Pendal Midcap Fund update

June 12, 2020

The Pendal Midcap Fund continues to perform well versus the broad market, acting as a good portfolio diversifier. This emphasises one of the reasons we believe a specific Midcap exposure can benefit portfolios.

The fund held up better than the broad market in the downturn (-33.1% vs -36.2% for the ASX 300 peak to trough) and delivered a stronger rebound (+37.2% vs +32.9% for the ASX 300 trough to date).

The fund is now down only -8.3% from the peak vs -15.2% for the ASX 300.

Over one year it is up 2.5% vs -3.2% for the ASX 300.

Performance at June 8, 2020 (net of fees)

	YTD	Peak (20/2/20) to date	1 year	3 year pa	5 year pa
Pendal Midcap Fund	-2.66	-8.28	2.48	8.50	9.21
S&P/ASX 51-150	-5.49	-11.89	-0.88	7.00	9.16
Active vs benchmark	2.83	3.61	3.36	1.50	0.05
S&P/ASX Midcap 50	-5.93	-11.66	1.76	6.31	9.49
S&P/ASX 300	-8.99	-15.21	-3.23	6.21	6.25
Active vs S&P/ASX 300	6.33	6.93	5.71	2.29	2.96

Source: Morningstar, Pendal, as at June 8, 2020. After fees and before taxes.

The fund is also doing well versus the Midcap sector in the year to date and since the market's peak.

It is lagging the index in the rebound. A key part of this is not owning Afterpay (APT), which is now 3.2% of the index (one of the largest weights) and is up +456% from its trough. It is 22.3% higher than the pre-crisis peak. We see several risks we believe are not reflected in APT's implied valuation, including under-appreciated increases in costs to acquire new customers, as well as credit risks as government stimulus rolls off.

Nevertheless, strong performance in the downturn means the fund remains comfortably ahead of the S&P/ASX Midcap 50 – and its own benchmark – over the peak-to-date and year-to-date.

Major contributors to year-to-date performance versus benchmark have come from different types of stocks:

Overweight Metcash (MTS): Defensive exposure; benefiting from neighbourhood shopping and eat-from-home.

Overweight Regis Resources (RRL): Gold miner; the portfolio maintains a material exposure to gold given it is a hedge against a disappointing economic outcome and, longer term, a potentially weaker USD.

Overweight Xero (XRO): Growth names continue to outperform. Some near-term risk to XRO from economic disruption, however mitigated by policy support, its subscription-based model, and potential for new business formation as a result of disruption.

Positions

The market is optimistic at the pace of re-opening and initial signs of a strong rebound in demand. The scale of policy and liquidity response are keeping markets buoyant.

The health situation looks promising. At this point there are few signs of a second wave here or overseas as restrictions are rolled back – however it is early days. Risk remains.

In the past month the fund has been adding selectively to some stocks that will benefit from a recovery in economic activity:

Coca Cola Amatil (CCL): Domestic recovery play as cafes and restaurants re-open.

Invocare (IVC): End to limit of funeral mourners will help revenue recover.

However there is a material risk of disappointment with the pace at which the uptick in demand can be staged and the ultimate level to which the economy recovers.

As a result, we continue to maintain our scenario analysis and portfolio construction which is not positioned for a binary outcome. Key positions include:

Recession Protection: Regis Resources (RRL), ResMed (RMD), Metcash (MTS), A2 Milk (A2M)

Quality Defensives: Xero (XRO), Cleanaway (CWY), NextDC (NXT)

Policy Beneficiaries: Seven (SVW) (domestic infra), Atlas Arteria (ALX) (French infra), JB Hi-Fi (JBH) (govt support for consumer)

Franchise Winners: Nine Entertainment (NEC), Reece (REH)

Recovery Hedges: Crown Resorts (CWN), Tabcorp (TAH), ALS (ALQ)

One example where we have been adding to other parts of the portfolio is **Charter Hall Retail REIT (CQR).** This is a more defensive holding, which tends to own neighbourhood-style malls anchored on a supermarket, with a high degree of non-discretionary tenants such as pharmacies, medical practitioners and banks.

Top 5 active overweights

Stock	Weight	Active	Rationale
Seven Group	5.13%	4.44%	Limited impact to WesTrac business from Covid-19; sales and servicing continue. Coates saw a hit to events business, but small exposure. Material upside from infrastructure.
Metcash	5.06%	4.18%	Preferred consumer staple. Has underperformed due to cap raising, but we see sensible use for the capital. Recent environment helped trend towards convenience shopping – capitalising on new IGA store strategy
Nine Entertainment	4.81%	4.11%	Seeing hit to FTA TV ads. However offsetting factors from strong demand for digital (9Now, Stan). Any resilience or stimulus in housing will help Domain. Govt ruling that social platforms must pay for content also material.
Atlas Arteria	5.44%	3.62%	Has seen traffic volumes recover faster than expected in France. Capital raise paves way to gear up the toll road asset and win infrastructure contracts from French govt looking to stimulate economy
JB Hi-Fi	4.80%	3.46%	Benefiting from resilience in demand for consumer electronics. Likely to emerge from disruptive period in stronger competitive position.

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