PENDAL

Factsheet

Equity Strategies

February 2019

Pendal Sustainable Australian Share Fund

ARSN: 097 661 857

About the Fund

The Pendal Sustainable Australian Share Fund (**Fund**) is an actively managed portfolio of Australian shares. 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 S&P/ASX 200 Accumulation Index over the medium to long term, whilst maximising the portfolio's focus on sustainability. The recommended 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, diversification across a broad range of Australian companies and industries.

The Fund uses an active stock selection process that combines sustainable and ethical criteria with Pendal's financial analysis. The Fund actively seeks exposure to companies that demonstrate leading environmental, social and corporate governance (ESG) and ethical practices and avoiding exposure to companies with activities we consider to negatively impact the environment or society.

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, risk factors (financial and non-financial), franchise and management quality.

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

- the 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 a company has a material business involvement in an activity if 10% or more of its total revenue is derived from that activity.
Pendal actively engages with the management of the companies we invest in to manage risk, effect change and realise potential value over the long term.

Investment Team

The Fund is managed by Rajinder Singh in Pendal's Australian Equity team who has more than 17 years' industry experience.

Management Costs[1]

Issuer fee[2]	0.85% pa

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

[2] 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 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.

Performance

(%)	Total Returns		Benchmark
	(post-fee)	(pre-fee)	Return
1 month	6.09	6.16	5.98
3 months	9.22	9.45	9.95
6 months	-2.45	-2.03	-0.26
1 year (pa)	3.76	4.65	7.05
2 years (pa)	5.95	6.86	8.57
3 years (pa)	10.64	11.59	12.91
5 years (pa)	6.28	7.20	7.30

Sector Allocation (as at 28 February 2019)

Energy	6.3%
Materials	21.8%
Industrials	10.5%
Consumer Discretionary	4.5%
Consumer Staples	1.0%
Health Care	10.8%
Information Technology	2.0%
Telecommunication Services	5.3%
Financials ex Property Trusts	29.4%
Property Trusts	5.2%
Cash & other	3.2%

Top 10 Holdings (as at 28 February 2019)

BHP Billiton Limited	8.4%
ANZ Banking Group Limited	8.2%
CSL Limited	7.9%
Westpac Banking Corporation	7.6%
Telstra Corporation Limited	4.2%
Qantas Airways Limited	3.8%
Amcor Limited	3.6%
Rio Tinto Limited	3.4%
National Australia Bank Limited	3.4%
Insurance Group Australia	3.3%

Other Information

Fund size (as at 28 Feb 2019)	$341 million
Date of inception	October 2001
Minimum investment	$25,000
Buy-sell spread[3]	0.50% (0.25%/0.25%)
Distribution frequency	Half-yearly
APIR code	WFS0285AU

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

CERTIFIED RESPONSIBLE INVESTMENT ® CERTIFIED BY RIAA

The Pendal Sustainable Australian Share 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.

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.

Fund performance

The Fund outperformed its benchmark over the month of February

Overweight ANZ

There was a marked rotation away from defensives in February, towards cyclicals and the unloved as some of the macro fears receded. This in conjunction with the disappearing overhang from the Royal Commission helped Banks to outperform despite posting lacklustre updates. That said, the revenue environment remains challenging for the industry, alongside continued margin pressure. ANZ is our preferred "Big Four", given its cost-cutting initiatives and strong capital position.

Not held Woolworths

Results from reporting season for Woolworths (WOW, -0.9%) painted a picture of tough conditions for supermarkets. It is proving difficult for companies to pass on higher input costs as competition remains tight. WOW is set to face the higher labour costs as a result of new employee benefit agreements (EBAs) over the next year. This is a broader theme within the market, with some companies looking to undertake new EBAs ahead a possible change in Federal Government this year. The supermarkets are also finding it tough to grow: most of their sales growth is coming in online channels, which means higher costs and almost no margin.

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.

The banks enjoyed a relief bounce as the ultimate findings of the Royal Commission were seen as largely benign, although there is little doubt that it has wrought material changes upon both the structure of the financial sector and how the banks are likely to be managed in the near future. We see the banks as having valuation support at their current levels, however trading updates revealed that the environment remains challenged. The banks will do well to hold earnings flat in the next few halves and we may even see some some declines. As such, it is hard to see the banks outperforming in the near term.

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.

Regnan Sustainability Snapshots#

Australia and New Zealand Banking Group Ltd (ANZ)

Australia and New Zealand Banking Group provides a range of banking and financial products and services.

Processes to identify environmental risks in lending continue to advance. In FY17, existing sector policies for water, hydroelectricity and forestry were enhanced by the development of an overarching social and environmental risk policy, further setting out environmental and social considerations when assessing customer relationships. More recently, it was expanded to require the establishment of effective grievance mechanisms. Implementation is supported by ESG training risk modules across the credit risk team. While little has been disclosed on the specifics of its scenario analysis, climate change has been included in risk appetite statements and additional criteria disclosed for high risk sectors, including energy, resources and commercial property in FY18.

Execution capability for key strategic initiatives is generally positive. ANZ articulates a clear cultural strategy aligned to broader transformation objectives. The 'new ways of working' approach, launched in August 2017, focuses on the creation of multidisciplinary teams formed around specific customer objectives. This builds on previous 'agile' programs to further productivity and cultural objectives. Encouragingly, against a backdrop of organisational change and declining public sentiment, ANZ has managed to keep employee engagement and other human capital metrics either steady or improving.

High profile conduct issues, including recent ACCC charges against ANZ employees for alleged cartel breaches, continue to damage reputation, and raise concerns about possible systemic failures in conduct and risk management controls. ANZ has proactively responded to criticisms raised at the Royal Commission, taking action to revise its risk appetite for products and services where conduct and customer related risks are elevated (for instance third party car financing and reverse mortgages.) The principles of its 'agile' working transformation, 'new ways of working', have been applied to customer remediation efforts to formalise a group-wide approach seeking to finalise cases efficiently and address underlying causes.

Costa Group Holdings Ltd (CGC)

Costa Group Holdings is a horticulture company primarily engaged in the growing of mushrooms, blueberries, raspberries, glasshouse grown tomatoes, citrus and other fruits in Australia. The company distributes its products within Australia and to export markets.

Disclosure of climate change mitigation and adaptation plans improved in 2018. CGC's protected crops (2/3rd of all crops in FY2018) operate under controlled conditions and are therefore less impacted by acute and chronic impacts of climate change. Advanced harvest management systems, the use of 'internet of things', and data analytics – which help predict optimal harvesting times – add to the Group's ability to mitigate climate risks and to enhance business resilience. The company also invested in energy efficient smart technologies across Eastern Creek Costa Farms and Logistics Centre, and the Mernda mushroom facility.

The company explicitly recognises water security as a material risk, noting management action to expand dam capacity at Corindi berry farm to increase storage to 450ML to future-proof the site's requirements. Development and implementation of substrate farming techniques – which apply precise doses of water and fertiliser to plants, increasing water efficiency – will add to CGC's technology leadership.

The Group has materially reduced the use of third-party labour hire firms (from ~60 to ~12) to recruit seasonal workers, increasing visibility and control over labour conditions and arrangements. Availability of labour, especially seasonal agricultural workers, remains a key operational risk given workforce numbers grow by ~62% during peak harvest season. Pay incentives in place to attract seasonal workers, to retain workers within their harvest trail, and to encourage workers to return to CGC in future years, provide greater resilience to seasonal labour supply risks. Demonstrating a focus on safety culture, both the Group's total recordable injury frequency rate (TRIFR) and lost time injury frequency rate (LTIFR) have improved since 2014.

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

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iii. the company's suitability or attractiveness from an investment perspective.

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