PENDAL

Factsheet

Equity Strategies

March 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 31 Mar 2019)	$584 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	0.76	0.82	0.73
3 months	11.39	11.59	10.92
FYTD	0.57	1.14	3.12
6 months	-1.14	-0.78	1.59
1 year (pa)	7.62	8.18	11.74
2 years (pa)	8.54	9.82	7.21
3 years (pa)	12.10	13.27	11.39
5 years (pa)	9.31	10.42	7.39

Sector Allocation (as at 31 March 2019)

Energy	11.7%
Materials	19.6%
Industrials	16.7%
Consumer Discretionary	5.3%
Consumer Staples	2.9%
Health Care	10.1%
Information Technology	2.7%
Telecommunication Services	7.8%
Financials ex Property Trusts	19.0%
Cash & other	4.2%

Top 10 Holdings (as at 31 March 2019)

BHP Billiton Limited	8.9%
CSL Limited	8.3%
Commonwealth Bank of Australia Limited	7.4%
Transurban Group	5.9%
ANZ Banking Group Limited	5.8%
Qantas Airways Limited	5.6%
Santos Limited	5.6%
Telstra Corporation Limited	4.1%
Nine Entertainment Co Ltd	3.7%
Rio Tinto Limited	3.7%

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

The strong rebound Australian equity investors had enjoyed since the beginning of 2019 stalled somewhat through March, with the S&P/ASX 300 Accumulation finishing the month 0.7% higher Beneath the muted headline return, performance diverged across sectors: Resources (+1.9%) was aided by the elevated iron ore price; whereas Industrials (+0.4%) was the laggard, dragged down by the poor performance of heavyweight Financials (-2.6%).

On the macro level, US yield curve inversion has some calling for an American recession, while the Brexit saga provided a new twist each day as the British parliament neared – and then passed - the deadline by which its divorce from the EU was supposed to have happened.

Turning to the specifics of sector performance, Metals & Mining (+4.3%) outperformed and helped Materials (+3.4%) to become the largest contributor to the headline index performance: the iron ore miners continued to rise in response to an operations update from Vale. The Brazilian miner's new 2019 volume estimates take into account the effect of mine closures and disruptions from the review into the safety of its tailings dams. New guidance suggests that, even with some deployment of existing inventory, the cut in volumes will be at the upper end of the market's range of expectations. Fortescue Metals (FMG, +17.3%), Rio Tinto (RIO, +8.4%) and BHP Billiton (BHP, +5.5%) all outperformed on the view that FY19 iron ore prices will be higher than previously thought.

Offsetting some of the iron ore miners' gains, Alumina (AWC, -5.1%) and South32 (S32, -2.2%) came off as Norsk Hydro and Brazilian prosecutors agreed to the steps by which the Alunorte aluminium refinery – the world's largest – could return to full production. Alunorte has been running at 50% production since breaching pollution regulations in early 2018, which has seen tighter aluminium markets. Signs of agreement in Brazil potentially signal the end of this sweet spot for the Australian-listed producers.

Elsewhere, Real Estate (+5.4%) managed to post the strongest sector return over the month amongst all. The housing REITs are showing some signs of life, as auction data has actually come in better than expected, even as listings remain depressed and new dwelling stats also continue to fall. The result is some nuance in the outlook for the housing-related stocks. A falling 10-year bond yield also contributed to the sector's solid performance: Australia's 10-year bond yield dropped to 1.77%, a level that was below the lows last seen in mid-2016.

Outside Real Estate, some key retail stocks also performed well. These include electronics retailer JB Hi-Fi (JBH), which was up by +15.0% and Harvey Norman (HVN) that added 11.7%. It was largely attributable to the expectation of a generous Federal budget early in April.

On the other end of the spectrum, Energy (-4.1%) finished the month in the red as the oil and gas stocks were among the period's worst performers. LNG is typically priced off oil, however there has been a short-term divergence between the two benchmarks, with LNG weakening as oil remains steady. There are a couple of factors at play here, including reports of LNG inventory overbuild during the northern hemisphere winter, alongside the recent addition of volumes from the Ichthys and Prelude projects in WA's Browse Basin. As such, some investors are tempering their expectations for the contracted rates for delivery of Australia gas to Asia. Woodside Petroleum (WPL, -4.5%), Oil Search (OSH, -4.8%) and Santos (STO, -1.3%) all weakened in response.

Fund performance

The Fund's return was largely in line with the benchmark index in March as the market edged higher. There was a positive contribution from several of the Fund's more non-consensus positions, such as JB Hi-Fi (JBH, +15.0%), Nine Entertainment (NEC, +3.2%) and Metcash (MTS, +1.5%). This offset the drag from the underweight in Woolworths (WOW, +6.0%).

Contributors

Overweight JB Hi-Fi

Electronic retailer JB Hi-Fi (+15.0%) outperformed the market by a double-digit return in March, despite the lack of new company specific news. With the Federal government lined up to deliver the latest round of Budget in early April, market is expecting some generous spending plan that will help stimulate the domestic retail market.

Overweight Transurban

Traditional defensive bond-sensitives outperformed over March as a result of the decline in long-term bond yields – the Australia 10-Year bond ended the month at 1.77%, a level that was last seen in mid 2016. TCL remains our preferred infrastructure name, given its high quality infrastructure assets as well as better valuation support and fewer near-term headwinds.

Detractors

Overweight Whitehaven Coal

Whitehaven Coal (WHC) was down -8.0% on concerns over the embargo on Australian thermal coal at Dalian port in China's north. Although the unofficial ban does not directly affect WHC – which ships primarily to India, Korea, Japan and Taiwan – there are concerns that it might put extended pressure on the price of Newcastle coal. At this point we remain reasonably sanguine about the medium term outlook for coal, while mindful that this issue could continue to drag in the short term. Ultimately, we believe the Chinese authorities will be reluctant to pursue a policy which drives the price of its domestically-produced coal up too far, given the knock-on effects for power generation and pricing.

Overweight Seven Group

SVW consolidated in March, giving back some of its recent strong gains but remaining a material outperformer over the year to date. We continue to see SVW's underpinned on a multi-year basis by the pipeline of transport infrastructure projects on the east coast. At the same time, mining services is showing signs of life as companies begin to commission new mines – and embark on fleet maintenance – following several years of tight purse strings.

Strategy and outlook

There was a divergence in the resource sector in March on concerns over the embargo on Australian thermal coal at Dalian port in China's north. At this point we remain reasonably sanguine about the medium term outlook for coal, while mindful that this issue could continue to drag in the short term. Ultimately, we believe the Chinese authorities will be reluctant to pursue a policy which drives the price of its domestically-produced coal up too far, given the knock-on effects for power generation and pricing.

While the coal price wallowed, iron ore continued to forge ahead alongside the consensus earnings expectations of its miners. Resilient expectations of Chinese demand, coupled with a likely shortage of supply as Brazilian production is disrupted following another tragic tailings dam collapse, is seeing a surge in the expected iron ore price for FY19. This saw the portfolio's holdings in both BHP Billiton (BHP, +5.5%) and Rio Tinto (RIO, +8.4%) outperform in March.

March capped a remarkable quarter in which the market rebounded from its slump in Q4 2018. February's reporting season confirmed that large parts of the Australian market face the twin challenges of low revenue growth and higher cost pressures. However the earnings results and outlooks were really no worse than the market expected – and in some cases weren't as bad as some feared. As a result it presented no impediment to the improvement in sentiment on several key macro issues, including the pace of Fed tightening and outlook for Chinese growth.

Looking forward, we would not be surprised to see the market consolidate for a period given its strong run. Valuations remain at a reasonable level given prevailing interest rates, although the market's P/E rating may come under pressure if we start to see a material deterioration in the outlook for earnings growth. The consensus outlook for ASX200 earnings remained broadly unchanged across reporting season and stands at about 5% for FY19. That said, there has been a material change in the underlying drivers, as resource stocks continue to see significant upgrades, while the remainder of the market continues to see lower earnings expectations.

We continue to see attractive opportunities in the market. In particular, we like mining and infrastructure services, which are enjoying the cyclical tailwinds of increased capex spending and transport infrastructure investment. We are also positive on the near term outlook for iron miners as supply disruption supports a higher price. Several of our highest conviction stocks are among the more cyclical parts of the economy, including Qantas and Nine Entertainment, where we see compelling valuation coupled with company-specific opportunities to deliver attractive shareholder return.

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

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