PENDAL

Factsheet

Bond, Income & Defensive Strategies

March 2019

Pendal Enhanced Cash Fund

ARSN: 088 863 469

About the Fund

The Pendal Enhanced Cash Fund (**Fund**) is an actively managed portfolio of debt securities such as short-term money market instruments and medium term notes. Key features of the Fund include next day access to funds and quarterly distribution.

The Fund invests in medium-term securities that are investment graded rated and short-term securities with a credit rating of A-3 or higher by Standard and Poor's or equivalent rating agency. Duration is managed in a range of +/- 0.5 year around the index.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Bloomberg AusBond Bank Bill Index. The recommended investment time frame is 12 months or more.

Investment Approach

The Fund aims to add value through active management by exploiting market inefficiencies through the shape of the money market curve and the mispricing of credit securities. Research is focused on assessing economic factors, the likely direction of interest rates and credit analysis. Credit margin relative value is assessed with reference to rating, sector, maturity, liquidity and underlying credit fundamentals.

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 and Multi-Asset. The portfolio manager of the Fund is George Bishay, who has more than 23 years industry experience.

Portfolio Characteristics

Weighted average maturity	+/- 0.5 years around the index
Minimum credit rating	BBB- (Long term rating) A-3 (Short term rating)
Liquidity	Following day access (before 2.30pm)

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 asset.
- **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.
- **Valuation risk -** The risk that the value of an investment in a less active or liquid market is lower than what is reflected in the Fund's unit price.

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

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.27	0.30	0.17
3 months	0.74	0.80	0.52
FYTD	1.80	1.99	1.52
6 months	1.15	1.28	1.00
1 year (pa)	2.34	2.60	2.02
2 years (pa)	2.62	2.87	1.88
3 years (pa)	2.77	3.02	1.90
5 years (pa)	2.72	2.98	2.13

Post-fee return is based on management fees deducted from the unit price: currently 0.25% (pa).

Sector Allocation (as at 31 March 2019)

Money market	57.9%
Corporate	38.6%
Residential mortgage backed	3.5%
Government bond	0.0%
Other asset backed securities	0.0%

Security Credit Ratings (as at 31 March 2019)

AAA	3.5%
AA	25.4%
A	7.5%
BBB	5.7%
Money market	57.9%

Statistics (as at 31 March 2019)

Modified duration	0.15 years

Other Information

Fund size (as at 31 Mar 2019)	$674 million
Date of inception	January 1994
Minimum investment	$25,000
Buy-sell spread[1]	0.06% (0.03%/0.03%)
Distribution frequency	Quarterly
APIR code	WFS0377AU

[1] 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[2]

Issuer fee[3]	0.25% 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.

Market review

Australian bond yields experienced a significant fall that was shared by global peers over the month. The decline appeared tied to more dovish messaging from central banks, as well as emerging concerns over the outlook for the US economy. These developments overshadowed wavering trade war and Brexit-related headlines.

In Australia, the RBA left rates unchanged at 1.50% as widely-expected and its accompanying March statement offered few changes. The meeting minutes later revealed more in-depth discussions by the Board surrounding the weakness in house prices and the perceived effects on household consumption. This was echoed in communication by board members through the month and continued the more dovish language adopted by the central bank in February. In turn, expectations for a rate cut increased further with two reductions now priced by year-end. This contributed to a decline in OIS rates, while separately repo rates fell and translated to lower funding costs for the banks.

Data-wise, fourth quarter GDP figures revealed a weak 0.2% pace of growth over the quarter, which brought the year-on-year rate to 2.3%. On a per-capita basis, GDP fell -0.2% indicating population growth had outstripped the increase in output for the second consecutive quarter. Labour data was mixed with only 4.6K jobs added, yet a drop in participation helped the unemployment rate fall by 0.1% to 4.9%. Meanwhile, leading indicators were weak with business and consumer confidence both falling as well as retail sales growing a meagre 0.1%.

Looking abroad, the outlook for Fed policy was perceived as more dovish post the March FOMC gathering. The majority of Committee members no longer anticipate additional hikes this year and a need to be "patient" on further increases was emphasised in their communication. In combination with softening economic data, market-implied pricing shifted to an eventual cut from the Fed over the next year. Data varied with the weaker data prints including a meagre 20K in jobs additions and a drop in ISM Manufacturing from 56.6 to 54.2.

In Europe, the ECB also adjusted its policy stance to a more dovish lean at its March meeting. President Mario Draghi pushed back the central bank's expected timeframe for a rate hike to the end of the year. The Governing Council also introduced a new targeted loan programme and stated it would continue reinvesting proceeds from maturing bonds that were purchased as part of QE. Most leading indicators weakened over the month, including a -0.6 point drop in the Composite PMI reading to 51.3.

In Asia, Chinese policymakers announced a lower growth target of between 6% and 6.5%, from the previous "around 6.5%". Signs of softness were evident in a -14% year-on-year decline in industrial profits and a -20.7% fall in exports over the same period. Import restrictions on Australian coal introduced in February continued to put pressure on the price of the commodity through the month.

Finally in terms of market movements, Australian 3 and 10 year yields fell 23bps and 33bps to 1.40% and 1.77% respectively. 3 month BBSW saw a more modest decline of 10bps to 1.77% and the OIS-BBSW spread narrowed further. In the US, 2 and 10 year yields dropped 25bps and 31bps to 2.26% and 2.41%. As a result, the AU-US 10 year yield differential fell a small 2bps further into negative territory. At the same time, the Australian Dollar finished the month flat.

Turning to credit markets, spreads narrowed as the increasingly dovish tilt from major central banks buoyed appetite for risk assets. Investors also looked past the noise from trade wars and Brexit rumblings. In turn, the offshore macro environment was relatively supportive and guided domestic credit spreads, while there was less influence from local developments.

The Australian iTraxx index (Series 30 contract) traded in a 6bp range finishing the month 2.5bps tighter to +66.5bps. The new Series 31 contract finished the month at +75.5bps. Physical credit spreads also closed the month 2.5bps narrower, with the best performing sectors being domestic banks and utilities tightening 6 and 3bps respectively. The worst performing sector were resources and telecoms which only narrowed 1bp each. Semi-government bonds underperformed widening 1bp to government bonds.

Fund performance and activity

The Fund outperformed the benchmark by 13 basis points (pre-fee) in March. Positive performance came from financials and industrials sectors.

Activity included investing in the infrastructure sector funded out of cash.

As at the end of the month, the Fund had a credit spread of 60bps over bank bills, interest rate duration of 0.15 years and credit spread duration of 1.25 years.

Outlook

The Reserve Bank left the cash rate unchanged at its meeting in early April. A slight tweak in the statement was seen to indicate a move towards potential easing with a note that it will "set monetary policy to support sustainable growth in the economy". As recent economic growth numbers have disappointed the next move in the near term for monetary policy is more likely an easing.

However with the cash rate at 1.50% the hurdle for further policy easing is high. Previously the catalyst was most likely to come from inflation disappointing or the labour market deteriorating. A deteriorating global economic environment can be added to the mix. Economic growth prospects for Europe in particular look poor and the inversion of the US yield curve, albeit briefly, has garnered headlines about the possibility of the US heading into recession in the near to medium term. Global trade data does not indicate positive momentum.

The Reserve Bank remains upbeat on the outlook for the labour market and increasing tightness feeding into wage inflation and in turn generate increasing underlying inflation. With the unemployment rate at 4.9% 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. The risk is more likely that inflation continues to undershoot the Reserve Bank's forecast. The economy continues to be supported by elevated commodity prices and a large pipeline of infrastructure investment. The upcoming Federal election will likely see the Reserve Bank on hold in the near term however further monetary policy easing in the latter half of the year cannot be ruled out.

With a more dovish stance from the Federal Reserve and fewer worries over trade wars the global macro backdrop for credit has improved and as such we maintain a more positive view towards the asset class. At the same time, we are cognisant that geopolitical risks continue to linger beneath the surface and tariff concerns may return to damage sentiment. As such, positioning is tactical in nature to maintain flexibility should the environment deteriorate.

The Fed's recent messaging has suggested that rate hikes have effectively been paused and opened speculation of easing. 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 as evident by the allegations against Huawei. As such, there is a risk that 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 has also become more apparent, as evident in several earnings results from US corporates.

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 in recent months. 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. That said, issuance volumes are still low compared to similar periods in previous years. As such, the combination of lighter issuance and stronger demand should be supportive for spreads.

Overall, the backdrop for risk assets has ameliorated this year with the predominant driving force being more flexible central banks. However, we are wary that sentiment towards the trade war can shift with each individual battle and the underlying issues yet to be 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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