Pendal Enhanced Cash Fund

ARSN: 088 863 469

Factsheet

Bond, Income & Defensive Strategies

September 2019

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	0.14	0.16	0.08
3 months	0.47	0.53	0.29
FYTD	0.47	0.53	0.29
6 months	1.11	1.24	0.74
1 year (pa)	2.28	2.54	1.74
2 years (pa)	2.39	2.65	1.81
3 years (pa)	2.64	2.89	1.79
5 years (pa)	2.60	2.85	2.01

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

Sector Allocation (as at 30 September 2019)

Money market	38.4%
Corporate	59.4%
Residential mortgage backed	2.2%
Government bond	0.0%
Other asset backed securities	0.0%

Security Credit Ratings (as at 30 September 2019)

AAA	2.2%
AA	39.5%
A	13.0%
BBB	6.9%
Money market	38.4%

Statistics (as at 30 September 2019)

Modified duration	0.09 years

Other Information

Fund size (as at 30 Sep 2019)	$735 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 bonds gave back some of their prior month's gains during September. This was amid a global sell-off in rates at the long end of curves as investors shifted back into risk-assets. Meanwhile at the very front-end, yields were pulled slightly lower in several markets due to central bank action. This included Australia, where speculation of a cut by the RBA increased through the month and was ultimately delivered at the outset of October.

Governor Lowe cited increased downside risks, particularly tied to greater uncertainty over the global outlook, in his statement. There was also a greater emphasis on the labour market and achieving full employment. The gap between the unemployment rate and that associated with full employment widened during September with a slight increase in the former of 0.1% to 5.3%. The rise was driven by a tick higher in the participation rate by the same magnitude to 66.2%, while employment growth surprised to the upside at +34.7K.

Broader domestic data was weaker overall. Among the leading indicators, the NAB Conditions and Confidence measures both retreated to +1 from +2 and +4 respectively. Consumer confidence also dropped with a fall of -1.7% back into pessimism territory at 98.2. Similarly retail sales weakened (-0.1% month-on-month) and the final September CBA Markit Manufacturing PMI slipped from 50.9 to 50.3.

In the US, the Federal Reserve cut its benchmark rate by 25bps to 1.75%. However, the accompanying projections and address from Chairman Powell suggested a less dovish message than anticipated. This included greater division in the committee's expectations for future rates.

Meanwhile, US data continued to paint a mixed picture with a weaker manufacturing sector at one end offset by a healthy consumer at the other. The August ISM Manufacturing survey slid below 50 to 49.1 and a further deterioration in the September number (printed in October) sparked concerns of a broader slowdown. In contrast, retail sales rose a respectable 0.4% and the University of Michigan consumer confidence survey rose to 92 and beat expectations. Inflation measures also picked up, including the Core PCE deflator (+1.8% year-on-year from +1.6%) and average hourly earnings (+3.2% over the year). The monthly NFP report missed expectations with only 130K jobs added.

In Europe, the ECB also eased policy further with a 10bps cut to its deposit rate to -0.50%. Additionally, President Draghi unveiled a new open-ended quantitative easing programme. The decision was alongside a continued deterioration in the region's leading indicators. This included a drop in the Eurozone Markit Manufacturing PMI from 47 to 45.7.

Beyond monetary policy developments and the economic data, investors appeared less concerned over geopolitics through most of the month. The ongoing protests in Hong Kong, Boris Johnson's Brexit woes and trade wars shifted to the background for risk sentiment. However, towards month-end the formal impeachment enquiry launched against President Trump was met by angst from investors.

Finally in terms of market movements, Australian 3 and 10 year yields rose 6bps and 13bps respectively to 0.74% and 1.02%. However expectations for the RBA rate reduction saw 3 month BBSW fall 3bps to 0.95%. Similarly in the US, the 2 and 10 year added 12bps and 17bps to 1.62% and 1.67%, while the 3 month LIBOR rate fell 5bps to 2.09%. With only a small change in the AU-US interest rate differential, the Australian Dollar was afforded a small 0.25% gain.

Credit markets enjoyed the benefits of the recovery in risk appetite. Credit spreads tightened through the first half of the month alongside the fading geopolitical concerns. However, there was a slight reversal and widening into month-end as the impeachment developments rattled confidence. Domestic news again played second fiddle to the global risk backdrop.

The Australian iTraxx index (Series 31 contract) traded in a 8bp range finishing the month 4.5bps tighter to +58.5bps. The new Series 32 contract finished the month at +67bps. Physical credit spreads underperformed with the average spread moving out 2bps. The worst performing sector was supranationals which widened out 4bps, whilst the best performing sector was utilities that were unchanged. Semi-government bonds outperformed tightening 1bp to government bonds.

Fund performance and activity

The Fund outperformed the benchmark by 8 basis points (pre fee) in September. Positive performance came from financials, infrastructure and industrials.

Activity during the month included re-investing in short term money market securities.

As at the end of the month, the portfolio had a credit spread of 63bps over bank bills, interest rate duration of 0.09 years and credit spread duration of 1.82 years.

Outlook

The Reserve Bank cut the cash rate by 25 basis points at its meeting in early October. The statement was more dovish than what the market had expected and resulted in expectations for further monetary policy easing prior to year end rising. The line in the statement that prompted this response was that 'it is reasonable to expect that an extended period of low interest rates will be required in Australia to reach full employment'. No reference to full employment was made in the September statement, rather that 'an extended period of low interest rates will be required in Australia to make progress in reducing unemployment'. The current unemployment rate of 5.3% is a fair way from the 4.5% rate that the Reserve Bank sees as being the non-accelerating inflation rate of unemployment (NAIRU). With forward labour market indicators reflecting a slowing labour market it is more likely to the unemployment rate rises in the near term.

Given the sub-trend economic growth in the Australian economy and the risks to global growth being clearly tilted towards the downside further monetary policy easing appears likely, particularly if other central banks cut interest rates further. The Reserve Bank does not want to see an appreciating currency in the current environment.

The global macro environment continues to offer the greatest guidance to domestic credit and it has proven a very dynamic and fast-evolving backdrop. The two key elements of influence remain trade wars and expectations of more dovish central banks, including the Fed and ECB. Attitudes towards the former have shown a tendency to shift quickly and overshadow growing expectations for a more dovish Fed. 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 wars threaten to devolve into a more prolonged "cold war". As illustrated through the year-to-date, any perceived progress can evaporate quickly along with a positive perspective from investors. It is also increasingly evident that US-China relations have not materially improved despite some small progress at the G20 summit earlier in the year. 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 both the Chinese and US economies as visible in the deterioration of activity indicators like manufacturing surveys and a slowdown in GDP growth. In Asia, this has flow-on effects for China's neighbours, particularly those that are highly dependent on exports to the Asian giant (such as South Korea). 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 and Q2 earnings surprises to the upside.

On the Fed, the more dovish stance adopted in January and subsequent cuts in July and September represent a significant shift from last year. In turn Fed policy is more of a tailwind for credit than a headwind as in 2018. The prospect of further easing has resurfaced the idea of the “Fed put” that would effectively limit the extent of a sell-off in risk assets. Similarly, new open-ended stimulus and the prospect of further easing from the ECB is supportive for the area. 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 more supportive fiscal policy in the wake of the Coalition’s win in the Federal Election, as well as three cuts this year from the RBA. The weight of the Royal Commission has also been lifted from the shoulders of the major banks. Moreover, new issuance has been well-bid and supply relatively light compared with prior years.

Overall, the backdrop for risk assets continues to fluctuate 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 we maintain a cautious stance and prefer tactical positioning in order to remain nimble.

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

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