PENDAL

Factsheet

Pendal MidCap Fund

ARSN: 130 466 581

Equity Strategies

February 2019

About the Fund

The Pendal MidCap Fund (**Fund**) is an actively managed portfolio of Australian mid cap shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Pendal MidCap Custom 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 portfolio of primarily 40-60 Australian mid cap shares and are prepared to accept higher variability of returns. Pendal defines the mid cap universe to include companies ranked between 51 and 150 of the S&P/ASX 200 Index. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange, 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).

The Fund may have assets denominated in foreign currencies. This means that changes in the value of the Australian dollar relative to foreign currencies may affect the value of the assets of the Fund. The Fund's foreign currency exposure may be hedged from time to time, in whole or part.

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.

Investment Team

Pendal's Equity team is headed up by Crispin Murray who has extensive experience and a strong record in equities research. Andrew Waddington is the portfolio manager for the Fund.

A combination of the Australian equities large cap and small cap teams' research is used to construct the Pendal MidCap Fund.

Investment Guidelines

Investable universe	ASX and NZX listed and soon to be listed companies, generally with a market capitalisation of A$0.5 billion to A$5 billion; derivatives; cash
Investment ranges	Australian shares 80 - 100% New Zealand shares 0 - 10% Cash 0 - 20%
Ex-ante tracking error	3 – 8%
Number of stocks	Typically 40 – 60
Absolute stock position	15%
Maximum active stock position	+/- 5%[1]
Maximum active sector position relative to index	+/- 10%[1]

[1] compared to benchmark.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	5.23	5.30	5.47
3 months	5.16	5.39	7.89
6 months	-6.78	-6.37	-4.44
1 year (pa)	-2.31	-1.38	2.40
3 years (pa)	13.37	14.68	14.34
5 years (pa)	11.55	12.94	11.36
7 years (pa)	12.64	14.39	10.64
10 years (pa)	14.96	16.79	12.40
Since Inception (pa)	9.84	11.99	5.75

Sector Allocation (as at 28 February 2019)

Energy	6.3%
Materials	19.8%
Industrials	12.4%
Consumer Discretionary	12.7%
Consumer Staples	8.4%
Health Care	5.1%
Information Technology	7.6%
Telecommunication Services	8.1%
Utilities	0.0%
Financials ex Property Trusts	3.9%
Property Trusts	2.1%
Cash & other	13.6%

Top 10 Holdings (as at 28 February 2019)

Metcash Trading Limited	4.7%
Nine Entertainment Co Ltd	4.5%
Xero Limited	4.2%
Resmed Inc	3.9%
Flight Centre Limited	3.6%
JB Hi-Fi Limited	3.5%
Seven Group Holdings Ltd	3.3%
Monadelphous Group Limited	3.1%
Tabcorp Holdings Limited	3.1%
Regis Resources Limited	2.9%

Other Information

Fund size (as at 28 Feb 2019)	$498 million
Date of inception	June 2008
Minimum investment	$25,000
Buy-sell spread[2]	0.50% (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	BTA0313AU

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

Management Costs[3]

Issuer fee[4]	0.90% p.a.
Performance fee[5]	20% x the Fund's performance (before fees) in excess of the performance hurdle

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

[4] 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.

[5] The Fund's performance fee is 20% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (Pendal MidCap Custom Index) plus the issuer fee of 0.90% 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.

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 in general, despite the latest reporting season seeing more earnings downgrades than the historical average – the market environment is tougher, however investors were braced for poor news. The S&P/ASX 51-150 Accumulation Index was up 5.5% for the month.

Ten out of the eleven GICS sectors recorded positive gains in February, with the exception of the Real Estate (-1.0%) sector. Given the combination of its more defensive characteristics and the pressure on the retail sub-sector. This was exemplified by the fall in heavyweight Westfield Unibail Rodamco (URW, -7.1%) – with its exposure to European retail – and Shopping Centres Australiasia (SCP, -3.2%) which owns retail assets.

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 +10.4%, with the diversified financials outperforming as the overhang from the Royal Commission disappeared. Magellan Financial Group (MFG, +25.0%) was the largest contributor amongst all. The Fund manager reported a strong set of results in February, with 1H19 adjusted profits increasing by 62% compared to that of last year. It was driven by strong operating leverage as well as FUM growth and higher performance fee; margin however fell by 3bps. Management also indicated the upcoming development of retirement income solutions which was well received by market. In contrast, the regional bank duo, Bendigo & Adelaide Bank (BEN, -8.5%) and Bank of Queensland (BOQ, -11.4%) lost ground on the view that they are doing it even tougher than their larger peers in an environment of muted revenue growth.

Following Financials, Information Technology (+8.2%) also outperformed the headline index. Electronics design software provider Altium (ALU, +32.3%) led the gainers with a double-digit return. Strong performance from all divisions helped software company Altium (ALU,+32.3%) to deliver a solid print of revenue growth for the first half. In terms of users subscription, Management reaffirmed its target of 100,000 users by 2025 which helped to support sentiment. Offsetting some of these gains were Wisetech (WTC, -5.3%) and NEXTDC (NXT, -8.9%). Although both printed a good set of results, they failed to meet expectations implied in their valuation ratings.

On the other side of the spectrum, we saw Materials (+3.3%), Consumer Discretionary (+4.5%), Consumer Staples (+3.9%) and Utilities (+0.2%) underperform the headline index. As investors turned more risk-on, the gold price pulled back which weighed on the share price of gold miners, including Evolution Mining (EVN, -9,1%) and St. Barbara (SBM, -10.8%). 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. Nufarm (NUF, -16.0%) was the other key detractor from Materials outside the gold miners. The herbicides manufacturer has underperformed the market lately on concerns in relation to adverse seasonal conditions, high channel inventories, and competitive pressures in various markets.

Lastly, stock performance was somewhat divergent within Consumer Staples. Market darling A2 Milk (A2M, +14.0%) continue to edge higher on the back of strong sales growth both domestically and in China; whereas a poor trading update from vitamins manufacturer Blackmores (BKL, -27.2%) created a drag for sector performance. BKL delivered +0.4% growth in net profit after tax (NPAT) for the first half. However, sales growth in China was up +8% for the half which, after +18% growth in the first quarter, implied a deceleration in Q2 FY19 and the aggregate result came in behind the market's expectations. Management also provided a cautious outlook for the second half.

Fund performance

The Fund underperformed 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, +17.2%) 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

Not Held Altium

Strong performance from all divisions helped software company Altium (ALU,+32.3%) to deliver a solid print of revenue growth for the first half. In terms of users subscription, Management reaffirmed its target of 100,000 users by 2025 which helped to support sentiment. We do not own ALU, and it weighed on performance.

Not Held Magellan Financial Group

Magellan Financial Group (MFG, +25.0%) reported a strong set of results in February, with 1H19 adjusted profits increasing by 62% compared to that of last year. It was driven by strong operating leverage as well as FUM growth and higher performance fee; margin however fell by 3bps. Management also indicated the upcoming development of retirement income solutions. We do not own MFG, and it weighed on performance.

Strategy and outlook

The portfolio rebounded in February as broad equity market sentiment improved, although it was a touch behind the index.

The tech growth stocks led the market's rebound, demonstrating that these stocks remain popular despite heady valuations and the high expectations they imply. The Fund's underweight in stocks such as A2 Milk, Webjet and Afterpay Touch dragged on performance as a result. We continue to believe that it will become more difficult for some of these growth stocks to maintain their ratings as we move into an environment of lower liquidity. Our positions in Bendigo Bank and Whitehaven Coal also detracted.

This was offset to some extent by strong performance from some of the stocks which dragged in late 2018, as their results demonstrated that the market was overly pessimistic on the outlook for earnings. Our stakes in Nine Entertainment, Viva Energy, Seven Group and Monadelphous were therefore among the strongest positive contributions to performance. In each instance, we believe the stocks remain undervalued.

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.

We believe we remain in an environment of subdued asset returns. There are pockets of strong organic growth – such as in mining services – however in aggregate economic growth remains muted. At the same time, we believe that liquidity will be tighter than has been the case in the previous five years. The implication is that we will see divergences within the market. Companies which are able to generate growth, exercise capital discipline, return cash to shareholders, and respond to disruptive threats should be well rewarded. Those that cannot are likely to be punished by the market, as we no longer have the rising tide of abundant liquidity lifting all boats. While this is an environment which does present challenges, it is one in which company level insight and the ability to identify companies with good strategies and adroit management, should be rewarded.

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

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