PENDAL

Factsheet

Equity Strategies

March 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 (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	1.54	1.61	0.73
3 months	11.38	11.61	10.89
6 months	0.50	0.93	1.75
1 year (pa)	9.13	10.07	12.06
2 years (pa)	5.12	6.02	7.20
3 years (pa)	9.78	10.72	11.46
5 years (pa)	6.49	7.41	7.40

Sector Allocation (as at 31 March 2019)

Energy	5.4%
Materials	21.6%
Industrials	10.5%
Consumer Discretionary	4.6%
Consumer Staples	0.9%
Health Care	11.2%
Information Technology	1.7%
Telecommunication Services	5.7%
Financials ex Property Trusts	28.8%
Property Trusts	5.5%
Cash & other	4.1%

Top 10 Holdings (as at 31 March 2019)

BHP Billiton Limited	8.6%
CSL Limited	8.4%
ANZ Banking Group Limited	7.8%
Westpac Banking Corporation	7.4%
Telstra Corporation Limited	4.5%
Qantas Airways Limited	3.9%
Amcor Limited	3.6%
Rio Tinto Limited	3.5%
National Australia Bank Limited	3.4%
Transurban Group	3.4%

Other Information

Fund size (as at 31 Mar 2019)	$346 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.

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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

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 outperformed the benchmark over the month of March. Key contributors we overweight positions in JB Hi-Fi, Charter Hall Group AE, Telstra Corporation and Rio Tinto. Key detractors were overweight positions in ANZ Banking Group, Caltex Australia and Oil Search.

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 Telstra

Whilst there was no new company specific news for the national carrier, the share price of TLS advanced in March. As peers Vodafone and TPG reported, the compiled industry data showed that Telstra gained market share in both Broadband and postpaid mobile. The potential merger of TPG and Vodafone remains to be seen at this stage - the ACCC has just recommended the timeline over the month, with the new announcement date now being set for 9th May.

Detractors

Overweight ANZ

The 'Big Four' banks underperformed in March as investors refocused on the regulatory capital requirement that the Reserve Bank of New Zealand is proposing to impose on the major banks' Kiwi subsidiaries. This hurt our positions in ANZ (-7.0%). To recap, the RBNZ has been contemplating raising the minimum core tier one capital requirement from 8.5% to 16% - versus 10.5% in Australia. A worst-case scenario would hit National Australia Bank hardest; while only 16% of its NPAT is NZ-sourced – versus 30% for ANZ – NAB has the lowest existing capital position and would have to raise additional capital, also placing further pressure on its payout ratio. ANZ is best placed in terms of capital, however the higher allocation of capital against its NZ business could see it breach APRA's limits on offshore capital, perhaps forcing it to partially float its NZ subsidiary if the limit does not get relaxed by APRA.

Overweight Caltex

Caltex Australia (CTX, -6.3%) pulled back in March. The company delivered an update ahead of the buy-back; with management flagging disappointing trends in their retail petrol business. This was ascribed to the lag in higher oil prices flowing through to the pump and there is good chance that they will get at least some of this back. Nevertheless, the revelation of a hole in earnings only three weeks after their half-yearly report was not well received. CTX is buying back $260m of its $6.9bn market cap.

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 where we see compelling valuation coupled with company-specific opportunities to deliver attractive shareholder return.

Regnan Sustainability Snapshots#

Ramsay Health Care Limited (RHC)

Ramsay Healthcare is a global operator of hospitals and medical facilities which cater for a broad range of health care needs from primary care to highly complex surgery, as well as mental health care and rehabilitation. The company maintains operations in Australia, the UK, France, Indonesia, Malaysia, Italy, Germany, Sweden, Norway, Denmark and Hong Kong.

The company faces challenges due to reduced consumer demand for private healthcare, government funding headwinds in various jurisdictions and longer term shortages of nurses and health professionals. In light of these challenges, the company continues to see value in cultivating its 'Ramsay Way' culture on a global level, an initiative which partially works to attract and retain key talent. Work practices continue to improve and include flexible work practices, focus on worker health and wellbeing, remuneration and reward practices and upskilling/training staff.

The company targets health care students and graduates in its recruitment initiatives and also offers programs to attract overseas workers. These initiatives simultaneously mitigate longer term risks of labour supply issues resulting from an ageing workforce. Oversight of people and culture improved in 2017 after the appointment of a global head of human resources.

Safety management practices are in place which additionally contributes to employee engagement and morale. Likewise, the company's focus on patient safety and clinical risk management is key to business success and an ongoing source of reputational value.

The company faces increased exposure to margin pressures through the potential for electricity price hikes, given hospitals are high energy consumers with little room to limit energy use. Ramsay adequately recognises price volatility and maintains an Energy Efficiency Initiatives program which seeks to replace equipment with more efficient types, including lighting and cooling plants.

Westpac Banking Corporation Ltd (WBC)

Westpac provides a range of banking financial services, primarily in Australia and the Asia-Pacific.

Long recognized for its leading position on sustainability, it was the first Australian bank to undertake climate change scenario analysis and publicly acknowledge the need to limit global warming to two degrees. This is reinforced by clear positions with respect to limiting credit to coal mining and coal-fired power generators that have contributed to portfolio decarbonisation as well as targets in support of expanding lending to clean technologies including renewable energy, water technologies and green buildings. Its approach is supported by overarching ESG frameworks for lending and investment, although scope remains to extend its more detailed positions into other sectors with heightened climate-related risks.

Westpac has generally escaped controversies during the post-GFC period relative to peers and the sale of its advisor business sees its overall business model de-risked relative to peers. Human capital performance is generally strong and aligned with its strategic focus on service leadership and enhanced digital offerings, supporting continued progress on customer service objectives. There is also evidence that its broader diversity insights are beginning to inform customer innovation.

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

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