PENDAL

Factsheet

Equity Strategies

February 2019

Pendal Focus Australian Share Fund

ARSN: 113 232 812

About the Fund

The Pendal Focus Australian Share Fund (**Fund**) is an actively managed concentrated portfolio of Australian shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes), that significantly exceeds the S&P/ASX300 Accumulation Index over the medium to long term. The suggested investment timeframe is five years or more.

Description of Fund

This Fund is designed for investors who want the potential for long term capital growth and tax effective income from a concentrated portfolio of primarily 15-30 Australian shares and are prepared to accept higher variability of returns. The Fund may also hold cash and may use derivatives.

Pendal's investment process for Australian shares is based on our core investment style and aims to add value through active stock selection and fundamental company research. Pendal's core investment style is to select stocks based on our assessment of their long term worth and ability to outperform the market, without being restricted by a growth or value bias. Our fundamental company research focuses on valuation, franchise, management quality and risk factors (both financial and non-financial risk).

Derivatives may be used to reduce risk and can act as a hedge against adverse movements in a particular market and/or in the underlying assets. Derivatives can also be used to gain exposure to assets and markets.

Fund Positioning

The Fund is designed to complement a conventional, core share portfolio by providing satellite exposure to selected Australian equities with the potential for performance enhancement.

Investment Team

Pendal's nineteen member Equity team is one of the largest in the Australian fund's management industry. The portfolio manager for the Fund is Crispin Murray, who has more than 27 years' industry experience. Crispin is also Head of Equity.

Other Information

Fund size (as at 28 Feb 2019)	$573 million
Date of inception	April 2005
Minimum investment	$25,000
Buy-sell spread[1]	0.50% (0.25%/0.25%)
Distribution frequency	Half-yearly
APIR code	RFA0059AU

Investment Guidelines

Ex-ante tracking error	4.5% - 8.0%
Max absolute stock position	15%
Min/max sector position relative to index	+/- 15%
Min/Max BARRA style factors	+/- 0.5 SD
SIRA style factors	Within 1 SD
Maximum cash level	30%
Shorting	No
Borrowing	No

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	6.99	7.05	6.01
3 months	8.73	8.93	9.86
FYTD	-0.19	0.32	2.37
6 months	-2.19	-1.83	-0.35
1 year (pa)	3.02	3.59	6.80
2 years (pa)	10.14	11.50	8.55
3 years (pa)	13.26	14.39	12.86
5 years (pa)	9.10	10.21	7.28

Sector Allocation (as at 28 February 2019)

Energy	12.8%
Materials	17.1%
Industrials	16.4%
Consumer Discretionary	5.4%
Consumer Staples	2.9%
Health Care	10.4%
Information Technology	2.6%
Telecommunication Services	7.6%
Financials ex Property Trusts	21.2%
Cash & other	3.6%

Top 10 Holdings (as at 28 February 2019)

Commonwealth Bank of Australia Ltd	8.8%
BHP Billiton Limited	8.4%
CSL Limited	8.2%
ANZ Banking Group Limited	6.5%
Qantas Airways Limited	5.7%
Santos Limited	5.6%
Transurban Group	5.3%
Telstra Corporation Limited	3.9%
Nine Entertainment Co Ltd	3.7%
Westpac Banking Corporation	3.6%

Management Costs[2]

Issuer fee[3]	0.75% pa
Performance fee[4]	15% x the Fund's performance (before fees) in excess of the performance hurdle.

[1] The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

[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.

[4] The Fund's performance fee is 15% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (S&P/ASX 300 Accumulation Index) plus the issuer fee of 0.75% pa. If a performance fee is payable, it is charged in addition to the issuer fee. The fee is calculated each Business Day based on the investment performance and value of the Fund on that day. If we are entitled to a performance fee, it is paid to us as at 30 June each year.

Risks

An investment in the Fund involves risk, including:

- **Market risk**: The risk that factors affecting one or more countries that can influence the direction and volatility of an overall market, as opposed to security-specific risks.
- **Security specific risk**: The risks associated with an individual security.
- **Concentrated portfolio risk** - The Fund's investment strategy of seeking to generate high returns by investing in a concentrated portfolio of Australian shares makes the Fund more volatile than a diversified Australian share fund.

Please read the Fund's Product Disclosure Statement (**PDS**) for a detailed explanation of each of these risks.

Market review

Australian equities extended gains through February, despite the latest reporting season seeing more earnings downgrades than historical average – the market environment is tougher; however investors were braced for poor news. The S&P/ASX 300 Accumulation Index was up by 6.0%.

There was a marked rotation away from defensives over the month, towards cyclicals and the unloved as some of the macro fears receded. Financials outperformed, up +9.1% (S&P/ASX 300 Financials), with the banks outperforming despite lacklustre updates as the overhang from the Royal Commission disappeared. ANZ (ANZ) was the strongest of the Big 4, up +11.9% for the month. Resources (S&P/ASX 300 Resources) were up +6.9% as cyclicals shifted back in to favour. The S&P/ASX 300 AREIT sector underperformed, up +1.9% given the combination of its more defensive characteristics and the pressure on both the retail and residential housing sub-sectors. This was exemplified by the fall in Westfield Unibail Rodamco (URW, -7.1%) – with its exposure to European retail – and Stockland Group (SGP, -7.4%) which owns both residential and retail assets. Gold stocks such as Evolution Mining (EVN, -9.1%) and Newcrest (NCM, -0.1%) lagged as investor confidence improved.

At a stock level, Cochlear (COH, -11.9%) was among the notable underperformers, as a highly-rated growth stock not delivering on expectations. It was the largest drag on Healthcare (-11.8%). Dominos Pizza (DMP, -8.0%) and Treasury Wine Estates (TWE, -3.0%) are two other market favourites which are finding it hard to meet expectations. The Australian domestic demand for DMP seems to be slipping, perhaps in response to the greater choice offered by online food delivery companies. TWE hit its numbers, which had been preannounced, but the low conversion of reported earnings into cash disappointed the market.

The regional banks Bank of Queensland (BOQ, -11.4%) and Bendigo and Adelaide Bank (BEN, -8.5%) also lost ground on the view that they are doing it even tougher than their larger peers in an environment of muted revenue growth. Reporting season revealed that supermarkets, too, are in a challenging environment. Both Coles (COL, -9.4%) and Woolworths (WOW, -0.9%) are facing issues from higher costs coming through and the top line not moving as much as required to offset the margin pressure. The duo weighed on Consumer Staples (-1.4%), the only sector that finished the month in the red.

While the banks outperformed in February, some of the diversified financials (+11.5%) did even better. IOOF (IFL, +36.9%) was among the market's best, enjoying a relief rebound – and short squeeze – as some of the market's fears around the Royal Commission went unrealised. Fund managers Magellan (MFG, +25.0%) and Janus Henderson (JHG, +17.5%) bounced along with equity market sentiment. In Insurance (+9.1%), QBE's strong final week saw it up 15.1% for the month.

Elsewhere, the implications of Vale's tailings dam tragedy dominated the macro for the miners. Reduced production has seen tighter iron ore markets and a sharp reduction in the discount for lower grade 58-fines ore – such as that mainly produced by Fortsecue Mining (FMG, +12.6%) – below 62-fines. The issue continues to escalate, with the Vale board bowing to government pressure and standing down its executive and installing temporary management. Ultimately, as much as 70m tonnes could be withdrawn from the seaborne market in the near term, from a total Brazilian production of ~440m tonnes. Iron ore futures are currently trading at ~US$85 a tonne, but there is an expectation that this tightness could shift this into the US$90 range. Most consensus mid-to-long term forecasts have iron ore at US$60-$65, implying material upgrades for the miners. Over the month, this helped both BHP (+6.9%) and Rio Tinto (RIO, +10.5%) to outperform. The Materials sector finished February 6.4% higher as a result.

Fund performance

The Fund outperformed its benchmark over the month of February.

Contributors

Overweight Viva Energy

Viva Energy (VEA, +31.0%), which distributes Shell fuel in Australia, soared on the back of a deal which saw it purchase the right to set the retail fuel margin at the Coles-operated petrol stations, which had been previously set by Coles management. This will result in a meaningful earnings uplift for VEA, as well as allowing it to drop the fuel price – currently at a material premium to the market – in order to win back some market share. VEA has recently battled with the headwind of low refining margins, which should see some seasonal improvement as northern hemisphere refiners shut down for maintenance as they move into Spring.

Overweight Nine Entertainment

Nine Entertainment's (NEC) result from reporting season demonstrated that it has been able to pull the lever on costs and make gains in market share to offset a weaker overall TV ad market. The tie-up with Fairfax was underpinned by a desire to create a more diversified media company and this proved helpful as the metro media division also held up better than expectations. Stan continues to gain subscribers and, with pricing increases, should be profitable in FY20. While there is no doubt that a reduction in bank and government advertising has seen weaker free-to-air (FTA) television advertising revenues, we think the market had over-stated the risk.

Detractors

Overweight CSL

Our preferred growth stock, CSL (CSL, -0.5%) underperformed in February, despite delivering a decent result which is on track to hit the upper end of management guidance. The market focused on weakness in Albumin volumes, which management has attributed to a one-off issue as it waits for a licence to supply Chinese demand from an additional plant.

Overweight Evolution Mining Limited

Investors turned away from defensive assets in February as some of the macro fears receded, this in turn weighed on the gold price and the share price of many gold miners. In terms of company specific news for EVN from reporting season, the miner delivered in-line results – cash flow generation and dividend payment remain strong.

Strategy and outlook

February was eventful on several fronts. The market was braced for reporting season, conscious of the potential implications of softer consumer sentiment and declining house prices. As it transpired, there were more downgrades than usual as companies were generally cautious in their outlook and flagged a tougher environment. However we are not seeing a collapse in earnings and the aggregate outcome or reporting season was not as bad as many had feared.

A reasonable reporting season therefore provided no impediment to the positive turn in sentiment on several macro issues which, in turn, saw a market re-rating and a 6.0% gain in the S&P/ASX 300. The US Federal Reserve's decision to pause its hiking cycle has seen the fear of a policy mistake and over-tightening recede. At the same time, there are signs of Chinese stimulus measures starting to gain traction, cooling fears about the pace of economic deceleration and the effect upon global growth. The outcome of Sino-American negotiations remains unclear, but here too the consensus is more positive, with the expectation that some sort of deal will be forthcoming which will remove the uncertainty. Sentiment has swung quickly on these issues – and we are mindful that it could deteriorate just as quickly – but for the moment the more positive tone has allowed the market to bounce back and almost return to its level of October 2018.

We have also seen material changes in the outlook for iron ore. The devastating tragedy in late January in Brazil - where the collapse of a tailings dam at the Corrego do Feijao mine in Minas Gerais state resulted in 186 deaths - has seen the government step in and look to shut down production at a number of mines where “downstream”-style tailings dams have been constructed in potentially vulnerable locations. While the outcome is uncertain, at this point there are indications that reduced production could see a shortfall against demand in FY20, resulting in much higher iron ore prices than consensus currently expects.

For more information please call **1800 813 886**,
contact your key account manager or visit **pendalgroup.com**

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