Pendal Focus Fund update

May 6, 2020

- The Fund outperformed the index in April.
- It outperformed in the drawdown – and so far is outperforming in the rebound. This demonstrates the importance of our approach to portfolio construction.
- We have been adding to some domestic recovery plays.
- Recent market strength may reflect some over-optimism in regard to the effect of easing restrictions.
- Nevertheless, the scale of policy support is acting to help underpin markets.

Performance update

- In March, the portfolio's "Recession Protection" stocks made the best contribution to relative performance. Uncertainty and fear around COVID-19 infection rates and policy response was at its nadir.
- Positions in Metcash (MTS), Telstra (TLS), Insurance Australia Group (IAG) and gold miner Evolution (EVN) made the best contributions to relative performance. This more than offset impact from Qantas (QAN) and Santos (STO) which were at the forefront of disruption from travel restrictions and oil price collapse.
- Outperformance in the April rebound has come from several sources:
  - STO and QAN saw rebounds as the market gained confidence they would survive this disruptive period. These are part of our "Recovery Insurance" segment.
  - EVN continued to do well in the "Recession Protection" space.
  - Some of the "Policy Beneficiaries" outperformed. This includes James Hardie (JHX) (housing) and Seven Group Holdings (SVW) (infrastructure and mining).
  - Key "Long-term Franchise Winners" also did well including Nine Entertainment (NEC), Aristocrat (ALL) and JB Hi-Fi (JBH). These are stocks that face a near-term hit – but offer a rare and compelling buying opportunity on a longer-term view.

Portfolio construction and recent changes

- Our approach to portfolio construction is always about driving alpha through insight at a company level, while building portfolios that can perform in a range of environments and scenarios.
- This approach, adapted for the current period, has served well in helping performance and as well as positioning the portfolio amid elevated uncertainty.

Building a portfolio for the current environment

- **Recession protection**
  - Asset backed plays, low gearing, little earnings effect from recession
- **Beneficiaries of policy response**
  - Recipients of stimulus related spending
- **Good businesses impacted by market fall**
  - Companies in good industry structures, strong market positions, good free cash flow
- **Recovery plays**
  - Selective exposure to stocks facing immediate impact of demand decline

- In recent weeks we have seen increasing signs of a possible divergence in outlook for Australia and New Zealand compared to other parts of the world.
- The scale and speed of containment measures here – coupled with our geography and a less complicated political backdrop than the US or Europe – means we can try a suppression/elimination strategy. In other parts of the world the only option is to build herd immunity while keeping infections at a rate that medical systems can cope with.
- As a result we may see domestic restrictions lifted further here, while international borders remain locked down. Overseas the need to control infection rates may mean restrictions are only partially lifted.
- This is supportive for the outlook for domestically-focused ASX companies. As a result, we have been adding two new companies to our "Recovery Protection" segment – **Downer (DOW)** and **Tabcorp (TAH)**. Both are relatively resilient businesses well-positioned to benefit from an easing of domestic restrictions.

Outlook

- The essential tussle at the heart of markets is between the largest economic hit in living memory on one hand – and a package of unprecedented liquidity and fiscal support on the other.
- The scale of the economic hit is still unknown and the pathway to normalisation is a key variable. Infection rates will be crucial in coming weeks as restrictions are eased. Signs that infections remain manageable would be a positive development. A material second wave of infections requiring re-implementation of restrictions would be a material negative.
- The recent bounce reflected optimism about a path to recovery. However we are unlikely to recover swiftly to a pre-coronavirus level of activity. As restrictions are rolled back and we start assessing the degree of economic damage, it will be hard for the market to sustain its recent rally.
- That said, we are mindful of the scale of liquidity supporting markets. This certainly provides a strong degree of downside support.
- We see this phase as being very company-specific as the market discovers which companies have been well placed and which have not – and to which degree the latter have been affected. There will be a high degree of differentiation between (and within) industries. This environment plays to our strengths.

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