Pendal Enhanced Cash Fund

ARSN: 088 863 469

Factsheet

Bond, Income & Defensive Strategies

April 2019

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	0.24	0.26	0.16
3 months	0.77	0.83	0.50
FYTD	2.04	2.25	1.69
6 months	1.24	1.37	0.99
1 year (pa)	2.39	2.65	2.02
2 years (pa)	2.65	2.90	1.88
3 years (pa)	2.76	3.01	1.88
5 years (pa)	2.71	2.97	2.12

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

Sector Allocation (as at 30 April 2019)

Money market	63.5%
Corporate	33.1%
Residential mortgage backed	3.4%
Government bond	0.0%
Other asset backed securities	0.0%

Security Credit Ratings (as at 30 April 2019)

AAA	3.3%
AA	21.1%
A	7.4%
BBB	4.7%
Money market	63.5%

Statistics (as at 30 April 2019)

Modified duration	0.11 years

Other Information

Fund size (as at 30 Apr 2019)	$685 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 fell at the front-end leading the curve to steepen during April. This was driven largely by growing expectations of a rate cut from the RBA. The Board's communication during the month was perceived as relatively dovish, including the discussion of a low-inflation and higher unemployment scenario that would require lower rates. Later in the period, a weaker-than-expected first quarter CPI print fanned expectations further and by month-end the market was pricing a roughly 50% chance of such a move.

The first quarter inflation data revealed headline CPI was flat at 0.0%, while the RBA's preferred gauge (the trimmed mean) rose a sluggish 0.3% over the same period. Meanwhile, labour market data was mixed. While the unemployment rate ticked higher by 0.1% to 5.0%, it was driven by an increase in the participation rate as jobs growth was relatively strong at 26K. Similarly there were varied signals from leading indicators. Retail sales was strong at 0.8% month-on-month, however business confidence fell to 0 – a multi-year low.

Looking abroad, risk sentiment remained supported by the Fed's recent "pivot" to a more dovish stance. Similarly, traders viewed trade war developments with more optimism than pessimism and quickly looked past negative newsflow. This included Trump's threats of new tariffs on EU imports, which arose after the WTO suggested European subsidies may have put American aircraft producers at a disadvantage. Data-wise, US first quarter GDP beat expectations with a healthy 3.2% annualised increase. Jobs data also exceeded forecasts as did first quarter corporate earnings results.

In Europe, the ECB offered no changes to their forward guidance at their April monetary policy meeting. President Draghi reaffirmed that rates will stay at current levels at least until the end of the year. Meanwhile, core inflation for the region grew at a soft 0.8% year-on-year and regional governments including Italy and Germany downgraded their economic growth forecasts.

In Asia, Chinese credit data revealed a lift over the month and boosted investor sentiment towards the region. First quarter GDP growth also surprised to the upside at 6.4% year-on-year. Leading indicators also beat expectations including industrial production and retail sales.

Finally on market movements, the Australian 3 year yield fell by 12bps while the 10 year rose 3bps to 1.28% and 1.80% respectively. At the very front-end, 3 month BBSW dropped a more substantial 21bps to 1.56%. The BBSW-OIS spread also narrowed further and funding pressures eased with the continued decline in repo rates. The US curve also steepened over the month with the 2 year flat at 2.27% while the 10 year added 10bps to 2.50%. This caused the AU-US yield differential to fall by 7bps deeper into negative territory. In turn, the AUD faced further pressure and fell by 0.68% against its US counterpart.

Turning to credit markets, spreads continued to tighten amid a supportive environment for global risk appetite. This follows in the wake of the Fed's "dovish pivot" earlier in the year and a positive perspective on global trade wars. These global developments have offered the greatest guidance to local spreads and overshadowed a weaker domestic backdrop.

The Australian iTraxx index (Series 31 contract) traded in a 10bp range finishing the month 9.5bps tighter to +66bps. Physical credit spreads narrowed 2bps over the month, with the best performing sectors being utilities and domestic banks tightening 7 and 5bps respectively. The worst performing sectors were supranationals and offshore banks that were unchanged and 2bps narrower respectively. Semi-government bonds were basically unchanged to government bonds.

Fund performance and activity

The Fund outperformed the benchmark by 10 basis points (pre-fee) in April. Positive performance came primarily from financials and industrials sectors.

Activity included issuer switches in the industrial sector, whilst also reducing financials exposure ahead of expected new issuance supply post bank reporting.

As at the end of the month, the portfolio had a credit spread of 55bps over bank bills, interest rate duration of 0.11 years and credit spread duration of 0.95 years.

Outlook

In its April statement that accompanied the Reserve Bank's monetary policy decision they stated they will 'continue to monitor developments and set monetary policy to support sustainable growth in the economy and achieve the inflation target over time'. Whilst there was no explicit easing bias in their April statement the weaker first quarter inflation data is likely to see them either ease monetary policy at their May meeting or move to an easing bias which sets up a likely rate cut shortly thereafter. Whilst inflation has been below target for an extended period now the first quarter inflation data cannot be ignored: it was weak and trending the wrong way. Their forecasts in the Statement on Monetary Policy released on 10th May will reflect an even more benign inflationary environment against a backdrop of slowing economic growth – if the Reserve Bank does not ease policy in that environment then questions will be asked over how bad things really need to get before they act. Household consumption weakened noticeably in the latter half of 2018, weighed down by low income growth and high household debt levels. The hurdle for further easing was high given the cash rate is at 1.50% but that point has been reached.

The Reserve Bank has been upbeat on the outlook for the labour market with increasing tightness feeding into wage inflation and in turn generating higher underlying inflation. An unemployment rate of 5% does not suggest a surge in wage inflation is likely to occur anytime soon however. Forward indicators are providing mixed signals with job vacancies data indicating ongoing strength and the ANZ job ads series reflecting slowing labour demand. Inflation from a tightening labour market will not occur quickly enough to see the Reserve Bank on hold for an extended period.

We expect the Reserve Bank to ease monetary policy twice before the end of 2019.

With a more dovish stance from the Federal Reserve and fading fears over trade wars the global macro backdrop for credit has improved and as such we have a more positive view towards the asset class than late last year. 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 with Q1 earnings surprising to the upside and demand for credit overall has been robust.

The local market has benefited from the positive global tailwinds as well as the weight of the Royal Commission being lifted from its shoulders in recent months. Relatively light issuance year-to-date has also been supportive from a supply and demand standpoint. That said, we are wary that after a recent hiatus the major banks are likely to tap the market for fresh debt capital over the coming month and that the increased supply could cause spreads to widen.

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. Moreover, May is a seasonally weak month for risk assets. As such we have reduced some of the fund’s exposure and prefer tactical positioning in order to remain nimble.

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

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