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Pendal Concentrated Global Share Fund

Market insights and fund update

March 27, 2020

As we are all appreciating, the environment has turned extremely quickly, and we have hit the depths of market sentiment, quicker than any other time since the 1987 crash.

Suffice to say, our portfolio was not well positioned for this event with large holdings in various sectors that have been impacted such as aeroplane manufacturers, regional banks and casinos.

In times like this though, we rely on our fundamental investment beliefs and then implement our process to help us weigh up the different scenarios and probabilities to ensure we invest with conviction amid the noise and poor sentiment.

Our core investment beliefs are summarised below:

We have a long term view

This means re-setting the portfolio to what we think will outperform from this point on a three-to-five year view. We are not repositioning the portfolio to outperform while the crisis is enduring. Rather we believe the opportunity to outperform will be outsized for clients over our investment time horizon of three-to-five years. This is because there are significant pricing anomalies in most of our preferred companies.

We are contrarian when be buy

We want to buy out-of-favour stocks that have been mispriced, acknowledging that in the short term some of these companies will remain out of favour. That principle may test some clients in the current environment, given the extremes of the price moves and unprecedented nature of this crisis. However, the principle is fundamental to how we manage money. We believe, with the right risk management in place, this will see us deliver meaningful outperformance over time, given the opportunities being presented.

We manage the downside by buying well capitalised, industry leading businesses

The priority for the team has been to make assessments on various upside and downside scenarios. Given that our approach is to buy stocks when they are most out of favour, our immediate and most important focus has been to assess the ability of the companies we own to withstand the most dire of economic conditions.

The framework we are therefore applying in this environment is centred around three core questions:

Question 1: How quickly can the virus be contained?

Like many market participants we are becoming amateur epidemiologists, but we have little insight here. We are closely monitoring the infection rates across various jurisdictions and analysing the effectiveness of each country's approach in managing the crisis. This does provide us with some colour as to how long the effective economic shutdown and government-enforced restrictions may last, which in turn informs our scenario analysis.

We are also monitoring scientific progress on methods for testing the virus, anti-viral solutions, and of course vaccines. But our base case is that a combination of "suppression and mitigation" will be what sees us through, rather than a medical breakthrough. These tactics will be more effective as the scientific understanding of the virus continues to improve.

Question 2: What level of downturn can a business survive?

A realistic scenario is that many companies we own will not be generating any meaningful revenues over the next three months. A more negative, but still very feasible situation, is this extends to around six months. In the latter scenario, it is likely that we see depression-like statistics appear across economies in the next year or so – even after the health crisis comes under control.

On that basis we are structuring the portfolio so it only holds companies with sufficient liquidity to withstand this downside situation for 18 months.

The reality is that we still don't know how long the economic disruption will last, or the scale of the impact on the economy. Our approach is therefore to always hold the strongest and most competitive one or two businesses in an industry peer group.

Question 3: What level of stimulus can governments provide?

We are gaining greater detail each day on what various governments can and will do to protect the economy and people's livelihoods.

At this point, signals are that the size of the stimulus will be around 10% of GDP. The level of stimulus and type of initiative implemented will change depending on how the situation develops, and most governments have stated this.

What is clear, though, is a "whatever it takes" mentality has been consistent, regardless of the country. Execution, implementation and efficacy remains to be seen

Portfolio positioning

We have recently sold companies for two broad reasons

- **Companies with too much debt:** Given the potential for a more extreme economic downturn, companies such as Getlink and Howard Hughes have been sold to zero. In this environment we deem the downside risk too great.
- **Profit-taking to redeploy in contrarian opportunities:** We have taken profits in companies such as Colgate, Merck and some of the stock exchanges, in order to buy into companies where we are seeing extremely attractive valuations.

What have we been buying?

Most of our new or additional purchases have been in stocks where near-term earnings have been deeply impacted by the crisis, but they have the balance sheet and competitive characteristics to see them through.

Given the current sentiment, all these purchases are trading on multi-year low valuations. These are summarised below:

Monopoly or duopoly businesses

- **Zurich Airport**: A monopoly asset with 1x net debt
- **Anheuser Bushch:** The largest duoply brewer
- **Intel**: A duopoly in cloud/server build-out and a net cash position
- **Airbus**: in a net cash position, a duopoly supplier and received 22 deliveries in March quarter

Dominant businesses or largest supplier in an industry

- Infineon: the largest silicon supplier to the auto industry
- Freeport: the biggest copper producer

Companies in stressed industries with the financial power and flexibility

- MGM & Las Vegas Sands have high levels of liquidity and flexible capex and will benefit from structural demand from a growing Chinese base.

The portfolio remains diversified

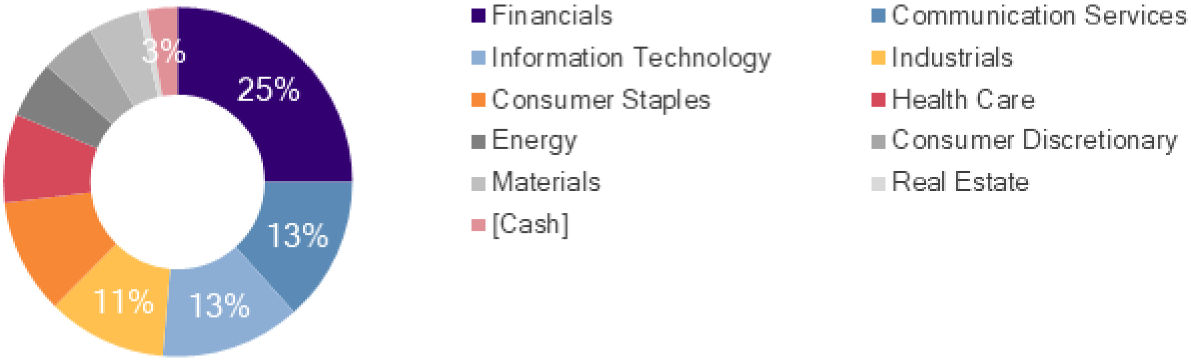
The pie chart below shows the portfolio remains very well diversified across different sectors and parts of the global economy.

While a quarter of the portfolio is in financials, these are spread across regional banks across the world, commodity and stock exchanges and asset managers, all of which have different drivers.

Beyond that, the sector mix is broad. We maintain a small exposure in Energy, owning the lowest cost producers which ultimately will benefit from the current stress in the market relative to peers.

We also maintain a good percentage of stocks in sectors that will prove resilient in the current environment across Health Care, Consumer Staples and the IT sectors

Pendal Concentrated Global Share Fund Sector weights



Summary

We are seeing a mix of outlook statements from companies. Some are attempting to put a number on the impact of coronavirus, some are widening the band of expectations, while others are more optimistically looking for a snap-back in pent-up demand in the second quarter.

However, subsequent to first quarter financial releases, a number of companies have warned that the impact the spread of the virus is having on business conditions is now significant.

We are now finally seeing earnings estimates for the second quarter and beyond being revised down. But we reiterate that we are less concerned about the next few quarters of company earnings. We continue to focus on owning companies with dominant market shares, robust business models and nimble management teams.

While we will continue to monitor the impacts of the coronavirus and how businesses are responding, our primary focus is on the longer-term sustainability of the companies we invest in, many of which are once-in-a-decade cheap.

When valuations become compelling, we invest with conviction. We have the confidence that these companies can prosper over the long term regardless of what economic or geopolitical events they are presented with.

For more information contact your
key account manager or visit **pendalgroup.com**

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