Pendal Focus Australian Share Fund

ARSN: 113 232 812

Factsheet

Equity Strategies

January 2020

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 Jan 2020)	$752 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 (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	4.05	4.04	4.89
3 months	7.40	7.61	6.03
FYTD	9.86	10.35	8.32
6 months	6.82	7.23	5.20
1 year (pa)	28.03	29.00	24.99
2 years (pa)	12.00	12.85	12.40
3 years (pa)	13.79	14.94	12.39
5 years (pa)	10.87	11.99	9.42

Sector Allocation (as at 31 January 2020)

Energy	7.9%
Materials	18.4%
Industrials	15.0%
Consumer Discretionary	3.7%
Consumer Staples	2.7%
Health Care	11.1%
Information Technology	3.4%
Telecommunication Services	9.7%
Financials ex Property Trusts	21.3%
Property Trusts	1.2%
Cash & other	5.6%

Top 10 Holdings (as at 31 January 2020)

CSL Limited	9.2%
Commonwealth Bank of Australia Ltd	6.5%
Telstra Corporation Limited	6.2%
BHP Billiton Limited	6.1%
ANZ Banking Group Limited	5.2%
Santos Limited	4.1%
Atlas Arteria	4.0%
Qantas Airways Limited	3.9%
Westpac Banking Corporation	3.9%
Macquarie Group Limited	3.5%

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

The market staged a strong start to 2020, with the S&P/ASX 300 Accumulation index gaining +4.9% in January. However with Resources up only +0.65% and Financials (+4.7%) somewhat in-line with the market, the gains were concentrated in narrow part of the market – particularly Health Care (+12.0%), Information Technology (+10.2%) and Consumer Staples (+7.8%).

This rotation away from cyclicals - and towards bond-sensitive defensive and growth stocks – is a reversal of the prevailing theme of the last quarter and reflects a cautious turn in investor sentiment in recent weeks. Coronavirus has played a role in this, but even prior to this uncertainty there had been some weaker signals on global growth. Copper has fallen over 8% during the month and oil is down almost 20%, while gold is up 1%. People are now looking for further monetary easing to support the global economy, with a further 50bps of rate cuts currently priced into the bond market. US 10 year bond yields contracted 41bps to 1.51% over the month, while their Australian equivalents came in 42bps to 0.95%.

A few companies kicked of the year with a downgrade. Treasury Wine Estates (TWE, -20.0%) released its results early and shifted full year earnings growth expectations from 15-20% down to 5-10%. Management cited a squeeze on its bulk wine business in the US, which is seeing rising costs from Australian grapes, while stronger competition is limiting its ability to pass the costs on.

Health insurer NIB (NIB, -13.7%) downgraded full year operating profit by 15%. This reflects broader pressure on the health insurance industry structure. More younger people are opting out of private health insurance, or trading down, as the requirement to cross-subsidise older holders is leading to higher premiums. At the same time, claims inflation remains strong.

Insurance Australia Group (IAG, -7.6%) also downgraded its expected insurance margins to 14.5-16.5% versus previous guidance of 16-18%. This followed a review of natural perils claims, prompted by a 2019 hailstorm. Underlying operations remain decent and the industry structure remains supportive in terms of its ability to price risk. A one off remediation charge also exacerbated the downgrade.

Elsewhere the combination of bushfires and the coronavirus – and the potential effects on travel and tourism - hit a raft of stocks including Flight Centre (FLT, -10.8%), Qantas (QAN, -9.9%), Star Entertainment (SGR, -9.1%) and Sydney Airport (SYD, -3.1%). The underperformance of global cyclicals such as BlueScope Steel (BSL, -5.4%) and Alumina (AWC, -5.2%) indicates the broader uncertainties over the global economy.

The list of better performing stocks looks like carbon copy of 1H 2019 and reflects the more negative bent in sentiment and lower bond yields. Afterpay Touch (APT) was up 31.7%, while fellow technology stocks Altium (ALU, +14.7%), Appen (APX, +12.9%), Wisetech (WTC, 7.1%) and Xero (XRO, +7.0%) also outperformed.

Health care, the other key growth sector, was also strong. ResMed (RMD) was up +14.4% and CSL (CSL) +13.2%. The latter continues to benefit from a shortage in plasma supply in the US. More efficient use of blood in surgery has meant that the Red Cross, which supplies 25% of the market, has not been growing collections. Meanwhile demand for immunoglobulin (IG) products sourced from blood plasma has been growing in the mid to high single digits each year. CSL has benefited from the twin tailwinds of higher US prices, as well as a mix shift as it supplies more product into the US.

Fund performance

The Fund underperformed its benchmark over the month of January.

Contributors

Overweight James Hardie

James Hardie (JHX, +14.1%) received some brokers upgrade during January, as the company continues to benefit from the modest growth in the US housing market. Domestically, sentiment has also improved somewhat as house price growth has strengthened. As previously communicated, management expected to continue wining more share in Australia.

Overweight CSL

CSL (+13.2%) continues to benefit from a shortage in plasma supply in the US. More efficient use of blood in surgery has meant that the Red Cross, which supplies 25% of the market, has not been growing collections. Meanwhile demand for immunoglobulin (IG) products sourced from blood plasma has been growing in the mid to high single digits each year. CSL has benefited from the twin tailwinds of higher US prices, as well as a mix shift as it supplies more product into the US.

Detractors

Overweight Qantas

Our high conviction position Qantas (QAN, -9.8%) pulled back over the month, and weighed on relative performance. The combination of bushfires and the coronavirus – and the potential effects on travel and tourism - hit a raft of stocks including Qantas.

Do not hold Woolworths

Consumer staples such as Woolworths (WOW, +15.7%) and Coles (COL, +11.5%) benefited from a more defensive investor mindset. We believe that valuations in both look stretched, given low single digit earnings growth. Our preference remains for Metcash (MTS, +2.0%), which is valued at a historically wide discount to WOW and which has greater leverage to the shift in grocery price inflation.

Strategy and outlook

The coronavirus has quickly replaced trade at the nexus of uncertainty over the outlook for Chinese economic growth The rate at which infection rates are developin - and whether it is slowing – is a key factor in trying to gauge the length and scale of the ultimate impact from coronavirus. Nearer term, the focus will be on how China returns to work following the extended Lunar new year holiday. We will be keeping a close watch on this over the coming weeks.

Within China manufacturing may start to ramp up faster than construction, as the latter relies more on migrant labour which may be impacted by travel restrictions. The market is working through the implications for commodity demand. There are also questions over the impact on regional and global supply chains, with stories emerging of some auto plants experience issues as they run short of components.

This issue is likely to have implications of some degree for a swathe of Australian industries and companies. The effect on commodity demand is front and centre for the resource sector - and extends beyond the first order implications for iron ore demand. For example, CNOOC, China's largest buyer of LNG, has declared force majeure and stated that it is unable to take delivery of some contracted LNG shipments due to the impact of coronavirus. This could ultimately lead to gas originally intended for export finding its way into the Australian domestic east coast market, putting pressure on prices and on domestic gas suppliers.

There are also likely to be impacts on companies which sell to Chinese consumers. Treasury Wine Estate, for example, downgraded in January on a weaker outlook for the US business - however the effects of any hit to demand in China or disruption in distribution are still yet to feed through.

As always, there will be industries, companies and management teams who are better placed to deal with these issues than others. Some industries will be able to make adjustments. Airlines such as Qantas, for example, have the ability to react to weaker demand for flights via reduced capacity. For the miners, in contrast, mined ore not bought by Chinese steel plants sits as unsold inventory.

The outlook for China is just one factor the market must think through as we enter reporting season. Across the Pacific, data from the US provided a brighter counterpoint to concerns over China as monthly employment came in much stronger than expected. We believe that the US economy remains in reasonable shape. This is important because the effects of any Chinese demand shock will take place against a US economy which has some momentum, rather than one hovering at stall speed.

The domestic economy remains patchy, however we are mindful that any signs of an improvement– perhaps in response to government stimulus – may see a sharp rebound in lowly-rated cyclicals. This rebound may be enhanced by the degree of valuation dispersion between cyclicals and growth stocks.