PENDAL

Factsheet

Pendal Focus Australian Share Fund

ARSN: 113 232 812

Equity Strategies

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

Other Information

Fund size (as at 31 Aug 2019)	$649 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		Benchmark
	(post-fee)	(pre-fee)	Return
1 month	-2.25	-2.19	-2.27
3 months	3.06	3.26	4.30
FYTD	0.54	0.66	0.63
6 months	9.51	9.92	9.53
1 year (pa)	7.11	7.92	9.14
2 years (pa)	11.72	12.70	12.25
3 years (pa)	12.91	14.14	11.34
5 years (pa)	9.56	10.67	7.94

Sector Allocation (as at 31 August 2019)

Energy	7.1%
Materials	17.1%
Industrials	18.0%
Consumer Discretionary	3.6%
Consumer Staples	3.0%
Health Care	11.1%
Information Technology	3.0%
Telecommunication Services	9.0%
Financials ex Property Trusts	18.5%
Property Trusts	1.4%
Cash & other	8.2%

Top 10 Holdings (as at 31 August 2019)

CSL Limited	9.5%
Commonwealth Bank of Australia Ltd	6.7%
Qantas Airways Limited	6.1%
BHP Billiton Limited	6.0%
Transurban Group	5.8%
ANZ Banking Group Limited	5.7%
Telstra Corporation Limited	5.4%
Santos Limited	4.2%
Nine Entertainment Co Ltd	3.6%
Westpac Banking Corporation	3.4%

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 (TR) 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

Australian stocks (S&P/ASX 300 Accumulation Index) fell 2.3% in August. With the sudden escalation in the Sino-US trade dispute, and a mixed reporting season, six out of the eleven GICS sector ended in the red. Defensive sectors, Healthcare (+3.4%) and Real Estate (+2.4%) were the best performers in August. Real Estate was aided by some housing recovery as the RBA cut the cash rate to 1%; whilst the respective 52/30 bps decline in the US/AU 10-year bond yield also helped the bond sensitives in general. Amongst all, Lend Lease (LLC, +19.4%) led the sector as Sydney and Melbourne property markets are starting to rebound. The company managed to close a large number of their apartment sales around Australia, and particularly in Barangaroo Sydney, which investors had been worried about. Management also made comments around the bottoming out of the Australian residential market, which coincided with similar comments from other companies that the property market is seeing some early signs of stabilisation. In addition, the absence of any new news from LLC's engineering business, which had a catastrophic outcome last year helped investor sentiment in general.

Within Healthcare, CSL Limited (CSL, +4.9%) experienced strong growth in FY19 - driven by high product volume. Despite some initial approval issues in China, CSL managed to substantially improve the country's albumin sales in the second half of FY19. On the flipside, Ramsay Health Care disappointed markets (RHC, -9.8%) when its EPS growth fell short of market expectations.

Elsewhere, Consumer Staples (+0.1%) made reasonable gains. Within the sector, Treasury Wine Estates (TWE, +5.9%) reported strong organic sales growth and an earnings to cash conversion rate that were in line with market expectations. These helped to reverse some prior doubtful sentiments. Other stocks, such as A2 Milk's (A2M, -20.8%), disappointed. A2 Milk revealed a set of underwhelming results, with management reporting an FY19 EBITDA margin of 28.2%, which was 12% below market consensus.

Lastly, some growth stocks performed well during the month. Market favourite, Afterpay (APT, +15.9%) reached a record high in August after publishing encouraging company news. With a strong growth in sales metrics, a solid US network and a positive UK market entry, Afterpay continued to impress the market with its rapid expansion. Domino's Pizza (DMP, +12.3%) has also recouped some losses since reaching a two-year's low. Whilst we did see a decrease in EBIT (as compared to last year's figure) for the ANZ and Europe regions, the market was already aware of the sluggish sales growth and stores rollouts.

On the other side of the tally board, Energy (-5.6%) and Materials (-7.3%) were the sector laggards. Metals & Mining (-8.0%) fell on the back of the pull back in commodity prices, including copper and iron ore. The notable drop in iron ore price (-28.3%) was largely attributed to the sudden escalation in the Sino-American trade dispute, as well as the restart of Brazil Vale's production. As a result, despite of reporting some strong results in the first half of FY19, with a 24% revenue growth and a higher than expected dividend growth, the share price of Rio Tinto (RIO, -8.4%) still dropped over the month. A large boost to RIO's earnings was due to the high commodity prices, and with the recent price decreases the main concern is whether the miner can sustain its growth. Similarly, BHP (-11,0%) and Fortescue Metals Group (FMG, -4.0%%) both retreated. Offsetting some of these losses, gold miners, such as Newcrest (NCM, +4.6%) and Evolution Mining (EVN, +4.4%) fared better in August. The rising gold price on the back of heightened geopolitical uncertainties and a low-interest-rate environment remains supportive to the cohort.

The Financials sector (-2.6%) also underperformed marginally over the month, as the share price of all Big Four banks fell in the range of -1.1% (CBA) to -4.2% (ANZ). CBA experienced softer earnings and overall profits, with a 12% decrease in retail banking profitability – when compared to last year. Management has stated that the rate cuts have put pressure on their profit margins, as they cannot pass on the decrease in rates onto their deposit accounts (worth $160 billion). For Diversified Financials, both Magellan (MFG, -16.2%) and AMP (-5.3%) decreased in share price amidst capital raising plans. The former raised $275 million to primarily fund their new High Conviction Trust IPO; whereas the latter issued a heavily discounted capital raising of $650 million to help fund the restructuring of their wealth management arm..

Fund performance

The Fund performed broadly in line with its benchmark over the month of August.

Contributors

Overweight Qantas

Qantas (QAN, +7.0%) delivered a decent result despite the headwind of higher fuel costs and softer demand in the domestic market. It also dialed up their capital return by $100m to $600m a half year, which was well received. There was also a positive read through from Virgin Australia's (VAH) result. VAH's announcement that it is looking to cut unprofitable routes – plus the increased gearing that comes with its USD denominated debt – had some questioning its ability to survive. We believe that it does, however it is in no position to start aggressively discounting fares, while fewer routes means less capacity in the domestic Australian market. Both are good for QAN.

Overweight James Hardie

James Hardie (JHX, +13.4%) posted a double-digit gain in August, on the back of a surprisingly good result. While US housing remains soft, JHX's share of fibre cement is showing signs of growing and the fibre cement category itself is growing in usage, so 2 out of the 3 tenets of their story are now better placed. Pulp prices are also falling which is also supportive for JHX.

Detractors

Overweight Viva Energy

Viva Energy (VEA, -18.1%) retreated following a weak print of 1H19 results. Whilst refining margins have improved more recently, the retail fuel margin came in lower than expected for the period, and management guided 2H19 to be in line with 1H19 if the weakness in retail margin persists. We think this could be attributed to some aggressive competition from EG Group, which bought the Woolworths fuel business in April. The market has quickly priced in an expectation that currently weak margins will persist, weighing not just on Viva but also on Caltex (CTX, -11.3%). We remain mindful that, historically, retail fuel margins have been volatile and can reverse swiftly. The current levels also imply a material proportion of petrol stations are currently unprofitable, which is not sustainable.

Does not hold Woolworths

Woolworths (WOW, +6.0%) outperformed after releasing its FY19 results. Whilst the majority of the print was in line with market expectation, Australian Foods was the standout and management noted that there was lower discounting in long-life (i.e, packaged) goods. We do not hold Woolworths, and our preference in the sector is Metcash (MTS, +2.8%). We believe the commentary from WOW is yet another sign that grocery deflation may have bottomed after several years which, if so, would be a tailwind to MTS that is not reflected in its current valuation.

Strategy and outlook

August's reporting season certainly reflected the fact that economic growth and consumer demand has slowed over the past twelve months, however it was not as bad as many feared would be the case. While the overall market declined, this was driven more by macro uncertainty over the US-China trade dispute - which saw the MSCI World TR index fall -2.33% in August - rather than an overly negative reporting season.

Around 42% of companies which reported downgraded their earnings guidance for the next twelve months, versus an historical average of just over 30%. Conversely, only 10% upgraded compared to the historical average of just under 20%. The greatest pressure came in areas such as steel - which saw earnings estimates for the next twelve months fall 15% - and also in media (down -13%) and telcos (-10%). Very few sectors of the market saw aggregate upgrades - and where they occurred, they were small. Consumer Discretionary (+1%) and health care (also +1%).

In aggregate, earnings expectations for the ASX200 for the next twelve months fell 3%, which reflects an environment in which housing construction has slowed and where weaker house prices have weighed on consumer demand.

That said, price action tended to reflect the both the view that broad outcomes were not as bad as some had feared. There is also a broad expectation that stimulus - in the form of cuts to interest rates and taxes as well as the possibility of more fiscal spending - could help underpin demand and prevent further falls. Signs of an improvement in the housing market are helping in this regard.

Hence media and steel - the two sectors with the largest downgrades - both outperformed the market and posted positive gains in August. Building materials did likewise, despite downward revisions. Discretionary stocks also did very well as companies like JB Hi-Fi noted in their outlook that demand and sales had started to tick up again in recent weeks.

All in all growth remains muted, however further signs of an uptick in the domestic economy could drive stock specific opportunities given how cheap many domestic industrial cyclicals are. We retain our exposure via positions in Qantas and Nine Entertainment among others.

We are mindful that both growth and defensive yield stocks have had a strong twelve month run on the back of falling bond yields. Yields are likely to remain depressed for a period - now is not the time to go aggressively underweight. However these stocks are unlikely to replicate the same degree of outperformance over the coming year unless Australian bond yields fall to near zero. Our preferred growth stocks include CSL and Xero, while we continue to like Transurban and Atlas Arteria among the defensive yield stocks.

For more information please call 1800 813 886,
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