Pendal Australian Share Fund

ARSN: 089 935 964

Factsheet

Equity Strategies

October 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 31 Oct 2019)	$974 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	0.10	0.17	-0.38
3 months	-0.51	-0.31	-0.78
FYTD	1.99	2.26	2.16
6 months	7.07	7.50	7.73
1 year (pa)	16.31	17.25	19.50
2 years (pa)	9.21	10.09	10.88
3 years (pa)	12.64	13.55	12.53
5 years (pa)	8.35	9.21	8.56

Sector Allocation (as at 31 October 2019)

Energy	7.8%
Materials	18.3%
Industrials	11.5%
Consumer Discretionary	6.0%
Consumer Staples	2.6%
Health Care	11.8%
Information Technology	2.0%
Telecommunication Services	7.1%
Financials ex Property Trusts	25.2%
Property Trusts	4.5%
Cash & other	3.2%

Top 10 Holdings (as at 31 October 2019)

CSL Limited	8.8%
Commonwealth Bank of Australia Ltd	6.9%
BHP Billiton Limited	6.1%
ANZ Banking Group Limited	5.2%
Telstra Corporation Limited	5.0%
Qantas Airways Limited	4.2%
Westpac Banking Corporation	4.0%
Transurban Group	3.6%
Santos Limited	3.4%
Macquarie Group Limited	3.1%

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, as measured by the S&P/ASX 300 Accumulation index (-0.4%) gave back some of the September gains this month. The meaningful rotation from Value to Growth last month quickly reverted, with the MSCI Australia IMI Value Total Return index underperforming its Growth counterpart by 3.1% this month, as the big banks and miners pulled back. Industrials (-0.1%) recorded marginal losses; whereas Resources (-1.6%) were the main detractors.

Six of the 11 GICS sectors finished the month in the black; although poor performance from Communication Services (-1.4%), Information Technology (-3.2%), Consumer Staples (-2.2%), Materials (-1.8%) and Financials (-2.9%) more than offset the gains. Within Financials, ANZ (-6.2%) reported full year results, and dragged down the heavyweight banking group. It was the worst performer amongst the big four, while Westpac (WBC) fell -4.8%, Commonwealth Bank (CBA) -2.7% and National Australia Bank (NAB) -3.7%. While the issues facing banks on revenue, earnings and capital are well known, ANZ's result still came as a slightly negative surprise. Some of this is due to ANZ's relatively large exposure to institutional loans, part of which is Asian-based and has the additional pressure from falling global rates.

ANZ has also been the only bank attempting to reduce costs in an absolute sense in recent years. It has been successful in reducing costs from over \$9bn to \$8.6bn currently – towards a stated target of \$8bn. However management flagged that while the long-term target remained, costs were likely to rise over the next year. Capital provided one of the few bright spots. Changes to the Reserve Bank of New Zealand's treatment of capital are likely to eat into the previously large surplus ANZ enjoyed, but there are solid indications they will be able to manage the position while maintaining dividends for the moment. ANZ's result painted a clear picture of the tough environment for banks.

Elsewhere, the iron ore majors, BHP (-2.1%) and Rio Tinto (RIO, -1.9%) underperformed alongside their gold peers, including Newcrest Mining (NCM, -9.9%), Norther Star Resources (NST, -10.6%) and Evolution Mining (EVN, -8.8%). Whilst there was no clear catalyst for the diversified miners' pullback, the ongoing poor performance from the precious metal cohort since August could be attributed to a pickup in the risk appetite amongst investors: there have been some early signs of progress on Brexit and a more constructive backdrop on US-China trade. In NST's case, it was compounded by a disappointing quarterly production report, which saw output fall almost 40% from its previous quarter at its Pogo operation in Alaska. On the other end of the spectrum, Bluescope Steel (BSL, +11.0%) and Iluka Resources (ILU, +17.6%) were the largest performance contributors to Materials over the month. Iluka gained as management countenanced the possibility of selling off its iron ore royalties; whereas BSL benefited from some optimism of improvement in the US steel market.

Turning to the sectors in positive territory, Health Care (+7.3%) was the best performing sector over the month, as CSL (+9.6%), Ramsay Health Care (RHC, +5.6%) and Resmed (RMD, +7.2%) outperformed. ResMed delivered yet another decent quarter with a slowdown in price deflation underpinning good revenue momentum. Outside Health Care, some of the standouts within the ASX 100 include Sydney Airport (SYD, +9.3%), Brambles (BXB, +7.7%), Xero (XRO, +10.8%) and Santos (STO, +5.0%). In SYD's case, the release of Productivity Commission report which found Australian airports were not abusing their market position, rejecting airline demands for commercial arbitration. That said, the government is not obliged to adopt the Commission's recommendations and we may not have heard the last on this issue.

Fund performance

The Fund outperformed its benchmark over the month of October.

Contributors

Overweight CSL

Our preferred growth company, CSL (+9.6%) performed strongly in October, amid some selective selloffs amongst the growth cohort. Many of the stocks within this cohort are on challenging valuations, however we believe CSL to be among the few where genuine underlying growth can justify a higher valuation rating. Its most recent result demonstrated strength in it core IG business, where it continues to win share from competitors and benefit from an improving product mix. Its Speciality businesses also continues to do well, while the flu vaccine business continues to move closer to break even.

Overweight Santos

Santos (STO, +5.0%) announced plans to buy ConocoPhillips' north Australian gas assets for just over \$2 billion, which was well received by the market. It reinforces our view of STO as the best LNG play in the Australian market right now, not least for its diversified, bite-sized growth options. The acquisition in northern Australia also includes operational control of the Darwin LNG plant, putting it in an enviable strategic position.

Detractors

Overweight Metcash

The news that 7-Eleven was tending for its fresh and dry food supply contract, for which Metcash (MTS, -5.7%) is the incumbent saw the company pull back in October. Whilst the media compared this contract to MTS's recently lost contract of Drake's, the 7-Eleven contract is a known quantity and at a much lower margin. However, we are conscious of the implications to the stock's rating if something like a "Foodworks" was to drop-off. That aside, there is growing evidence that we are seeing inflation creeping back, to which MTS has the highest operating leverage to. The company is also trading at a much more appealing P/E multiple than peers.

Does not hold Sydney Airport

Sydney Airport (SYD, +9.3%) gained following the release of Productivity Commission report which found Australian airports were not abusing their market position, rejecting airline demands for commercial arbitration. That said, the government is not obliged to adopt the Commission's recommendations and we may not have heard the last on this issue. We do not hold Sydney Airport, and Transurban (TCL, +1.0%) and Atlas Arteria (ALX, +2.9%) remain our preferred infrastructure names.

Strategy and outlook

The last couple of months have seen a shift away from growth stocks and towards value by global equity investors. Growth stocks in the Australian market – which include the health care, technology, and some China-related food and beverages stocks – have outperformed the broader market by well over 100% since the GFC. If the rotation away from growth to value persists, it could lead into a very different environment than has been in place for several years.

We are mindful that while there is a sense of investors rebelling against the extreme valuations to which some growth stocks have been driven, we are nevertheless likely to remain in an environment of low rates for some time. This does support the technical valuations for growth stocks at higher levels than in the past.

As always, our approach is to not try and time shifts in sentiment on thematic and style-based factors. Our edge lies in our access to and knowledge of companies – and we design our portfolios to be driven by that edge. As a result, we have both growth and value stocks in the portfolio. We monitor the degree to which portfolio risk is driven by these factors, to ensure that stock-driven risk remains dominant.

In this vein, it is interesting to note that the rotation away from growth was not absolute in October. Two high profile tech companies, Afterpay Touch (APT, -19.5%) and Wisetech Global (WTC, -24.7%) gave up considerable ground. Not owning these companies made a positive contribution to the Fund's relative performance. However two of our favoured growth companies – CSL (CSL, +9.6%) and accounting software firm Xero (XRO, +10.8%) – actually outperformed. In our view, it helps that there is greater certainty around earnings support for both CSL and XRO.

At the same time, the rotation into value was also not broad-based. Notably, the banks did not participate in the gains, as market remained wary of persistent stiff headwinds on revenues, earnings, margins and capital heading into financials reporting season. This divergence within style-based cohorts suggests that investors are remaining mindful of fundamentals despite what could be a change in a multi-year investment trend.

The domestic economy remains in a soft patch. House prices appear to have stabilised, although listings numbers have been light. We will be watching this figure closely as we move further into the warmer months. While housing is no longer deteriorating, there will nevertheless be a lag in construction activity picking up again, particularly given the long lead times around apartment development. In tandem with a delay in some infrastructure projects and weak consumer data, it paints an uninspiring picture of the economic outlook.

In the absence of further fiscal stimulus, it appears that the outlook will remain soft. Cuts to tax and interest rates plus lower utility prices looks to have done enough to halt a slide into recession, but we do not expect a sharp pick up in activity and demand in the near term.

Nevertheless, it is important to note that there are companies who are doing a reasonable job of navigating a tough patch. Environments like this do help highlight the stronger management teams and companies and weak sentiment means they can sometimes be bought for an attractive price. This notion, coupled with the divergence in fortunes within both the growth and value cohorts, is driving a stock-picker's market in our view. This plays to the strengths of our company-focused approach.

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

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