a close, with numbers on the whole better than consensus. That said, in aggregate the market has recorded a second consecutive quarter of negative earnings growth. At the month's close, the S&P500 registered a decline of 1.8%, while the NASDAQ fell by 2.6%.

The major European markets were uniformly down in August. Negative sentiment emanating from the global economy's health was exacerbated by further complications with the UK's uncertain Brexit path, together with the UK debt yield curve inversion – being the first such instance since 2008. UK economic data released during the month revealed a slowdown in economic growth through the first half of 2019, largely explained by weaker business investment and slowing global economic growth. Elsewhere in Europe, earlier weakness was recouped to a degree by month end, although a definite bias emerged towards defensive sectors such as Consumer Staples, Utilities and Health Care and away from the cyclically oriented Financials, Information Technology and Energy sectors was evident. In terms of market performance, the region's benchmark Euro Stoxx Index declined by 1.2%, with the UK (-5.0%), Germany (-2.1%) and Spain (-1.8%) leading the region lower.

Asian equity markets were far from a place of refuge for investors during August. Social unrest in Hong Kong continued while the Chinese yuan was allowed to fall through a key threshold to an 11-year low, attracting accusations of currency manipulation by Trump. China's economic data provided little comfort, with industrial production slowing to a lower-than-expected 4.8% year-on-year growth in July, while fixed asset investment rose 5.7% over the first seven months of the year. The manufacturing purchasing managers' index (PMI) slipped further into contractionary territory to a reading of 49.5 in August compared with 49.7 in July. Hong Kong (-7.4%) bore the brunt of selling, followed by Singapore (-5.9%), Japan (-3.4%) and Thailand (-3.3%).

The Australian dollar weakened against all major currencies, headlined by falls of 3.9% against the yen, 1.6% against the US dollar and British pound, and 0.8% against the euro. Commodity markets trended lower, led by a 6% fall in the oil price. Weaker iron ore prices also contributed to the Australian trade weighted index being down by 1%.

Portfolio performance

The Pendal Core Global Share Fund returned -0.54% (post-fee, pre-tax) in August, underperforming its benchmark by 0.81%.

The Fund underperformed its benchmark over August 2019, with underperformance in all core regions, although the primary driver of the negative active returns was Europe.

Thematically, Value experienced negative active returns across all regions and was primarily responsible for overall underperformance over the month. In North America and developed Asia, Value drove underperformance, offset somewhat by positive returns in Momentum themes. In contrast, Momentum in Europe was the largest detractor from active returns, although Value also experienced negative returns in this region.

From a stock and industry attribution perspective, intra-industry stock selection drove underperformance, while industry tilts produced modestly offsetting positive active returns over the month. Stock selection within industries was weakest within Industrials and Health Care. At a sector level, the underweight in Energy and Financials were the notable positive contributors, while underweights in Consumer Staples and Communication Services generated negative returns.

At a stock level, the largest detractors to active returns came from an overweight position in Pfizer Inc., a US multi-national pharmaceutical corporation headquartered in New York City; an overweight position in Jiangsu Yangzijiang Shipbuilding Group Limited, a large Singapore-based corporate group with shipbuilding and offshore engineering as its core business; an overweight position in BT Group plc; a British multinational telecommunications holding company headquartered in London; an overweight position in The Hewlett-Packard Company, a US multi-national information technology company; and an underweight position in AT&T, a US multi-national conglomerate holding company trading primarily telecommunications products and services. The largest 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; Tyson Foods, Inc., a US multi-national corporation that primarily processes and markets chicken, beef and pork; Intuit Inc., an American business and financial software company that develops and sells financial, accounting, and tax preparation software; Pandora A/S, an international Danish jewellery manufacturer and retailer; and Merck & Co., Inc., a US multi-national pharmaceutical company.

Strategy and outlook

Entering September, 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 extended their rally in August as yields tumbled globally on a combination of factors. This included geopolitical risks with the further intensification of the trade war, as well as building concerns over weaker global growth. Such downside risks were noted by the RBA in its August policy statement. In the wake of two back-to-back cuts from the Board, it opted to keep rates on hold at 1.0% during the month and indicated it could “ease monetary policy further if needed”. Domestic data was mixed over the month. The NAB Business Conditions survey eased 2 points to +2, while confidence did the opposite. Retail sales (+0.4%) surprised to the upside and consumer confidence bounced back to 100 from 96.5. In contrast, the CBA August Composite PMI dropped into contractionary territory (49.3 from 52.1). Meanwhile among the lagging data, job additions of 41.1K beat expectations and were driven by full-time positions. However, an increase in the participation rate to 66.1% kept the unemployment rate steady at 5.2%. The Australian 3 year yield fell -13bps to 0.67% and the 10 year by -31bps to 0.90%. Meanwhile at the very front-end, 90 day BBSW slid a relatively marginal 3bps to 0.97%.

Portfolio performance

The Pendal Fixed Interest Fund returned 1.74% in August (post-fees, pre-tax), outperforming its benchmark by 0.23%.

The Fund’s outperformance during August, 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 Australia, New Zealand and the US. The Yield Curve strategy also added value from an Australian front-end curve flattener. Finally, the credit and government components both outperformed their benchmarks.

Strategy and outlook

The Reserve Bank left the cash rate unchanged at its meeting in early September. There was a minor change in the accompanying statement with the reference to monitoring developments in the labour market closely watered down. This was most likely done to avoid the assumption that a rise in the unemployment rate will automatically result in further monetary policy easing. The Reserve Bank continues to see an extended period of low interest rates, not surprising given their most recent forecasts in the Statement on Monetary Policy. Annual underlying inflation is not expected to reach 2% until mid-2021 and the unemployment rate is expected to remain above 5% for 2020 due to sub trend economic growth. The risks to global growth are also clearly tilted towards the downside. Given the benign state of the domestic economy and the offshore headwinds posed we expect further policy easing, most likely occurring prior to the end of the year.

International Fixed Income

Pendal Global Fixed Interest Fund

Market review

Global bonds extended their rally in August as yields tumbled on a combination of factors. This included geopolitical risks with the further intensification of the trade war, as well as building concerns over weaker global growth. Trade fears were reignited at the outset of the month as President Trump announced an additional 10% tariff on the US$300b of remaining Chinese imports, to take effect on September 1st. Adding to investor worries were a litany of regional events; Hong Kong protests, Argentina default speculation, Brexit uncertainty and another Italian political drama.

Beyond the politics, the Fed did not meet during the month after delivering a cut at the end of July, its first in more than a decade. Communication including an address by Chairman Powell at Jackson Hole was underwhelming, but suggested the central bank remained tilted towards further easing. Also in the US, a collection of leading indicators from the world's largest economy pointed to a further softening. Turning to market data, US yields experienced sizeable declines with the 2 and 10 year falling -37bps and -52bps to 1.51% and 1.50% respectively.

Portfolio performance

The Pendal Global Fixed Interest Fund returned 3.08% in August (post-fees, pre-tax), outperforming its benchmark by 0.12%.

Over the month, the Duration strategy remained the strongest performer, while the Yield Curve strategy added small gains and the FX strategy detracted slightly. The Cross-Market and Macro strategies were roughly flat. The portfolio risk was maintained at the relatively stable level around 3 risk units throughout the month.

The Duration strategy was again the largest contributor over the month. We continued to hold long duration positions in various markets. This month the largest contribution was from the long duration positions in the front end of the New Zealand and Australian curves. We took profits in the long positions in Europe early in the month and reinitiated long duration positions in the US later in the month. In developing markets, we took profits in the long duration positions in Korea and Singapore in the beginning of the month and held the long duration position in China for the month. All three positions contributed positively this month.

The FX strategy detracted from performance over the month. Earlier in the month, losses were contributed by a short EUR vs USD position. As the US-China trade war escalated in the month we opened a short USD vs JPY position, expecting the risk-off sentiment to continue. The position was taken off once the risk sentiment around the trade war improved. Gains were made from a long USD vs CNH position as the currency pair broke above 7 for the first time in 10 years, offsetting the losses from other positions.

The Yield Curve strategy contributed positively to the portfolio this month. Gains were from the flattening position in the front end of the Australian curve, which we continued to hold through the month.

In the Macro strategy we continued to hold a modest sell protection position in iTraxx Australia with the expectation of tightening credit spread in the near future. The position were roughly flat in performance.

In the Cross-Market strategy, the trade from our quantitative process had a flat performance for the month.

Strategy and outlook

The 'risk-off' environment in August saw safe-haven demand drive bonds higher, while stronger demand in certain countries caused even flatter yield curves. We believe there is still value at the front end including the US and New Zealand. Similarly with Australia, depending on how the data evolves. China is also a preferred area for long duration calls and short exposure to the Yuan against the Dollar given the economic slowdown and trade-related uncertainty. That said, we are running more modest exposure than in prior months. This is from profit-taking, some mixed signals from global data and wariness of a short-term correction in rates. We would see sell-offs as an opportunity to add risk at more attractive levels and our preference remains to be long duration over the medium-term.

Credit

Pendal Enhanced Credit Fund

Market review

Australian credit generated another positive return in August, driven by the continued fall in yields and healthy accruals. The drop in yields was alongside increased geopolitical risks and building concerns over a global growth slowdown.

Turning to issuance, August issuance totalled $10.5b and was dominated by financials. The largest deal was from ANZ, who raised A$3b of 3 and 5 year paper at 55bps and 77bps over swap respectively. Domestic rival WBC also tapped the market for tier 2 subordinated debt capital with an A$1b deal. In contrast, issuance from corporates was very light amid the domestic earnings season. QIC Shopping Centres raised A$300 million in a green bond issue.

The Australian iTraxx index (Series 31 contract) traded in a wide 17bp range finishing the month 4bps wider to +63bps. Physical credit spreads also underperformed with the average spread moving out 3bps. The worst performing sector was domestic banks who widened out 9bps, whilst the best performing sector was real estate only widening 1bp. Semi-government bonds underperformed moving out 3bps to government bonds.

Portfolio performance

The Pendal Enhanced Credit Fund returned 0.84% in August (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, performed strongly relative to other Australian credit sectors. Portfolio activity included reducing exposure to BNP Paribas and purchasing new issuance from ANZ.

Strategy and outlook

The Reserve Bank left the cash rate unchanged at its meeting in early September. There was a minor change in the accompanying statement with the reference to monitoring developments in the labour market closely watered down. This was most likely done to avoid the assumption that a rise in the unemployment rate will automatically result in further monetary policy easing. The Reserve Bank continues to see an extended period of low interest rates, not surprising given their most recent forecasts in the Statement on Monetary Policy. Annual underlying inflation is not expected to reach 2% until mid-2021 and the unemployment rate is expected to remain above 5% for 2020 due to sub trend economic growth. The risks to global growth are also clearly tilted towards the downside. Given the benign state of the domestic economy and the offshore headwinds posed we expect further policy easing, most likely occurring prior to the end of the year.

The global macro environment continues to offer the greatest guidance to domestic credit and it has proven a very dynamic and fast-evolving backdrop. The two key elements of influence remain trade wars and expectations of more dovish central banks, including the Fed and ECB. Attitudes towards the former have shown a tendency to shift quickly and overshadow growing expectations for a more dovish Fed. As such our positioning remains tactical in nature and we prefer to maintain flexibility to adapt should the environment change.

We are wary that the underlying issues behind the trade wars threaten to devolve into a more prolonged 'cold war'. As illustrated throughout August, any perceived progress can evaporate quickly along with a positive perspective from investors. It is also increasingly evident that US-China relations have not materially improved despite some small progress at the G20 summit earlier in the year. As such, there is a risk that the relationship between the world's two largest economies may remain frosty.

The negative impact of tariffs has become more evident on both the Chinese and US economies as visible in the deterioration of activity indicators like manufacturing surveys and a slowdown in GDP growth. In Asia, this has flow-on effects for China's neighbours, particularly those that are highly dependent on exports to the Asian giant (such as South Korea). The knock-on effect to the US has also become more apparent, as evident in several earnings results from US corporates. However we also note that in aggregate, US earnings have shown resilience with Q1 and Q2 earnings surprising to the upside.

On the Fed, the more dovish stance adopted in January and subsequent cut in July represented a significant shift from last year and in turn is more of a tailwind for credit than a headwind as in 2018. The prospect of further easing has resurfaced the idea of the "Fed put" that would effectively limit the extent of a sell-off in risk assets. If policymakers continue to swing to the more dovish end of the spectrum, it may more than compensate for concerns over the trade war.

The local market has also been afforded some support from positive domestic developments that may contribute to an outperformance compared to offshore credit. This includes more supportive fiscal policy in the wake of the Coalition's win in the Federal Election, as well as easing of monetary policy by the RBA. The weight of the Royal Commission has also been lifted from the shoulders of the major banks. Moreover, new issuance has been well-bid and supply relatively light compared with prior years.

Overall, the backdrop for risk assets continues to fluctuate as investors balance the risks posed by trade wars against the outlook for more flexible central banks. We are wary that sentiment towards the trade war can shift with each individual battle and the underlying issues are yet to be resolved. As such we maintain a cautious stance and prefer tactical positioning in order to remain nimble.

Cash

Pendal Managed Cash Fund and Pendal Enhanced Cash Fund

Market review

Australian bonds extended their rally in August as yields tumbled globally on a combination of factors. This included geopolitical risks with the further intensification of the trade war, as well as building concerns over weaker global growth. Such downside risks were noted by the RBA in its August policy statement. In the wake of two back-to-back cuts from the Board, it opted to keep rates on hold at 1.0% during the month and indicated it could "ease monetary policy further if needed". At month-end, markets were pricing a further 50 basis points in reduction by early next year.

Domestic data was mixed over the month. The NAB Business Conditions survey eased 2 points to +2, while confidence did the opposite. Retail sales (+0.4%) surprised to the upside and consumer confidence bounced back to 100 from 96.5. In contrast, the CBA August Composite PMI dropped into contractionary territory (49.3 from 52.1). Meanwhile among the lagging data, job additions of 41.1K beat expectations and were driven by full-time positions. However, an increase in the participation rate to 66.1% kept the unemployment rate steady at 5.2%.

Offshore, investor attention was focused on the latest escalation of trade conflict that in turn stirred another wave of safe-haven demand for bonds. Concerns were ignited at the outset of the month as President Trump announced an additional 10% tariff on the US$300bn of remaining Chinese imports, to take effect on September 1st. China responded in-kind by halting its purchases of US agricultural goods. A series of small concessions, followed by renewed threats saw sentiment swing considerably through the remainder of the month. Adding to investor worries were a litany of regional events; Hong Kong protests, Argentina default speculation, Brexit uncertainty and another Italian political drama.

Beyond the politics, the Fed did not meet during the month after delivering a cut at the end of July, its first in more than a decade. Communication including an address by Chairman Powell at Jackson Hole was underwhelming, but suggested the central bank remained tilted towards further easing. The lack of a more explicit stimulus signal was heavily criticised by President Trump.

Also in the US, a collection of leading indicators from the world's largest economy pointed to a further softening. ISM Manufacturing missed expectations and fell further to 51.2 while Markit's gauge edged down to 50.3 and closer to contractionary territory. Consumer confidence also fell, while retail sales beat expectations and rose a healthy +0.7%.

In Europe, there was no gathering for the ECB during the month. However, deteriorating data for the region reinforced speculation that the central bank would provide additional stimulus at their September meeting. Second quarter GDP growth for Germany, the region's largest economy, contracted alongside a weakening of more forward-looking indicators.

Turning to market data, Australian bond yields plumbed fresh record lows during the month and the curve flattened materially. The 3 year yield fell -13bps to 0.67% and the 10 year by -31bps to 0.90%. Meanwhile at the very front-end, 90 day BBSW slid a relatively marginal 3bps to 0.97%. US yields experienced more sizeable declines with the 2 and 10 year falling -37bps and -52bps to 1.51% and 1.50% respectively. Outside of rates, the AUD/USD dropped by 1.6% as risk appetite soured and iron ore plunged by -24%.

Portfolio performance

Managed Cash

The Pendal Managed Cash Fund returned 0.11% in August (post-fees, pre-tax), outperforming the benchmark by 0.03%.

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 58 days (maximum limit of 70 days). With yields having rallied aggressively longer dated yields do not look as attractive unless monetary policy easing does occur - something we expect to happen. The Fund is well positioned to outperform its benchmark.

Enhanced Cash

The Pendal Enhanced Cash Fund returned 0.04% in August (post-fees, pre-tax) underperforming the benchmark by 0.04%.

The portfolio's underperformance in August follows a very strong seven-month period of performance. Negative performance came from financials whilst industrials added to performance.

Activity during the month included investing in 3-year maturity major banks funded out of cash.

As at the end of the month, the portfolio had a credit spread of 63bps over bank bills, interest rate duration of 0.11 years and credit spread duration of 1.92 years.

Strategy and outlook

The Reserve Bank left the cash rate unchanged at its meeting in early September. There was a minor change in the accompanying statement with the reference to monitoring developments in the labour market closely watered down. This was most likely done to avoid the assumption that a rise in the unemployment rate will automatically result in further monetary policy easing. The Reserve Bank continues to see an extended period of low interest rates, not surprising given their most recent forecasts in the Statement on Monetary Policy. Annual underlying inflation is not expected to reach 2% until mid-2021 and the unemployment rate is expected to remain above 5% for 2020 due to sub trend economic growth. The risks to global growth are also clearly tilted towards the downside. Given the benign state of the domestic economy and the offshore headwinds posed we expect further policy easing, most likely occurring prior to the end of the year.

Australian Property

Pendal Property Securities Fund

Market review

The ASX 300 AREIT index was up 1.2% in August, outperforming the broader market by 350bp over reporting season. On a rolling 12 months, AREITS have delivered a total return of 23.9%, outperforming the broader market by 3.6%. Globally REITs were up 1.9% (USD return) for the month, with Japan delivering the best return (+5.5%) and Hong Kong the worst (-9.5%).

The best performing AREITs in August were Charter Hall Long WALE REIT (+14%) following its Telstra portfolio acquisition, National Storage REIT (11.9%) following news that rival Abacus Property Group had built a position and Charter Hall Group (+11.7%) with FUM increasing $2b in August 2019. The worst performers for the month were Abacus Property Group (-4.3%), Charter Hall Retail REIT (-3.5%) and Goodman Group (-2%) following news that it will leave the EPRA NAREIT index. REITs were driven by the 10 year bond yield falling 33bp to an all-time low of 0.88% as well as delivering solid results over reporting season.

The office and industrial sectors delivered the strongest results over the period with most office/industrial REITs seeing comparable NOI growth of 4.7%/4.2%. Retail REITs saw comparable operating income decelerate to 1.7%, with guidance of further deceleration following softer sales growth. NTA was +3.8%, driven by 20bp of cap rate compression and income growth. During the period Charter Hall/Funds acquired a 49% stake in Telstra portfolio for $715m and also acquired a 50% stake in Chifley Tower for $900m. Charter Hall and Abacus also jointly acquired an office tower at 201 Elizabeth Street, Sydney from Dexus/Perron Group on a 5% cap rate.

Macro data continues to disappoint with weak global PMIs, particularly in manufacturing with trade tensions beginning to slow activity. The Fed held the Funds rate flat and global bond yields continued to fall with the US bonds -40bp to close at 1.5%. In Australia the employment growth was solid +41k positions and unemployment rate remained steady at 5.2%. The RBA held rates flat, but noted that interest rates were likely to remain low for an extended period to make progress on full employment and hit inflation targets.

Portfolio performance

The Pendal Property Securities Fund returned 1.96% in August (post-fee, pre-tax), outperforming its benchmark by 0.64%.

Positive attribution came from overweight positions in Charter Hall Long WALE, Charter Hall Group, GDI Property Group and Centuria Industrial REIT and an underweight in Vicinity Centres. Underweight positions in Scentre Group, Shopping Centres Australia, National Storage REIT and Ingenia Communities and an overweight position in Rural Funds Group detracted from performance.

Over the month we participated in the Charter Hall Long WALE equity raising, increasing our overweight position, increased our overweights in Rural Funds Group, Viva Energy REIT and Charter Hall Retail REIT with funding coming from increasing our underweight positions in Dexus Property Group, Stockland Trust Group and selling out of Abacus Property Group.

Strategy and outlook

The AREIT sector is now priced on an FY20 dividend yield of 4.5%, a PE ratio of 19.4 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 26%.

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 continued to climb in August, posting a total return of 2.1%. North America (+3.0%) and Europe (+2.2%) were positive performers, while Asia Pacific (-0.3%) underperformed. Within Asia Pacific, results were negative across the region with the exception of Japan (+5.5%). Hong Kong (-9.5%) was the weakest performer, followed by New Zealand (-3.8%) and Singapore (-0.3%). In Europe, results were mostly positive across the region. Switzerland (+10.2%) posted the largest gain, followed by Sweden (+6.9%) and Finland (+6.2%). Conversely, Italy (-9.2%), the Netherlands (-2.4%) and Spain (-0.4%) were negative performers. In North America, the US and Canada returned 3.1% and 2.3%, respectively.

Portfolio performance

The Pendal Global Property Securities Fund returned 1.78% in August (post-fee, pre-tax), underperforming the benchmark by 0.29%.

North America

The North America portfolio returned 3.08% in August (before fees and withholding taxes), exceeding the FTSE EPRA Nareit North America Index by seven basis points. Modest outperformance relative to the benchmark was driven by positive stock selection results, while sector allocation results were largely neutral. In terms of stock selection, results were strongest in the industrial, office, and triple net lease sectors and were weakest in the hotel, apartment, and other residential sectors. Among the portfolio's holdings, top individual contributors to relative performance included overweight positions in outperforming STORE Capital (STORE), HCP, Inc. (HCP), and Americold Realty Trust (COLD). Detractors most notably included overweight positions in the underperforming Extended Stay America (STAY) and Host Hotels & Resorts (HST) and a lack of exposure to the outperforming Ventas (VTR).

Europe

The European portfolio returned 1.35% in August (before fees and withholding taxes), underperforming the regional EPRA benchmark by 84 basis points. Underperformance relative to the benchmark was driven by negative country allocation results and, to a lesser extent, negative stock selection results. Regarding country allocation, negative results were largely attributable to the portfolio's lack of exposure to the outperforming Switzerland and Belgium markets. In terms of stock selection, results were weakest in Germany, the United Kingdom, and Spain and were strongest in Sweden, the Netherlands, and Ireland. Among the portfolio's holdings, top contributors to relative performance included overweight positions in the outperforming Wihlborgs Fastigheter AB (Sweden) and Fabege AB (Sweden), and an underweight position in the underperforming Land Securities Group PLC (United Kingdom). Detractors most notably included an overweight position in the underperforming Deutsche Wohnen SE (Germany) and a lack of exposure to the outperforming Swiss Prime Site AG (Switzerland) and PSP Swiss Property AG (Switzerland).

Asia

The Asia portfolio returned -0.58% in August (before fees and withholding taxes), trailing the regional EPRA benchmark by 26 basis points. Underperformance relative to the benchmark was driven by negative stock selection results, which were partially offset by positive country allocation results. In terms of stock selection, results were weakest in Japan and Singapore, while results in Hong Kong were largely neutral. Regarding country allocation, positive results were driven by the portfolio's underweight to the underperforming Hong Kong as well as an overweight to the outperforming Japan. Among the portfolio's holdings, top contributors to relative performance included overweight positions in outperforming ORIX JREIT (Japan) and LaSalle LOGIPORT REIT (Japan), and an underweight position in the underperforming Sun Hung Kai Properties (Hong Kong). Detractors most notably included a lack of exposure to outperforming Nomura Real Estate Master Fund (Japan) and United Urban Investment (Japan), and an overweight position in the underperforming New World Development (Hong Kong).

Active Balanced

Pendal Active Balanced Fund

Markets review

Australian stocks (S&P/ASX 300 Accumulation Index) fell 2.3% in August. With the sudden escalation in the Sino-US trade dispute and a mixed reporting season, six out of the 11 GICS sector ended the month with a negative return. Defensive sectors such as Health Care (+3.4%) and Real Estate (+2.4%) were the best performers in August. Real Estate was aided by signs of some recovery in the housing market as the RBA cut the cash rate to 1%; while the respective 52/30 basis points (bp) decline in the US/AU 10-year bond yield also generally supported the bond sensitives.

The major equity markets retreated during August amid waning sentiment on the likelihood of resolution to the US-China trade issue, a persistent impasse on the Brexit issue and a more recent issue affecting bond markets. In terms of the latter, August saw an inversion of the US and UK yield curves, whereby the shorter dated yields have inverted to be higher than their 10-year counterparts. Such a development has been associated in the past as a predictor of a recession. Exacerbating the general uncertainty was a historic one-day market drop in Argentina, together with mixed global economic data. These developments, coupled with the latest instalment in the tariff saga with China announcing it would apply tariffs of 5-10% on US$75b worth of US imports from September, contributed to further caution on equity markets.

The US equity market adopted the trade rhetoric with an unsurprising negative tone, with a number of flat-to-down days characterising the month. Acceptance of the continued growth mantra that has supported the market appeared fragile, as evidenced by news that US economic growth decelerated in the second quarter by more than initially reported. Investors promptly drew conclusions about the growing impact of Trump's tariffs on the country's economic expansion. The US second-quarter reporting season also drew to a close, with numbers on the whole better than consensus. That said, in aggregate the market has recorded a second consecutive quarter of negative earnings growth. At the month's close, the S&P500 registered a decline of 1.8%, while the NASDAQ fell by 2.6%.

The major European markets were uniformly down in August. Negative sentiment emanating from the global economy's health was exacerbated by further complications with the UK's uncertain Brexit path, together with the UK debt yield curve inversion – being the first such instance since 2008. UK economic data released during the month revealed a slowdown in economic growth through the first half of 2019, largely explained by weaker business investment and slowing global economic growth. Elsewhere in Europe, earlier weakness was recouped to a degree by month end, although a definite bias emerged towards defensive sectors such as Consumer Staples, Utilities and Health Care and away from the cyclically oriented Financials, Information Technology and Energy sectors was evident. In terms of market performance, the region's benchmark Euro Stoxx Index declined by 1.2%, with the UK (-5.0%), Germany (-2.1%) and Spain (-1.8%) leading the region lower.

Asian equity markets were far from a place of refuge for investors during August. Social unrest in Hong Kong continued while the Chinese yuan was allowed to fall through a key threshold to an 11-year low, attracting accusations of currency manipulation by Trump. China's economic data provided little comfort, with industrial production slowing to a lower-than-expected 4.8% year-on-year growth in July, while fixed asset investment rose 5.7% over the first seven months of the year. The manufacturing purchasing managers' index (PMI) slipped further into contractionary territory to a reading of 49.5 in August compared with 49.7 in July. Hong Kong (-7.4%) bore the brunt of selling, followed by Singapore (-5.9%), Japan (-3.4%) and Thailand (-3.3%).

The Australian dollar weakened against all major currencies, headlined by falls of 3.9% against the yen, 1.6% against the US dollar and British pound, and 0.8% against the euro. Commodity markets trended lower, led by a 6% fall in the oil price. Weaker iron ore prices also contributed to the Australian trade weighted index being down by 1%.

Australian bonds extended their rally in August as yields tumbled globally on a combination of factors. This included geopolitical risks with the further intensification of the trade war, as well as building concerns over weaker global growth. Such downside risks were noted by the RBA in its August policy statement. In the wake of two back-to-back cuts from the Board, it opted to keep rates on hold at 1.0% during the month and indicated it could "ease monetary policy further if needed". Domestic data was mixed over the month. The NAB Business Conditions survey eased 2 points to +2, while confidence did the opposite. Retail sales (+0.4%) surprised to the upside and consumer confidence bounced back to 100 from 96.5. In contrast, the CBA August Composite PMI dropped into contractionary territory (49.3 from 52.1). Meanwhile among the lagging data, job additions of 41.1K beat expectations and were driven by full-time positions. However, an increase in the participation rate to 66.1% kept the unemployment rate steady at 5.2%.

The Australian 3 year yield fell -13bps to 0.67% and the 10 year by -31bps to 0.90%. Meanwhile at the very front-end, 90 day BBSW slid a relatively marginal 3bps to 0.97%.

Global bonds extended their rally in August as yields tumbled on a combination of factors. This included geopolitical risks with the further intensification of the trade war, as well as building concerns over weaker global growth. Trade fears were reignited at the outset of the month as President Trump announced an additional 10% tariff on the US$300b of remaining Chinese imports, to take effect on September 1st. Adding to investor worries were a litany of regional events; Hong Kong protests, Argentina default speculation, Brexit uncertainty and another Italian political drama.

Beyond the politics, the Fed did not meet during the month after delivering a cut at the end of July, its first in more than a decade. Communication including an address by Chairman Powell at Jackson Hole was underwhelming, but suggested the central bank remained tilted towards further easing. Also in the US, a collection of leading indicators from the world's largest economy pointed to a further softening. Turning to market data, US yields experienced sizeable declines with the 2 and 10 year falling -37bps and -52bps to 1.51% and 1.50% respectively.

Portfolio performance

The Pendal Active Balanced Fund returned -0.44% (post-fee, pre-tax) for the month of August, performing broadly in line with the benchmark.

The Fund's return for August reflected the detractions from equity markets which were generally weaker during the month. The impact of the drawdown was mitigated to a degree by positive returns from bond and listed property markets, both domestically and offshore, reflecting the impact of lower bond yields.

Performance relative to the benchmark broadly reflected the application of our active asset allocation processes. Our tactical decisions saw the Fund move to a neutral exposure to growth assets while retaining an overweight exposure to global fixed income.

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, CSL and James Hardie contributed to performance, while overweight positions in Viva Energy and Caltex, together with not holding Woolworths detracted from performance.

Within the global equities portfolio the Core, Concentrated and European Value strategies underperformed, while the Emerging Markets strategy significantly outperformed the benchmark (pre fees).

The Alternatives strategy delivered a total return (before fees) of 0.29% versus a cash return of 0.08%. Within our Alternatives core portfolio the Managed Futures, Fixed Income Relative Value and Dedicated Short Bias strategies generated positive returns, while the notable offsetting the Equity Market Neutral and Global Macro strategies detracted part of the sector's return.

In relation to our tactical positioning within the Alternatives component of the Fund, holding opposing positions in Gold and Copper as did our overall defensive positioning through added exposure to fixed income markets. Since the end of September we have removed the long volatility position and increased tactical exposure to equity markets.

Strategy and outlook

Consensus on the slowing rate of expansion for the global economy appears to be strengthening and the somewhat symptomatic distractions of trade wars and Brexit are acting to suppress small bouts of market confidence. With the recent yield curve inversion in the US and UK, the stated *lower for longer* mantra of the central banking community of a few years ago appears all but set to continue. The US Fed has moved to an easing stance, while in Australia the Reserve Bank left the cash rate unchanged at its meeting in early September and continues to see an extended period of low interest rates. Annual underlying inflation is not expected to reach 2% here until mid-2021 and the unemployment rate is expected to remain above 5% over the near term.

With the risks to global growth yet to play out, a diversified and actively managed exposure to all asset classes is warranted. There are several examples of market segments with better prospects than others, and an active, research based approach to capitalise on these within the construct of a well-managed portfolio should hold retirement savings in good stead over shorter and longer-term periods.

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 31 August 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)	-2.55	2.77	7.49	-0.10	5.07	10.43	11.25	7.70	9.94
Total Return (pre-fee, pre-tax)	-2.49	2.98	7.93	0.03	5.91	11.32	12.14	8.56	10.93
Benchmark	-2.27	4.30	9.53	0.63	9.14	12.25	11.34	7.94	10.04
Pendal Imputation Fund									APIR - RFA0103AU
Total Return (post-fee, pre-tax)	-2.24	2.44	6.97	-0.21	5.72	10.69	11.01	6.79	9.52
Total Return (pre-fee, pre-tax)	-2.17	2.68	7.46	-0.06	6.68	11.68	12.01	7.75	10.54
Benchmark	-2.27	4.30	9.53	0.63	9.14	12.25	11.34	7.94	8.91
Pendal Focus Australian Share Fund									APIR - RFA0059AU
Total Return (post-fee, pre-tax)	-2.25	3.06	9.51	0.54	7.11	11.72	12.91	9.56	9.42
Total Return (pre-fee, pre-tax)	-2.19	3.26	9.92	0.66	7.92	12.70	14.14	10.67	10.52
Benchmark	-2.27	4.30	9.53	0.63	9.14	12.25	11.34	7.94	7.89
Pendal Ethical Share Fund									APIR - RFA0025AU
Total Return (post-fee, pre-tax)	-2.58	2.78	7.16	-0.04	4.96	10.01	10.98	7.92	8.58
Total Return (pre-fee, pre-tax)	-2.50	3.02	7.67	0.12	5.95	11.06	12.04	8.95	9.64
Benchmark	-2.27	4.30	9.53	0.63	9.14	12.25	11.34	7.94	8.34
Australian Shares - Mid Cap									
Pendal MidCap Fund									APIR - BTA0313AU
Total Return (post-fee, pre-tax)	-1.70	2.86	6.87	2.61	-0.38	10.02	9.96	11.84	10.03
Total Return (pre-fee, pre-tax)	-1.63	3.09	7.35	2.77	0.52	11.36	11.23	13.20	12.14
Benchmark	-3.68	3.15	5.00	1.14	0.33	10.36	9.40	10.95	5.95
Australian Shares - Small Cap									
Pendal Smaller Companies Fund									APIR - RFA0819AU
Total Return (post-fee, pre-tax)	-4.03	1.24	2.19	0.41	-5.24	8.42	6.31	8.00	12.68
Total Return (pre-fee, pre-tax)	-3.94	1.56	2.83	0.62	-4.07	9.77	7.64	9.35	13.98
Benchmark	-3.85	1.41	4.14	0.49	0.95	11.12	8.41	7.82	7.73
Australian Shares - Micro Cap									
Pendal MicroCap Opportunities Fund									APIR - RFA0061AU
Total Return (post-fee, pre-tax)	-0.61	5.86	11.43	5.70	10.38	14.60	12.29	15.99	17.95
Total Return (pre-fee, pre-tax)	0.25	7.25	13.78	7.12	13.43	16.66	14.58	19.40	22.93
Benchmark	-3.85	1.41	4.14	0.49	0.95	11.12	8.41	7.82	3.47
International Shares									
Pendal Core Global Share Fund									APIR - RFA0821AU
Total Return (post-fee, pre-tax)	-0.54	6.20	4.36	1.35	-1.69	9.16	10.08	10.68	5.83
Total Return (pre-fee, pre-tax)	-0.46	6.44	4.83	1.52	-0.78	10.19	11.12	11.73	6.98
Benchmark	0.27	7.99	9.52	2.59	7.57	15.63	13.74	13.51	7.63
Pendal Global Emerging Markets Opportunities Fund - WS									APIR - BTA0419AU
Total Return (post-fee, pre-tax)	-1.39	2.07	4.20	-2.31	3.38	6.44	9.64	8.60	9.99
Total Return (pre-fee, pre-tax)	-1.28	2.43	4.93	-2.06	4.84	7.93	11.17	10.22	12.10
Benchmark	-2.69	2.66	0.66	-2.13	2.66	5.75	9.68	7.19	9.39
Pendal Concentrated Global Share Fund									APIR - BTA0503AU
Total Return (post-fee, pre-tax)	-0.86	5.84	4.22	0.80	7.00	14.25	13.55	N/A	13.71
Total Return (pre-fee, pre-tax)	-0.77	6.13	4.80	0.99	8.12	15.46	14.82	N/A	14.99
Benchmark	0.27	7.99	9.52	2.59	7.57	15.63	13.74	N/A	13.83
Property									
Pendal Property Securities Fund									APIR - BTA0061AU
Total Return (post-fee, pre-tax)	1.96	9.90	16.62	4.14	23.08	19.53	10.06	13.79	8.40
Total Return (pre-fee, pre-tax)	2.02	10.08	17.00	4.25	23.89	20.31	10.78	14.53	9.22
Benchmark	1.32	8.30	14.80	3.97	19.83	17.74	8.94	13.22	8.13
Pendal Global Property Securities Fund									APIR - RFA0051AU
Total Return (post-fee, pre-tax)	1.78	3.26	5.90	2.74	8.05	7.90	5.80	7.34	9.23
Total Return (pre-fee, pre-tax)	1.85	3.48	6.38	2.90	9.04	8.89	6.78	8.33	10.23
Benchmark	2.07	3.76	6.06	3.02	8.07	7.55	5.45	7.39	8.95
Fixed Interest									
Pendal Fixed Interest Fund									APIR - RFA0813AU
Total Return (post-fee, pre-tax)	1.74	4.15	8.11	2.86	10.13	6.87	3.99	4.78	6.52
Total Return (pre-fee, pre-tax)	1.79	4.28	8.38	2.95	10.68	7.40	4.51	5.31	7.08
Benchmark	1.51	3.54	7.53	2.48	11.20	7.46	4.68	5.30	6.77
Pendal Global Fixed Interest Fund									APIR - RFA0032AU
Total Return (post-fee, pre-tax)	3.08	5.37	9.25	3.88	10.39	5.07	2.94	4.60	6.14
Total Return (pre-fee, pre-tax)	3.12	5.51	9.54	3.97	10.97	5.62	3.49	5.15	6.72
Benchmark	2.96	4.97	8.70	3.66	11.40	5.87	3.82	5.31	7.04
Pendal Enhanced Credit Fund									APIR - RFA0100AU
Total Return (post-fee, pre-tax)	0.84	2.68	5.77	1.84	8.43	5.97	4.51	4.81	5.84
Total Return (pre-fee, pre-tax)	0.88	2.79	6.00	1.91	8.91	6.45	4.98	5.28	6.36
Benchmark	0.85	2.58	5.65	1.72	8.40	6.04	4.50	4.87	5.94
Cash & Income									
Pendal Enhanced Cash Fund									APIR - WFS0377AU
Total Return (post-fee, pre-tax)	0.04	0.53	1.25	0.32	2.36	2.45	2.68	2.62	4.80
Total Return (pre-fee, pre-tax)	0.06	0.59	1.37	0.36	2.61	2.70	2.93	2.88	5.14
Benchmark	0.08	0.34	0.82	0.20	1.82	1.84	1.81	2.03	4.72
Pendal Managed Cash Fund									APIR - WFS0245AU
Total Return (post-fee, pre-tax)	0.11	0.38	0.87	0.24	1.83	1.82	1.82	2.02	6.26
Total Return (pre-fee, pre-tax)	0.13	0.44	0.98	0.27	2.05	2.04	2.04	2.24	6.55
Benchmark	0.08	0.34	0.82	0.20	1.82	1.84	1.81	2.03	6.33
Pendal Monthly Income Plus Fund									APIR - BTA0318AU
Total Return (post-fee, pre-tax)	0.07	2.42	5.51	1.24	6.55	5.87	4.64	4.76	5.61
Total Return (pre-fee, pre-tax)	0.12	2.59	5.85	1.35	7.24	6.56	5.32	5.44	6.28
Benchmark	0.08	0.28	0.66	0.17	1.41	1.46	1.48	1.73	2.73
Diversified									
Pendal Active Balanced Fund									APIR - RFA0815AU
Total Return (post-fee, pre-tax)	-0.44	3.72	5.55	1.07	3.32	7.12	7.26	6.89	7.59
Total Return (pre-fee, pre-tax)	-0.36	3.97	6.06	1.24	4.30	8.14	8.28	7.90	8.66
Benchmark	-0.45	4.31	7.26	1.31	7.83	9.93	8.65	7.82	7.60

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