

Pendal Focus Australian Share Fund

ARSN: 113 232 812

Equity Strategies

October 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 Oct 2019)	\$690 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 Return
	(post-fee)	(pre-fee)	
1 month	0.21	0.27	-0.38
3 months	-0.54	-0.36	-0.78
FYTD	2.29	2.55	2.16
6 months	8.15	8.56	7.73
1 year (pa)	18.08	18.97	19.50
2 years (pa)	10.34	11.29	10.88
3 years (pa)	14.07	15.31	12.53
5 years (pa)	10.10	11.22	8.56

Sector Allocation (as at 31 October 2019)

Energy	7.1%
Materials	18.4%
Industrials	16.0%
Consumer Discretionary	4.0%
Consumer Staples	2.9%
Health Care	11.0%
Information Technology	2.4%
Telecommunication Services	9.6%
Financials ex Property Trusts	20.9%
Property Trusts	1.6%
Cash & other	6.1%

Top 10 Holdings (as at 31 October 2019)

CSL Limited	8.7%
Commonwealth Bank of Australia Ltd	6.9%
Telstra Corporation Limited	6.1%
BHP Billiton Limited	5.8%
ANZ Banking Group Limited	5.3%
Qantas Airways Limited	5.1%
Santos Limited	4.3%
Transurban Group	4.1%
Westpac Banking Corporation	3.7%
Nine Entertainment Co Ltd	3.5%

Management Costs²

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 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 its 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 Xero

CSL and Xero (XRO), our preferred exposure to the growth cohort both continued to outperform in October. In Xero's case, it continues to gain traction and subscribers with its cloud accounting software in the US and in the UK – both of which have far lower levels of penetration in small business online accounting than Australia and New Zealand. At the same time, Xero has a second string to its bow in its platform which hosts third party apps designed to help businesses with a range of administrative functions such as payroll, payment automation and cash flow management. This offers an additional avenue of growth.

Detractors

Overweight Evolution Mining

Evolution Mining is our preferred gold miner with a highly-regarded management team presiding over an improving suite of assets, which include five wholly-owned gold mines across NSW, Queensland and Western Australia. Over the last few years EVN has improved its portfolio with the disposal of smaller, lower quality mines – replacing them with larger, low-cost operations. It has substantially lowered its "all-in" sustaining cost, improving free cash flow generation, particularly as we enter an environment which is likely to be more supportive for gold prices. In October, the gold miners sold off on the back of signs of progress on Brexit, and a more constructive backdrop on US-China trade.

Overweight Nine Entertainment

Nine Entertainment pulled back in October, as investor sentiment was dampened by the latest trading update from Southern Cross Austereo (SXL). Whilst the choppy ad market across the broader media industry has been known for some time, the magnitude of decrease in SXL's 1Q20 revenues (-8.5%) implied another poor month for September.

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

PENDAL

This factsheet has been prepared by Pental Fund Services Limited (PFSL) ABN 13 161 249 332, AFSL No 431426 and the information contained within is current as at the date of this factsheet. It is not to be published, or otherwise made available to any person other than the party to whom it is provided.

PFSL is the responsible entity and issuer of units in the Pental Focus Australian Share Fund (Fund) ARSN: 113 232 812. A product disclosure statement (PDS) is available for the Fund and can be obtained by calling 1800 813 886 or visiting www.pentalgroup.com. You should obtain and consider the PDS before deciding whether to acquire, continue to hold or dispose of units in the Fund. An investment in the Fund is subject to investment risk, including possible delays in repayment of withdrawal proceeds and loss of income and principal invested.

This factsheet is for general information purposes only, should not be considered as a comprehensive statement on any matter and should not be relied upon as such. It has been prepared without taking into account any recipient's personal objectives, financial situation or needs. Because of this, recipients should, before acting on this information, consider its appropriateness having regard to their individual objectives, financial situation and needs. This information is not to be regarded as a securities recommendation.

The information in this factsheet may contain material provided by third parties, is given in good faith and has been derived from sources believed to be accurate as at its issue date. While such material is published with necessary permission, and while all reasonable care has been taken to ensure that the information in this factsheet is complete and correct, to the maximum extent permitted by law neither PFSL nor any company in the Pental group accepts any responsibility or liability for the accuracy or completeness of this information.

Performance figures are calculated in accordance with the Financial Services Council (FSC) standards. Where performance returns are quoted "Post fees" then this assumes reinvestment of distributions and is calculated using exit prices which take into account management costs but not tax you may pay as an investor. Where performance returns are quoted "Pre fees and tax", they exclude the effects of management costs and any taxes. Past performance is not a reliable indicator of future performance.

If market movements, cash flows or changes in the nature of an investment (e.g. a change in credit rating) cause the Fund to exceed any of the investment ranges or limits specified, this will be rectified by PFSL as soon as reasonably practicable after becoming aware of it. If PFSL does so, it will have no other obligations in relation to these circumstances. The procedures, investment ranges, benchmarks and limits specified are accurate as at the date of this factsheet and PFSL reserves the right to vary these from time to time.