Pendal Sustainable Australian Fixed Interest Fund

Previously known as 'BT Sustainable Australian Fixed Interest Fund'

ARSN: 612 664 730

Factsheet

Income & Fixed Interest Strategies

October 2018

About the Fund

The Pendal Sustainable Australian Fixed Interest Fund (**Fund**) is an actively managed portfolio of Australian fixed interest securities. Investments are selected based on a range of sustainable, ethical and financial criteria.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Bloomberg AusBond Composite 0+ Yr Index by 0.75% p.a. over rolling 3 year periods.

Description of Fund

The Fund offers investors access to a diversified portfolio of fixed interest securities and seeks exposure to issuers that demonstrate leading environmental, social and corporate governance (ESG) and ethical practices while avoiding exposure to issuers with activities that we consider to negatively impact the environment or society.

The Fund will not invest in issuers with material business involvement in the following activities:

- production of tobacco or alcohol,
- manufacture or provision of gaming facilities,
- manufacture of weapons or armaments,
- manufacture or distribution of pornography,
- directly mine uranium for the purpose of weapons manufacturing,
- extraction of thermal coal and oil sands production.

We consider that an issuer has a material business involvement in an activity if 10% or more of its total revenue is derived from that activity.

The Fund uses a security selection process that combines sustainable and ethical criteria with Pendal's credit analysis. Pendal's investment process for fixed interest aims to add value through multiple strategies and investment research. Pendal seeks to generate excess returns through strategies including active security (including Green, Social and Sustainable Bonds) and sector selection, duration, yield curve and credit management.

We believe our strategy is unique in the Australian marketplace due to our top down process which combines a large number of quantitative models, our qualitative overlay and technical analysis giving us a greater understanding of global forces that affect the domestic market and the opportunities it presents. This is a more robust process than focussing primarily on domestic economic factors when evaluating the opportunity set.

Our investment approach for credit management seeks to identify opportunities on a sector, issuer and security basis by incorporating top-down and bottom-up research. Top-down research includes analysis of economic and market data, along with macro credit fundamentals such as company earnings, balance sheet health, default rates and equity volatility. The bottom up research includes analysis of earnings and cashflow volatility, balance sheet, business diversity, industry and valuation.

Investment Team

Pendal's Income and Fixed Interest team includes thirteen dedicated investment professionals. The team also draws on a wide range of knowledge resources including Pendal's other specialist investment teams: Equity Strategies and Multi-Asset Strategies. The co-portfolio managers of the Fund are George Bishay and Tim Hext, who have a combined 48 years of industry experience.

CERTIFIED RESPONSIBLE INVESTMENT

CERTIFIED BY RIAA

The Pendal Sustainable Australian Fixed Interest Fund has been certified by RIAA according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsibleinvestment.org for details.

The Responsible Investment Certification Program does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Appropriate professional advice should be sought prior to making an investment decision. RIAA does not hold an Australian Financial Services Licence.

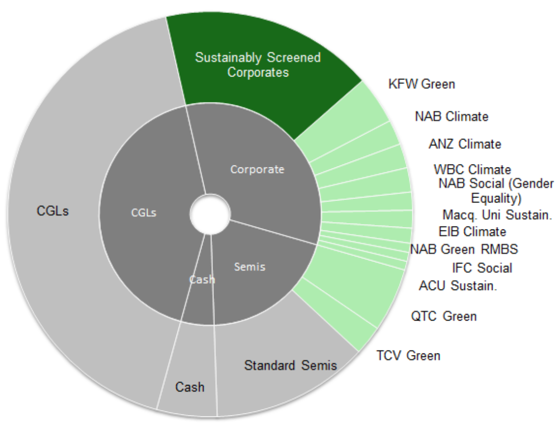
Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.35	0.39	0.48
3 months	0.64	0.74	0.87
6 months	1.85	2.06	2.21
1 year (pa)	2.42	2.83	3.09
2 years (pa)	2.12	2.53	2.36
Since Inception (pa)	1.24	1.65	1.47

Sector Allocation (as at 31 October 2018)

Government bonds^	42.2%
Semi-Government bonds^	12.6%
Sustainability Screened Corporate bonds	17.1%
ESG Thematic bonds	23.3%
Cash & other	4.8%

^ Ex Green, Social & Sustainable Bonds



Other Information

Fund size (as at 31 Oct 2018)	$211 million
Date of inception	August 2016
Minimum investment	$25,000
Buy-sell spread[1]	0.09% (0.05%/0.04%)
Distribution frequency	Quarterly
APIR Code	BTA0507AU

[1] The buy-sell spread represents a contribution to the transaction costs incurred by the Fund, when the Fund is purchasing and selling assets. The buy-sell spread is generally incurred whenever you invest in the Fund, and may vary from time to time without notice.

Management Costs[2]

Issuer fee[3]	0.40% pa

[2] You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

[3] This is the fee we charge for overseeing the operations of the Fund and managing the assets of the Fund. The Issuer fee is paid from the assets of the Fund and is reflected in the unit price of your investment.

Risks

An investment in the Fund involves risk, including:

- **Market risk**: The risk associated with factors that can influence the direction and volatility of an overall market, as opposed to security-specific risks. These factors can affect one country or a number of countries.
- **Security specific risk**: The risk associated with an individual security.
- **Interest rate risk**: The risk associated with adverse changes in asset prices as a result of interest rate movements.
- **Credit risk**: The risk of an issuing entity defaulting on its obligation to pay interest/principal when due.
- **Liquidity risk**: The risk that an asset may not be converted to cash in a timely manner.

Please read the Fund's product disclosure statement (**PDS**) for a detailed explanation of each of these risks.

Market review

Australian bond yields fell during October as a risk-off turn mid-month drove investors to safe-havens. There was no specific driver behind the deterioration in sentiment, however the combination of several factors likely played a part. These included continued trade war tensions, ongoing monetary policy normalisation, political uncertainty in Europe and stretched market valuations.

At the outset of the month, there was little action on the domestic monetary policy front with the Reserve Bank leaving rates on hold once again. The accompanying statement also suggested no changes in the near-term, however more constructive comments on the labour market and GDP growth were two small alterations to the communication. This was echoed in the monthly employment figures that revealed a drop in the unemployment rate from 5.3% to 5.0%, a 6 year low. The details were not particularly impressive though with a fall in the participation rate and only 5.6K jobs added, which was weaker-than-expected.

Third quarter inflation data was also softer-than-anticipated with a 0.4% rise in the trimmed mean measure over the period. This brought the year-on-year rate to 1.8%, well-below the midpoint of the RBA's 2-3% target band. Other domestic data points were more mixed with retail sales at a sluggish +0.3% and small increases in business and consumer confidence.

Looking abroad, the significant correction across global equity markets captured headlines over the month. Geopolitical developments remained a mainstay for markets. In the ongoing trade war, the US signed an agreement with Mexico and Canada that stands to shift more auto manufacturing to North America. Also State-side, political debate intensified ahead of the midterms, which added to investor uncertainty. Political doubts also lingered in Europe as Italian fiscal policy remained contested and separately Angela Merkel announced she would not run for another term as Chancellor. Further north, contention persisted over the terms of Brexit, including the border of Northern Ireland. While in contrast, a victory by far-right candidate Jair Bolsonaro in Brazil's federal election was cheered by investors.

Looking at data for the world's largest economy; US third quarter real GDP grew a healthy 3.5% annualised, which was driven by consumer and government spending. The monthly Non-Farm Payrolls print was weak at only 134K, however the 6 month average remained above 200K. The unemployment rate also dropped from 3.9% to 3.7%, the lowest since 1969. Meanwhile, the ISM Manufacturing survey fell 1.5 points to 59.8 and the Non-Manufacturing gauge rose to 3.1 to 61.6.

Turning to monetary policy abroad, the Fed did not meet during the month, however separately comments from Chairman Powell were perceived as hawkish. Similarly, the post-meeting press conference with ECB President Mario Draghi was interpreted as more positive. The central bank's monthly asset purchases dropped from 30bn euros to 15bn euros as scheduled and remain on track for finishing in December. Purchases from the BOJ have also effectively decreased over the past year, as part of their policy settings, which were left unchanged at its meeting during the month. In stark contrast, the PBoC cut its Reserve Ratio Requirement (RRR) rate for the third time in 2018, by 1.00% to 14.5%. Data in the region also deteriorated with softer GDP growth for the third quarter and weaker manufacturing surveys and industrial production.

On market movements, the Australian 3 and 10 year yields both fell 4bps to 2.04% and 2.64% respectively. At the very front-end, 90 day BBSW dropped 3bp to 1.91%. With RBA expectations firmly on hold, this led to a small tightening in the BBSW-OIS spread, although it remains elevated relative to history. In the US, the 2 and 10 year yields retraced most of their earlier increase to finish only 5bps and 8bps higher at 2.87% and 3.14%. In turn, the AU-US yield spread fell deeper into negative territory. This put pressure on the Australian Dollar among other factors, which slid 1.8% versus its US counterpart.

The Australian iTraxx index (Series 30 contract) traded in a 10bp range finishing the month 7.5bps wider to +82bps. On average, physical credit spreads finished the month unchanged. Semi-government bonds were also unchanged to government bonds over the month.

Fund performance and activity

The Fund returned 0.39% (pre-fee) over the month and underperformed the Bloomberg AusBond Composite Bond Index by -0.09%.

In the alpha component, the Duration strategy detracted from returns with small losses on a range of 3 and 10 year positions on the Australian curve. In contrast, the Relative Value strategy was flat from a 3 year Australian swap versus futures position.

The physical portfolio performed in line with the benchmark in October, however the long iTraxx position detracted. Both the government sector positioning and the non-government sustainably screened portion of the portfolio were flat. Infrastructure added to performance whilst industrials detracted.

Activity during the month included a semi-government switch out of NSW to Tasmania, as well as closing the long Australia iTraxx position as volatility increased.

Outlook

The Reserve Bank releases their Statement on Monetary Policy in early November with their updated forecasts. Third quarter inflation was in line with the Reserve Banks estimate however the unemployment rate is now lower than what they had expected. A tighter labour market may see them increase their inflation forecasts although any upward revision is likely to be only slight and would not indicate any near term monetary policy tightening.

The housing market continues to garner plenty of negative headlines. They are being too dramatic. Auction clearance rates are slowing however some of this may be attributable to some buyers thinking all prices are falling by the over dramatised levels quoted in the media and vendors hanging on to historical price expectations. We do expect house prices to continue to fall gradually though.

What hasn't been receiving the headlines that it should is the iron price. Iron ore is Australia's main export and its price has risen by just under 30% over the past year. The Newcastle coal price has also performed strongly over this period. Normally stronger commodity prices would see the Australian dollar stronger and weigh on key services exports such as tourism and education. That is not the case at the moment with the Aussie dollar and the trade weighted index falling by around 8% and 5% respectively. Economic growth in Australia is healthy, it is only the benign inflation environment at the moment that is preventing the Reserve Bank from removing some monetary policy accommodation.

We are neutral on credit markets with uncertainty stemming from a number of macro concerns balanced against healthy corporate fundamentals.

We have witnessed a number of geopolitical developments that have captured investor attention and impacted risk appetite over the year. Interestingly, the market's reaction to ongoing uncertainty over situations like trade wars and their impact on sentiment has varied considerably. There have been periods of resilience, as evident in September, while October illustrated some underlying fragility.

Similarly, the hardened reaction towards ongoing monetary stimulus withdrawal appeared to soften in October. Fears over the impact of Fed hikes and balance sheet reduction, as well as similar normalisation from its global peers, had subsided to a degree through most of the year. This followed growing recognition that policy changes will be gradual and in response to improving fundamentals. However during the month, the high hurdle to halt stimulus withdrawal likely eroded some investor confidence in risk-assets.

Offsetting uncertainty from these macro factors are solid corporate fundamentals that continue to paint a positive picture. Balance sheets are healthy, earnings growth has been solid and high yield default rates have been low. This was reflected by strong revenue and earnings growth in the third quarter US earnings season that commenced during the month.

Overall, we remain cognisant of the macro risk factors in credit markets. Geopolitical uncertainties may continue to emanate from trade wars as well as emerging markets. Central banks are also likely to remain on the path towards normalisation. Balanced against strong corporate fundamentals, we prefer a neutral stance on credit.