PENDAL

Factsheet

Equity Strategies

July 2019

Pendal Australian Share Fund

ARSN: 089 935 964

About the Fund

The Pendal Australian Share Fund (**Fund**) is an actively managed portfolio of Australian shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 (TR) 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, diversification across a broad range of Australian companies and industries 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. Derivative can also be used to gain exposure to assets and markets.

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 28 years' industry experience. Crispin is also Head of Equity.

Investment Guidelines

Ex-ante (forward looking) tracking error	2.0% - 6.0%
Min/max stock position	+/-4%
Min/max sector position	+/-8%

Other Information

Fund size (as at 31 Jul 2019)	$1,002 million
Date of inception	September 1992
Minimum investment	$25,000
Buy-sell spread[1]	0.50% (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	RFA0818AU

[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]	0.79% 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.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	2.51	2.58	2.97
3 months	7.62	7.83	8.58
FYTD	2.51	2.58	2.97
6 months	17.64	18.12	18.81
1 year (pa)	8.66	9.54	13.25
2 years (pa)	12.36	13.27	13.97
3 years (pa)	11.87	12.77	11.61
5 years (pa)	8.50	9.36	8.57

Sector Allocation (as at 31 July 2019)

Energy	8.8%
Materials	20.3%
Industrials	11.4%
Consumer Discretionary	5.8%
Consumer Staples	2.5%
Health Care	11.9%
Information Technology	1.6%
Telecommunication Services	6.9%
Financials ex Property Trusts	24.9%
Property Trusts	2.6%
Cash & other	3.3%

Top 10 Holdings (as at 31 July 2019)

CSL Limited	8.7%
BHP Billiton Limited	7.7%
Commonwealth Bank of Australia Ltd	7.3%
ANZ Banking Group Limited	5.8%
Telstra Corporation Limited	5.0%
Qantas Airways Limited	4.2%
Westpac Banking Corporation	4.1%
Transurban Group	3.7%
Santos Limited	3.3%
Amcor Limited	2.6%

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.

Market review

Performance was strong for the Australian market in July, with the S&P/ASX 300 Accumulation index recording another 3%. While all sectors finished the month in the black, both index heavyweights Financials (-1.8%) and Materials (+1.2%) were laggards. The latter's muted performance was also in a stark contrast to the stronger iron ore price over the period (+10%).

Brazil's Vale has been successful in bringing around one-third of its shuttered production back on line, following the shut-downs that occurred after the tragic tailings dam disaster earlier in the year. It will take Vale's production between 60 and 90 days to find its way back into the market – and it is still a long way short of previous production. The iron ore price has subsided from its highs and an increase in trade friction may prompt further volatility. As such, the iron ore trio, BHP (-1.0%), Fortescue Metals (FMG, -7.6%) and Rio Tinto (RIO, -4.7%) all pulled back over the month.

Within Financials, bank performance remained muted: CBA (-0.6%) received several downgrades from brokers ahead of August reporting season, as it was trading at a valuation premium to its Big Four peers, which is getting harder to justify given the subdued operating environment domestically. CYB Group (CYB) also fell -9.4% for the month following its quarterly update, which disappointed on margins as competitive pressure remains strong. Management have pointed to the fact that front book pricing has started to improve (i.e. their most recent loans). That said, the back book remains a headwind for margins. NAB (+6.7%) was the standout from the cohort, as its appointment of the new CEO was well received by the market. Ross McEwan, who is currently the outgoing CEO of RBS in the UK and previously the head of CBA's Retail Banking Services division, has committed himself to protecting and accelerating NAB's transformation program. Outside the banks, AMP (AMP, -15.6%) came under pressure as management announced that the sale of its life insurance and mature business to Resolution Life is unlikely to proceed following intervention by the Reserve Bank of New Zealand (RBNZ). The RBNZ requires New Zealand-related assets to be ring-fenced, which would require a renegotiation of terms with Resolution Life. Management cancelled its interim dividend as a result.

Turning to the other side of the tally board, Consumer Staples (+9.6%) led the gainers, with Woolworths (WOW, +7.2%) being the largest contributor. The supermarket giant is combining its liquor business, Endeavour Drinks – the owner of Dan Murphy's and BWS – with its ALH Group, which is Australia's largest poker machine operator to create Endeavour Group. WOW is also planning to spin off this newly created entity in 2020, which will be a $7-8bn standalone business, with an implied EV/EBITDA multiple of 12x based on the market's current pricing. Also within the sector, China growth related market darlings, a2 Milk (A2M, +23.6%) and Treasury Wine (TWE, +18.6%) both rallied. The recent retail price increase for A2M's infant formula has given some investors more confidence that the company is likely to beat earnings expectation in August. TWE also rose in anticipation of a decent FY19 result, although there is a sense that they may be pulling forward some Chinese demand.

Lastly, CIMIC (CIM, -18.0%) saw a backlash to its quarterly update, with the market concerned over weaker cash flows. CIM has been under some pressure from an institutional short-seller, who noted the use of "reverse-factoring" arrangements as an accounting tool which can potentially help improve the optics on working capital. The practice, which involves using third-party institutions to honour accounts payable, then repaying the institution, may prove to be a niche issue in the upcoming reporting season if its use is wider spread.

Fund performance

The Fund underperformed its benchmark over the month of July.

Contributors

Overweight Viva Energy

Viva Energy (VEA, +13.7%) rebounded strongly over the month, recouping the losses incurred in June. Both VEA and its peer Caltex (CTX, +8.9%) have been put under pressure over the past 18 months due to lower refining margins and refinery outage. In addition, there have been signs of economic deceleration in recent months which, in combination with higher oil prices in A$, has put some pressure on retail fuel volumes. VEA has a balanced portfolio of products which provides broader exposure, meaning it is not reliant just on retail fuel. Interest rate and tax cuts and the potential for further broader fiscal measures also provide a measure of underlying support for consumer demand. We retain our conviction in the company.

Woodside Petroleum – no holding

Woodside Petroleum (WPL, -4.6%) delivered an underwhelming set of 2Q19 results in July. Production volume came in somewhat weak, as a maintenance led plant outage at Pluto caused lower volumes. In addition, realised prices over the quarter were also below that of 2Q18, resulting in a $165m hit to sales revenue over the quarter.

Overweight Metcash

Woolworth's proposed demerger of its hospitality group over the month provided a positive read-through for our preference in Metcash (MTS, +12.5%). Metcash runs three lines of businesses: Food, Liquor and Hardware and is currently trading at ~7x EV/EBITDA. While it is not a perfect like-for-like comparison, the implied multiple of Bunnings from Coles; and that of Endeavour Group from WOW help to provide some benchmark pricing for Metcash's Hardware and Liquor businesses. As such, it suggests that Metcash's Food business, which has been operating in a challenging environment is clearly undervalued at 5x EV/EBITDA. This helps to underpin our investment thesis in Metcash, and that any sight of sales growth improvement in the Food business, however slim, will likely see a re-rate for the company.

Detractors

Overweight Fortescue Metals

Fortescue Metals (FMG, -7.6%) pulled back in July alongside its iron ore miner peers. The company's most recent quarterly update was reasonably constructive. The discount for its lower-grade ore – which had blown out at points in the last couple of years – was slimmer than most had expected. The miners remain hugely cash generative and recent dividends and buybacks can be sustained in the near term. We have been reducing our overweight in iron ore in recent weeks, mainly via a reduction in Rio Tinto, but retain our exposure in FMG.

Overweight Amcor

Packaging company Amcor (AMC, -4.1%) sold off over July, despite the lack of any company specific news. Pepsi did report the 2Q19 results where its North America volume was down 2% over the reported periods. Some investors might take the weak trend as a negative read through for Amcor, as its North American rigid plastics accounts for ~20% of the company's revenues.

A2 Milk – no holding

It was a strong month for a2 Milk (A2M, +23.6%), and not owning it dragged on portfolio relative performance. The recent retail price increase for A2M's infant formula has given some investors more confidence that the company is likely to beat earnings expectation in August. The stock is currently trading on a FY1 P/E valuation of ~36x which we find hard to justify.

Strategy and outlook

The market is entering the FY19 reporting season at an interesting juncture, having enjoyed a very strong surge over the previous six months but with macro uncertainty (trade wars, Brexit) driving bouts of volatility. At the same time, there are clear signals that domestic demand has not recovered post-election.

We are taking a cautious approach to consumer cyclicals as a result - reducing those which have done well in recent months - or where we see risk of near term disappointment. We retain exposure, but only in those where we see an overly negative outlook already factored into valuations.

There are two broad views of the current environment. One states that data signals a continuing slowdown in the global economy, which will lead to recession. The other is that we are likely to see a policy response, which will help support both the economy and also the equity market. We subscribe to the latter.

Domestically we are seeing a version of this debate play out. The Coalition Federal government has set its stall out on maintaining a fiscal surplus - whereas arguably this is the one year where we need fiscal stimulus, given moribund growth and diminishing utility of monetary policy. The means are there, in the form of the windfall of iron ore royalties, as well as government borrowing costs at less than 1%. What's more, any more pressure on depositors – seeing term deposit rates likely going to 1.3% - is likely to prompt a political backlash. So the debate will be whether logic prevails over political heel-digging.

The outlook for the banking sector remains muted. Lower rates are good for sentiment and will help keep bad debts at low levels, but they will also ultimately crimp margins. Hedging programmes mean this effect will be delayed, but any further cuts are likely to mean further pressure on margins over the next three years. That said, dividends remain reasonable and supported for the time being - which should help support bank stocks in the current low yield environment.

The resource sector has seen a sudden drop in iron ore prices - although they remain above consensus expectations and the sector remains enormously cash generative. The iron ore miners have done well and we have been scaling back our position in recent months. Iron ore prices are retreating from their highs due to two reasons. First, Brazil's Vale is restarting some shuttered production. Second, there are increased concerns over global growth and Chinese demand. On the first issue, Vale has only managed to restart around one third of the production it took off line - and this will take between six and nine months to feed through to the system. On the second, we remain mindful that China can quickly pull the stimulus lever in response to subdued demand - as we saw in 2016. As a result, we do not believe it is time yet to go aggressively underweight the resource sector.

The overall market's valuation looks reasonable, at just under 16x next-12-month earnings, and should retain a degree of support from low yields in alternative asset classes.

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

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