PENDAL

Factsheet

Bond, Income & Defensive Strategies

May 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	0.20	0.22	0.15
3 months	0.71	0.78	0.48
FYTD	2.24	2.48	1.84
6 months	1.33	1.45	0.99
1 year (pa)	2.42	2.68	1.99
2 years (pa)	2.62	2.88	1.88
3 years (pa)	2.74	3.00	1.87
5 years (pa)	2.69	2.95	2.10

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

Sector Allocation (as at 31 May 2019)

Money market	57.7%
Corporate	39.0%
Residential mortgage backed	3.3%
Government bond	0.0%
Other asset backed securities	0.0%

Security Credit Ratings (as at 31 May 2019)

AAA	3.3%
AA	26.7%
A	7.5%
BBB	4.8%
Money market	57.7%

Statistics (as at 31 May 2019)

Modified duration	0.13 years

Other Information

Fund size (as at 31 May 2019)	$684 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 substantially during May with larger declines at the long-end leading to a further flattening of the curve. The slide was driven by growing expectations of a rate cut from the RBA, as well as offshore movements led by the US. By month-end the market was pricing over a 90% probability of a rate reduction by the Reserve Bank in June. This followed an address by Governor Lowe in which he signalled an intention to act in the wake of a weaker employment picture and ongoing subdued inflation. At the time of writing, expectations had become reality with a 25bp cut delivered on June 4th.

Domestic data through the month supported such a decision. The unemployment rate unexpectedly rose to 5.2% in spite of a larger number of job additions than anticipated. First quarter wage numbers missed expectations with 0.5% growth over the period, which kept the year-on-year rate at a sluggish 2.3%. Leading indicators also softened including the NAB Business Survey; conditions fell from +7 to +3 and the employment subcomponent dropped from +6.2 to -1.2. Housing credit growth also slowed further from 4.2% year-on-year to 4.0% and retail sales grew by only 0.3% versus 0.8% in the prior month. There was likely a negative impact on some data points, particularly confidence data, due to uncertainty around the pending Federal Election.

Meanwhile offshore, attention was firmly centred on the latest bout in the ongoing trade war as a further escalation damaged investor sentiment. Concerns were renewed when President Trump raised tariffs from 10% to 25% on US$200bn of Chinese imports after claiming the Chinese broke a proposed deal. Policymakers in Beijing responded in kind with tariffs on US$60bn of imports from the US. Towards month-end tensions increased after Chinese telecom provider, Huawei, was blacklisted by US authorities. Separately, the Trump administration threatened tariffs on Mexico if illegal immigration from its southern neighbour was not curtailed.

Beyond trade developments, US data weakened over the period. In combination with the trade war concerns this fanned expectations that the Federal Reserve would be required to cut rates over the next twelve months. Leading indicators such as the ISM manufacturing gauge for April fell to 52.8, the lowest since October 2016. Durable goods orders for the same period fell -2.1%, advanced retail sales slipped -0.2% and industrial production contracted by -0.5%. Lagging indicators reflected a more constructive picture; payrolls grew at a stronger-than-expected 263k, which caused the unemployment rate to fall to a new 49 year low of 3.6%. Revised first quarter GDP also surprised to the upside with a healthy 3.1% annualised rate.

Elsewhere, the ECB did not meet during the month and Eurozone data showed signs of stabilising. The preliminary Eurozone composite PMI ticked 0.1 of a point higher to 51.6 and retail sales data was flat versus expectations of a contraction. Data in China was less encouraging with falls in both the official and Caixin measures of manufacturing PMI. Total social financing was also weaker-than-expected and fixed asset investment slowed to 6.1% year-on-year.

Turning to market movements, the Australian 3 and 10 year yields fell by a sizeable 19bps and 33bps to 1.10% and 1.47% respectively. 90 day BBSW also experienced a large fall of 15bps to 1.42% alongside a lower repo rate, partly reflecting firmer expectations of a June RBA cut. US yields witnessed even greater declines with the 2 year and 10 year lower by 34bps and 38bps to 1.92% and 2.13% respectively. Despite a narrower AU-US yield differential, the Australian Dollar ended lower against its US counterpart on a combination of weaker domestic data, the outlook for a lower cash rate and the broader risk-off environment.

Turning to credit markets, synthetic credit spreads widened as the supportive backdrop for risk appetite deteriorated throughout the month. This was tied predominantly to renewed fears and uncertainty over the negative impact of the trade war escalation. This overshadowed the more dovish policy stance from the Fed that had been offered earlier in the year. That said, the domestic physical credit market outperformed its offshore counterparts with support likely stemming from a positive reaction to the Coalition's victory in the Federal Election.

The Australian iTraxx index (Series 31 contract) traded in a 12.5bp range finishing the month 12bps wider to +78bps. Physical credit spreads on the other hand narrowed 1bp over the month, with the best performing sectors being utilities and real estate tightening 4 and 2bps respectively. The worst performing sector was domestic banks which finished 1bp wider. Semi-government bonds were basically unchanged to government bonds.

Fund performance and activity

The portfolio outperformed the benchmark by 7 basis points (pre-fee) in May. Positive performance came primarily from financials and industrials sectors.

Activity during the month included investing in a primary market short dated major bank deal funded out of cash.

As at the end of the month, the portfolio had a credit spread of 61bps over bank bills, interest rate duration of 0.13 years and credit spread duration of 1.12 years.

Outlook

The Reserve Bank eased monetary policy at its meeting in early June. It is highly likely that further easing occurs in the coming months. There had been ample opportunity for the Reserve Bank to ease at the May meeting - inflation data disappointed in late April and economic growth weakened over the second half of 2018. Why didn't the Board cut? The labour data had shown strong employment growth over the past 12 months and was at odds with the weak household consumption in the national accounts. Business liaison also indicated some labour tightness emerging in some areas. However, the increase in the unemployment rate from 5% to 5.2% revealed a weaker picture and in turn was the last domino to fall. The Reserve Bank had been looking for increasing labour market tightness feeding into underlying inflation. The increase in the unemployment rate put that to bed - there is more than ample slack in the labour market that will not result in the wage inflation outcomes they are looking for. For their forecasts to be achieved further policy easing will be required and soon, the question is not whether they ease again but how many times it occurs. The labour data will again be key in determining when the next rate cut occurs.

The global macro environment continues to offer the greatest guidance to domestic credit and it has proven a relatively dynamic and fast-evolving backdrop. The two key elements of influence remain trade wars and expectations over Fed policy. Attitudes towards the former have shown a tendency to shift quickly and overshadow growing expectations for a more dovish Fed policy stance. As such our positioning remains tactical in nature and we prefer to maintain flexibility to adapt should the environment change.

We are wary that the underlying issues behind the trade war threaten to devolve into a more prolonged "cold war". Prior reports of progress have demonstrated a capacity to evaporate quickly along with the positive perspective from investors. It is also increasingly evident that US-China relations have not materially improved and are in fact deteriorating further, as evident by the blacklisting of Huawei and threats of similar action by policymakers in Beijing. 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.

On the Fed, the more dovish stance adopted in January represented a significant shift from last year and in turn is much more of a tailwind for credit than a headwind as in 2018. The Committee's recent messaging has suggested that rate hikes have effectively been paused and speculation of renewed easing continues to gain momentum. This brings into play the idea of the "Fed put" that would effectively limit the extent of a sell-off in risk assets. If policymakers continue to swing to the more dovish end of the spectrum, it may more than compensate for concerns over the trade war.

The local market has also been afforded some support from positive domestic developments that may contribute to an outperformance compared to offshore credit. This includes a more supportive policy environment in the wake of the Coalition's win in the Federal Election. The weight of the Royal Commission has also been lifted from the shoulders of the major banks.

Overall, the backdrop for risk assets continues to waver as investors balance the risks posed by trade wars against the outlook for more flexible central banks. We are wary that sentiment towards the trade war can shift with each individual battle and the underlying issues are yet to be resolved. As such maintain cautious stance and prefer tactical positioning in order to remain nimble.