Pendal Australian Share Fund

ARSN: 089 935 964

Factsheet

Equity Strategies

September 2019

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 30 Sep 2019)	$975 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	1.99	2.06	1.91
3 months	1.89	2.09	2.55
FYTD	1.89	2.09	2.55
6 months	8.81	9.25	10.80
1 year (pa)	8.20	9.07	12.57
2 years (pa)	11.35	12.25	13.30
3 years (pa)	11.85	12.75	11.85
5 years (pa)	9.16	10.03	9.55

Sector Allocation (as at 30 September 2019)

Energy	8.1%
Materials	19.1%
Industrials	11.5%
Consumer Discretionary	6.6%
Consumer Staples	2.8%
Health Care	11.6%
Information Technology	1.8%
Telecommunication Services	7.0%
Financials ex Property Trusts	25.9%
Property Trusts	3.9%
Cash & other	1.7%

Top 10 Holdings (as at 30 September 2019)

CSL Limited	8.5%
Commonwealth Bank of Australia Ltd	7.2%
BHP Billiton Limited	6.5%
ANZ Banking Group Limited	5.9%
Telstra Corporation Limited	5.0%
Qantas Airways Limited	4.4%
Westpac Banking Corporation	4.2%
Transurban Group	3.6%
Santos Limited	3.3%
Macquarie Group Limited	2.7%

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

Australian equities (S&P/ASX 300 Accumulation Index) rose 1.9% in September, with seven out of the eleven GICS sector ending in the green. August laggards, Financials (+4.2%) and Energy (+4.5%) lead the market this month as a rotation to value saw many growth and long rallied defensive stocks fall. Within Energy, Oil Search (OSH, +11.5%) performed the strongest, after the Papua New Guinean government confirmed the development of the Papau LNG Project – where Oil Search has a 23% stake in the project. Although Oil Search's Alaskan asset reported a higher than anticipated cost base, the negative update did not infringe much on share price gain. Additionally, Oil Search also benefited from the surge up in oil price after the drone attacks upon the Abqaiq and Khurais oil facilities in Saudi Arabia – disrupting 5% of global oil supply. Other companies such as Beach Energy (BPT, +3.3%), Origin Energy (+6.6%), Worley Parsons (WOR, +5.9%) and Caltex Australia (CTX, +11.3%) also benefited from the uptick in price. Caltex Australia had earlier in the month experienced unexpected weakness in its retail fuel margins and Worley Parsons result had revealed the effects of a weaker oil price and a reduction in capex on new production.

Financials, another sector that has been beaten down this year, also rotated back into favour. Within Financials, the 'Big 4' banks outperformed the broader market – gaining between 2.3% and 8.6%. ANZ (ANZ, +6.7%) was the second best performing bank after it had lagged behind the rest of the Big Four over the last twelve months. However, a risk posed to ANZ at the moment is the uncertainty over the effect of new capital requirements from the NZ regulators, to which it has a large exposure. On the flipside, NAB spin-off CYBG (CYB, -18.4%) dragged within the sector following the announcement of an additional provision of GBP 350 – 400m against mis-selling claims for its payment protection insurance. The net effect of CYB's provision equates to 10% of the company's capital base. Despite the fact that payment amounts have been running in the low teens as a percentage of claims made, the administration costs in processing the claims renders the final amount required to be highly uncertain.

The performance in Materials (+3.0%) was largely driven by thematic. BHP (BHP, +4.4%), Rio Tinto (RIO, +5.8%) and Fortescue (FMG, +13.4%) all led the sector after benefiting from the higher iron ore price. Construction related companies, Boral (BLD ,+13.7%) and James Hardie (JHX, +10.2%) also performed better this month as housing sentiment picked up – NAHB housing market index indicated that builder confidence had hit a yearly high in September. James Hardie's return was also attributed to its positive update on its North American Strategy, as it started regaining lost market share in building products. On the other hand, many gold miners, including Newcrest Mining (NCM, -6.1%), Evolution Mining (EVN, -12.6%) and Northern Star (NST, -7.2%) fell as a result of the drop in gold price. Steelmaker, Bluescope Steel (BSL, -3.3%) also lagged after experiencing some softer steel margin spreads in the US and its sensitivity to the state of the Sino-American trade. Whilst BlueScope had previously benefited from the trade war's effect on US-made steel prices, the 'squeeze' from end users in the US and the slumping demand (particularly in China) now pose as major headwinds.

On the other side of the tallyboard, defensive sectors and last month's leads, Real Estate (-2.3%) and Healthcare (-2.2%) were the largest detractors this month. September was Healthcare's first down month this year as defensive sectors had outperformed strongly earlier. Healthcare leaders such as CSL (CSL, -2.4%) and Cochlear (COH, -3.7%) underperformed this month, after gaining 30% and 26% in price respectively from January through to August. Within Real Estate, many bond-sensitive defensive yield stocks such as Goodman Group (GMG, -2.3%), Charter Hall (CHC, -7.9%) and Mirvac (MGR, -4.1%) lagged after the Australian 10-year bond yield added 7bps over the month. On the other hand, the housing market rebounded in September, with Sydney and Melbourne seeing a 1.7% monthly growth – the biggest monthly rebound in two-and-a-half years. As a result, property developers such as Stockland (SGP, +0.7%) and Lendlease (LLC, +2.9%) were the few companies that gained in the sector. LendLease's growth is also attributed to its reports of selling its troubled Engineering and Services division.

Fund performance

The Fund outperformed its benchmark over the month of September.

Contributors

Overweight Fortescue Metals

The iron ore price continued to recover off its lows as signs emerged that both the US and China were softening the rhetoric around trade. Fortescue Metals (FMG) rose +13.4% as a result, followed by both Rio Tinto (RIO, +5.8%) and BHP (BHP, +4.4%). FMG remains our most preferred iron ore miner, over RIO. Recent updates have demonstrated that RIO continues to face operational issues in the Pilbarra, with high production volumes taking its toll on the rail network and resulting in higher maintenance costs and production delays and shutdowns. FMG, in contrast, offers a pure exposure to iron ore and does not face the same operational issues as RIO. The combination of tight supply and self-help has also seen a material reduction in the discount at which its ore sells to the benchmark price. The net effect is that we see FMG as offering the better opportunity to take advantage of the sell-off in iron ore miners in recent weeks.

Overweight Qantas

Qantas (QAN, +5.2%) continued to benefit from the positive company updates from itself and Virgin last month. The oil price rise over the month did weigh on Qantas. However, QAN's oil price exposure is already 100% hedged for FY20 and 40% hedged for FY21. Along with Virgin, QAN has the highest level of hedging among any airline globally, leaving it the least exposed to oil price volatility.

Detractors

Overweight Telstra

Telstra (TLS) fell -5.6% over the month, which looks to have been driven largely by offshore selling. Investors were disappointed with the earnings result revelation that the headwind from NBN would be $400m more than expected. That said, in our view this issue is unlikely to deteriorate, while we believe the market is underestimating the effect of slightly better pricing in mobile telephony. TLS is not at a demanding valuation and therefore lacks the risk of de-rating seen in other parts of the market. It is also offering a 4.6% dividend yield, pre-franking, in an environment where interest rates and bond yields remain low. We believe it could do well in this environment.

Underweight NAB

A rotation from Growth to Value saw the big four banks outperform the market in September. Our preferred bank, ANZ was up +6.7%. However It has lagged the rest of the Big Four over the last twelve months – and in the last three months has been well behind National Australia Bank (NAB, +8.6%).

Whereas ANZ has been the turnaround story of the last few years, there is a sense now that investors are hoping for the same from NAB under a new CEO. ANZ also has the additional uncertainty over the effect of new capital requirements from the NZ regulators, to which it has the greatest exposure. The key question remains the time frame that the NZ regulators will allow the banks to build capital – and whether this is long enough to avoid ANZ having to raise equity capital.

Strategy and outlook

The equity market continues to trade around shifts in sentiment on US-China trade, with a more optimistic bent in September driving a recovery from the reversal in August. The situation is unpredictable, to say the least, although signs that a deterioration in corporate confidence is starting to affect growth have raised the importance of getting some sort of deal done. December 15th looms as a key date; this is the deadline for the next round of potential tariffs, which will have a greater proportional effect on consumer goods and therefore on the hip pockets of middle America.

The trade war is one key touchpoint for sentiment in Australian equities. We see liquidity, the broader Chinese economy, and the state of the domestic economy as three others.

Coordinated monetary easing has reignited the search for yield beyond the traditionally defensive asset classes of term deposits and bonds. The dividend yield premium of the S&P/ASX 200 over ten year Australian government bonds is a touch over 3%. The last time it was anywhere near these levels – apart from the GFC – was back in 1942. And for much of the intervening period the equity market has yielded less than ten year sovereign.

We see this as supportive of the overall equity market, particularly given the relatively unpredictable macro-economic and geopolitical environment. It is also driving liquidity into the higher yielding parts of the market, such as REITs and infrastructure. It has also continued to drive growth stocks. We are less convinced that some of the stocks in these parts of the market can sustain their high valuation ratings – and there have been recent signs of a rotation away from these parts of the market.

This liquidity injection is perhaps the most important thematic element at play in today's market. However Chinese economy growth remains an important indicator. Here, there have been signs of stress from the ongoing trade war, however this far the authorities have been able to offset this via stimulus measures. As a result, the demand side of the equation remains largely intact for key commodities such as iron ore – for the moment. We think that increased supply will slowly erode iron ore prices, but that reasonable demand should help mitigate the risk of a calamitous drop. This is important for both the Australian mining sector – and also for the royalty revenues for the Federal government, which can be potentially used to fund stimulus measures.

Balancing factors are also at play in the domestic economy. Tighter lending standards and construction weakness are weighing on growth, while low wage growth is a limiting factor on consumption. Interest rate and tax cuts, plus lower utility bills, have thus far managed to prevent further slippage in growth, however we believe that it will take more fiscal stimulus to help drive any signs of recovery, particularly as the RBA nears the bottom of its tool bag in terms of rate cuts.

As always, the portfolio is built to be driven primarily by company specific opportunities, rather than thematic drivers. We think this is especially important in the current environment given heightened thematic uncertainty. We have exposure to growth via some of the more reasonably valued names such as CSL and Xero. Our preferred defensive yield plays include Transurban and Atlas Arteria, which have dominant toll road positions in Australia and France, respectively. We also continue to find companies – such as Qantas - with strong free cash flow and capital return to investors outside of the more traditional sectors. We do have some more cyclical exposures – such as James Hardie and JB Hi-Fi – while remaining very selective given signs of slowing growth.

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

PENDAL