# Factsheet

Bond, Income & Defensive Strategies

February 2019

# Pendal Sustainable Australian Fixed Interest Fund

ARSN: 612 664 730

### 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 Bond, Income & Defensive 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.

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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.

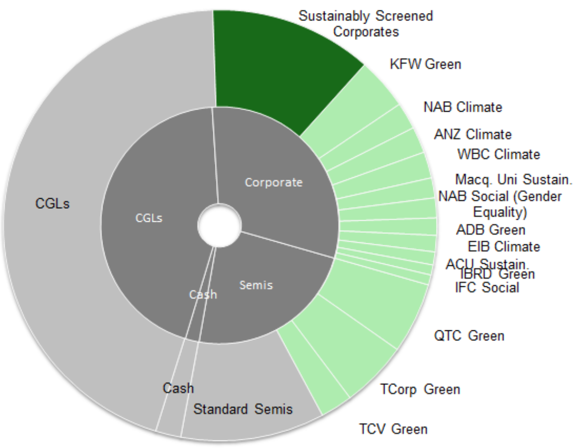
### Performance

| (%) | Total Returns (post-fee) | (pre-fee) | Benchmark Return |
|---|---|---|---|
| 1 month | 1.00 | 1.03 | 0.94 |
| 3 months | 3.07 | 3.17 | 3.11 |
| 6 months | 3.24 | 3.44 | 3.42 |
| 1 year (pa) | 5.52 | 5.94 | 6.16 |
| 2 years (pa) | 4.27 | 4.69 | 4.51 |
| Since Inception (pa) | 2.36 | 2.77 | 2.58 |

### Sector Allocation (as at 28 February 2019)

| | |
|---|---|
| Government bonds^ | 37.7% |
| Semi-Government bonds^ | 9.7% |
| Sustainability Screened Corporate bonds | 16.4% |
| ESG Thematic bonds | 30.8% |
| Cash & other | 5.4% |

^ Ex Green, Social & Sustainable Bonds




### Other Information

| | |
|---|---|
| Fund size (as at 28 Feb 2019) | $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 the month as the Reserve Bank shifted its communication to suggest the outlook for rate changes was "more evenly balanced". The central bank also downgraded its projection for economic growth and lowered its inflation forecast in its quarterly Statement on Monetary Policy. In turn, markets are now pricing at least one cut from the Board over the next twelve months. Also in money markets, a large fall in the 3 month BBSW rate caused the spread between it and the 3 month OIS rate to narrow to 39bps. This was driven in part by offshore movements as the comparable LIBOR-OIS spread tightened during February.

Meanwhile, local economic data was mixed over the month. Labour data was stronger-than-expected with 39K jobs added, which was attributed to a strong increase in full-time positions. A small rebound in consumer confidence and business conditions was also encouraging. In contrast, retail sales slipped 0.4% and building approvals fell a sizeable 8.4% month-on-month. Wage data revealed a 0.5% increase over the quarter, which brought the year-on-year rate to 2.3%.

Looking abroad, the Fed's tilt to a more neutral stance in January continued to buoy risk appetite and lift global equities. This was alongside optimism over a positive outcome to US-China trade negotiations that took place in Washington towards month-end. Although there was no formal agreement between both sides, some perceived progress and the delay of a proposed US tariff increase indefinitely was well-received by markets.

Economic data from the world's largest economy was less supportive for risk assets. GDP figures revealed a softer 2.6% annualised growth rate for the fourth quarter. Readings from leading indicators varied with the ISM manufacturing gauge ticking higher, but its services cousin falling. At the same time, consumer confidence rebounded and the monthly payrolls report revealed a constructive 304K addition for the month.

In Europe, fourth quarter Eurozone GDP growth printed at a preliminary 0.2% quarter-on-quarter. German GDP figures revealed the region's largest member had narrowly avoided a technical recession, while its Italian counterpart was not as fortunate. Leading indicators were more mixed with a 0.4 point rebound in composite PMI and 0.5 point recovery in consumer confidence, but a -1.6% fall in retail sales and -0.9% drop for industrial production.

In terms of market movements, the Australian 3 and 10 year yields fell -13bps and -15bps to 1.63% and 2.10% respectively. At the very front-end, 3 month BBSW dropped a more sizeable -20bps to 1.87%. At the same time, US 2 and 10 year yields increased by 6bps and 9bps to 2.52% and 2.72% respectively. This caused the AU-US 10 year yield spread to fall further into negative territory and end the month at -0.61%. Together with the growing expectations for an RBA cut, the Australian Dollar finished -2.5% lower versus its US namesake.

In credit markets, spreads for global CDS indices tightened further with risk appetite still well-supported by dovish messaging from the Fed. The reported progress on a Sino-US trade deal also aided market sentiment, as did a better-than-expected outcome from the Royal Commission into the local banking sector.

The Australian iTraxx index (Series 30 contract) traded in a 10bp range finishing the month 8bps tighter to +69bps. Physical credit spreads also closed the month narrower, with the best performing sectors being domestic banks, infrastructure and utilities all tightening 7bps. The worst performing sector was supranationals which only narrowed 1bp. Semi-government bonds performed well tightening 2bps to government bonds.

**Fund performance and activity**

The Fund returned 1.03% (pre-fee) over the month and outperformed the Bloomberg AusBond Composite Bond Index.

In the alpha component, the Duration strategy added value from a long duration Australia 3 year position that benefited from a fall in yields.

The physical portfolio outperformed the benchmark in February. Both the government sector positioning and the non-government sustainably screened portion of the portfolio added to performance. Infrastructure, financials and utility sector positioning all contributed positively.

Activity during the month included buying the new Queensland Treasury Corp (QTC) Green bond switching out of a non-green QTC bond. We invested in our preferred sustainable semi-government issuer Tascorp funded out of Western Australian Treasury Corp on the back of current valuations. We also bought financials and industrials funded out of commonwealth government bonds.

**Outlook**

The Reserve Bank left the cash rate unchanged at its meeting in early March and delivered a neutral statement. Fourth quarter economic growth data is due to be released the day after the Reserve Bank's meeting. Of particular interest within the numbers will be household consumption; despite solid employment growth, household consumption was weak in the prior quarter. Another weak number and the case for further monetary policy easing increases.

With the cash rate at 1.50% the hurdle for further policy easing is high with the catalyst most likely to come from inflation disappointing or the labour market deteriorating. The Reserve Bank is looking for labour market tightness to feed into wage inflation and in turn see underlying inflation increase. With the unemployment rate at 5% and according to the RBA's forecasts expected to fall only to 4.75% by June 2021 it is difficult to envisage wage inflation pressure rapidly increasing. The labour force participation rate is however around historically high levels that has kept the unemployment rate more elevated than would otherwise be the case.

Inflation has continued to disappoint, with the trimmed mean remaining below the Reserve Bank's 2-3% target band since March 2016. Its forecasts imply that underlying inflation will only rise above 2% in the second half of 2020. Such a benign environment does not require the Reserve Bank to be pre-emptive. The economy continues to be supported by elevated commodity prices and a large pipeline of infrastructure investment.

With a more neutral tilt from the Federal Reserve and optimism over prospective trade deals the global macro backdrop for credit has improved and we have taken a short-term positive view towards the asset class. At the same time, we are cognisant that geopolitical risks continue to linger and trade war concerns may resurface to damage sentiment. As such, positioning is tactical in nature to maintain flexibility should the environment deteriorate.

The Fed's messaging in January was perceived as a signal that the central bank had effectively paused its rate hikes and could halt its balance sheet reduction. In turn, investors' fears of aggressive tightening have been soothed and the wind has seemingly returned to risk assets' sails. Over the same period, investors have taken a more constructive view towards recent Sino-US trade negotiations. This includes the indefinite delay of a US tariff increase on US$200bn of Chinese imports.

However, we are wary that the underlying issues behind the trade war still threaten to devolve into a more prolonged "cold war". While some progress has been reported, US-China relations have not materially improved and if anything have become increasingly strained. This has been evident in the US allegations of intellectual property theft and sanctions breaches towards Chinese technology giant, Huawei. At this stage, such issues appear difficult to resolve. In turn, the relationship between the world's two largest economies may remain frosty.

The negative impact of tariffs has become more evident on the Chinese economy as visible in the deterioration of activity indicators like manufacturing surveys and a slowdown in GDP growth. This has flow-on effects for its neighbours, particularly those that are highly dependent on exports to the Asian giant. The knock-on effect to the US is also slowly becoming more apparent. Fourth quarter earnings season revealed the bite to corporate America's profits from the trade war and slowing Chinese demand. Two highly publicised victims included Harley Davidson and NVidia.

However, we also note that in aggregate US earnings have shown resilience and balance sheets remain relatively healthy. Demand for credit has also been reinvigorated in 2019 as evident in the tightening of spreads for global credit indices. The local market has also benefited from the weight of the Royal Commission being lifted from its shoulders over the past month. Appetite for issuance in the Australian market has also returned to some degree with the major banks and offshore corporates re-appearing with opportunistic deals. This is an improvement relative to the final quarter of 2018, however demand is still well-below the more deal-hungry periods of previous years.

Overall, the backdrop for risk assets has ameliorated this year with the predominant driving force being a more flexible Fed. However, we are wary that sentiment towards the trade war can shift with each individual battle and the underlying issues are far from resolved. For this reason, our positive positioning is short-term at this stage and tactical in nature.

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

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