PENDAL

Factsheet

Pendal Focus Australian Share Fund

ARSN: 113 232 812

Equity Strategies

April 2019

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 30 Apr 2019)	$601 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	2.25	2.31	2.46
3 months	10.23	10.43	9.41
FYTD	2.83	3.48	5.66
6 months	9.18	9.59	10.92
1 year (pa)	5.60	6.03	10.32
2 years (pa)	9.41	10.74	7.99
3 years (pa)	12.64	13.87	11.07
5 years (pa)	9.31	10.42	7.55

Sector Allocation (as at 30 April 2019)

Energy	11.6%
Materials	19.9%
Industrials	16.9%
Consumer Discretionary	5.0%
Consumer Staples	2.8%
Health Care	10.4%
Information Technology	2.9%
Telecommunication Services	8.0%
Financials ex Property Trusts	19.1%
Cash & other	3.4%

Top 10 Holdings (as at 30 April 2019)

BHP Billiton Limited	8.6%
CSL Limited	8.4%
Commonwealth Bank of Australia Limited	7.6%
Transurban Group	5.9%
Santos Limited	5.7%
Qantas Airways Limited	5.6%
ANZ Banking Group Limited	5.4%
Telstra Corporation Limited	4.3%
Nine Entertainment Co Ltd	3.7%
Rio Tinto Limited	3.5%

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 performance of the Australian market extended in April, with the S&P/ASX 300 Accumulation Index advancing by 2.5% over the month. We saw a general rotation between Materials (-2.1%) and Financials (+4.4%), particularly from miners (-3.9%) to the banks (+4.4%). As a result, Industrials (+3.8%) outperformed, whereas Resources (-2.5%) were the laggard.

In addition to the news that Brazil's major diversified miner, Vale, would restart production, Chinese officials issued some cautionary signals on stimulus, perhaps in response to a surging domestic equity market. This in turn caused the iron ore price to fall below its recent highs. This weighed on mining stocks in the second half of the month, although the iron ore price was still up by 9% over the month. Both BHP (-2.8%) and Rio Tinto (RIO, -2.6%) retraced in that regard; whereas the pull back by base metals, led by Aluminium (-6.7%) weighed on the likes of South32 (S32, -10.5%) and Alumina (AC, -7.4%). Gold miners, such as Newcrest Mining (NCM, -2.0%), Evolution Mining (EVN, -12.8%) and Northern Star Resources (NST, -8.5%) also finished the month lower.

The reasonably large reaction from the miners could be driven by a desire among some investors to bank some profits from the miners and reduce shorts and underweights in the banks. The market has been heavily underweight the banks. However, the prospect of rate cuts has strengthened based on consensus expectations which have firmed following the latest weak print of Australia's inflation data, which could ease funding pressures and bring some margin relief for the banks, depending on the proportion of any official cuts they pass through to borrowers. This may have prompted some investors to reduce their negative stance towards banks. The big four finished the month with gains in the range of +0.3% (NAB) to +6.1% (WBC). Macquarie Group (MQG, +4.1%) also outperformed.

Elsewhere, Consumer Staples (+7.3%) was one of the best-performing sectors over the month. It was led by a rebound of the supermarkets — both Woolworths (WOW, +4.8%) and Coles (COL, +6.4%) registered gains. Coles provided its latest trading updates at month end. Key highlights include a 2.2% rise in third-quarter supermarket like-for-like sales, compared with 1.5% for the previous quarter. The rise was mainly driven by higher fresh food inflation and bigger basket sizes due to the Stikeez collectable. Deflation for packaged grocery remained stable at -1%. A surge in some of the growth market darlings, such as A2 Milk (A2M, +17.2%) and Treasury Wine (TWE, +15.2%) also supported the sector. These names were propelled higher through a broad sense that the 'liquidity tap' has been opened a half-twist, considering subdued inflation in the US and Australia is driving expected interest rates lower.

Information Technology (+7.4%) also recorded a strong month in April, with Afterpay Touch (APT, +22.1%), Xero (XRO, +11.9%) and Computershare (CPU, +4.4%) being the largest contributors. The buy-now-pay-later service provider continues to experience solid growth in transaction volumes as more retailers adopt its system. The market is giving Management a benefit of the doubt that they will retain a sustainable margin, despite the likelihood of increased competition. Meanwhile, Wisetech (WTC, -3.2%) gave back some of its March gains and was the largest detractor for the sector.

Fund performance

The Fund underperformed its benchmark over the month of April.

Contributors

Overweight Xero (XRO) (+11.9%)

Growth stocks, such as Xero, took a leg higher in April as sentiment shifted towards an expectation of lower interest rates. We struggle to justify the valuations paid for many of these stocks, however we have conviction in Xero's ability to establish market share in overseas markets such as the UK, which can underpin its valuation multiple.

Overweight Metcash

Metcash (MTS, +8.3%) is a wholesale distribution and marketing company that specialises in grocery, fresh produce, liquor, and hardware. Its stable of brands includes IGA in supermarkets, Cellarbrations and ALM in liquor, and Mitre 10 and Home Timber & Hardware in hardware. The stock advanced amongst its supermarket peers, Coles (COL, +6.4%) and Woolworths (WOW, +4.8%), despite the lack of new company specific news. COL released its 3Q19 sales at month end, whereas WOW is also scheduled to report in early May. There were signs of improvements in Food inflation from COL's results, and packaged grocery deflation remained stable at -1%. MTS remains our preferred exposure to the sector: it is most leveraged to any improvement in price deflation, and at the same is not under the same pressure from renegotiated new employee benefit agreements that are likely to cripple WOW/COL's short-term earnings.

Detractors

Overweight Viva Energy

Viva Energy (VEA, -9.8%) released its March Geelong Refining Margin (GRM), which improved from January (US$3.9/bbl) and February (US$4.0/bbl) to US$6.5/bbl. Whilst this is somewhat pleasing, what caught the market off guard was VEA's Retail business update. For the four months of 2019, Management now expects a A$30-35m hit to the division's pre-tax earnings, due to lower retail fuel margins on the back of the rising oil prices, and the lag in passing them on to the end pump. Whilst the update was disappointing, it was in line with the recent update from Caltex (CTX, +3.8%) at March end.

Overweight Qantas

It was another month where the share price of Qantas (QAN, -0.9%) was dragged down by higher global oil prices, in the absence of any new company-specific news. Global oil prices edged higher in April, with global Brent finishing the month 6.4% higher at US$72.90/bbt, and WTI trading at US$63.84/bbt: the US government announced that they are ending waivers on their Iranian oil export sanctions, which previously allowed some countries to continue importing crude oil from Iran. Some investors remain sceptical at this stage on whether QAN will be able to cope with the additional fuel costs. The company is scheduled to provide its 3Q19 trading update in early May.

Strategy and outlook

The portfolio made decent gains in April but finished behind the index.

A stronger oil price weighed on Qantas (QAN), although this effect was offset to an extent by gains from Santos (STO). Growth stocks also continued their recent surge and the underweight in stocks such as A2 Milk (A2M) and Afterpay Touch (APT) hurt relative returns. Again, some of this effect was offset by the portfolio's positions in its preferred growth stocks such as Xero (XRO).

A key feature of the market has been the snap back in performance of the banks versus the resource companies over the last month. The positions in miners such as BHP Billiton (BHP) dragged on returns, as did our underweight in the banks.

This highlights the degree of reversion in market leadership, considering the stark difference in fortunes over the past year. Banks are still largely under water on a 12-month view as the Royal Commission dragged out bundles of dirty laundry at the same time that credit growth has begun to slow. Meanwhile, the mining majors have made high teen returns, while Fortescue Metals has risen by over 50% as the iron ore price has held up far better than the market anticipated.

In this vein, there is a sense that perhaps the market has reached an extreme in terms of negative sentiment and short positions on the banks, suggesting perhaps that some investors are reducing underweights and covering shorts.

However, we think it is still hard to build a case to rotate the portfolio from resources into banks. The most recent updates from ANZ and National Australia Bank confirmed revenue trends remain weak in their core lending businesses. Cost pressures continue to mount, not least from increased compliance and remediation, with only ANZ taking action to try and attack costs in an absolute sense. On capital, the potential for equity raisings at some of the banks has returned, with proposals that additional capital will need to be held against the system's New Zealand subsidiaries.

All in all it is not an attractive picture – and one that paints the possibility of earnings going backwards in the next few halves. Given this, we do not see any compelling valuation argument for being overweight the banks.

Conversely, we believe the resource sector still offers opportunity. The iron ore price remains above US$90 a tonne, while consensus expectations continue to imply an US$80 level. As a result, the sector is one of the few in the Australian market which are likely to see earnings upgrades. Management remain relatively disciplined and a material portion of cash flow is finding its way back to shareholders via dividends and buybacks.

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

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