PENDAL

Factsheet

Bond, Income &
Defensive Strategies

February 2020

Pendal Enhanced Cash Fund

ARSN: 088 863 469

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	0.06	0.08	0.08
3 months	0.44	0.50	0.23
FYTD	1.18	1.35	0.68
6 months	0.86	0.98	0.48
1 year (pa)	2.11	2.37	1.30
2 years (pa)	2.14	2.39	1.64
3 years (pa)	2.46	2.72	1.68
5 years (pa)	2.49	2.75	1.85

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

Sector Allocation (as at 29 February 2020)

Money market	37.7%
Corporate	57.7%
Residential mortgage backed	4.6%
Government bond	0.0%
Other asset backed securities	0.0%

Security Credit Ratings (as at 29 February 2020)

AAA	4.7%
AA	37.6%
A	11.1%
BBB	8.9%
Money market	37.7%

Statistics (as at 29 February 2020)

Modified duration	0.12 years

Other Information

Fund size (as at 29 Feb 2020)	$754 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 bond yields fell and the curve flattened further in February. The downward direction was dominated by global developments, chiefly related to COVID-19. Concerns had been relatively contained through the first half of the month before fear levels later became elevated, which drove investors to the safety of government bonds.

Amid the more subdued market volatility at the outset of the month, the RBA left its policy rate unchanged at 0.75%. Its statement downplayed the potential negative effects of the virus on economic growth as its path was still uncertain. The Board's forecasts released in its quarterly Statement on Monetary Policy (SoMP) indicated a projection of 2.75% annual GDP growth in 2020. Alongside the upbeat outlook by the central bank other communication suggested some hesitation to cut the cash rate further.

Data-wise, the unemployment rate missed expectations and rose by 0.2% to 5.3%, partly as a result of a rise in the participation rate. Meanwhile, wage growth remained subdued at 0.5% quarter-on-quarter and 2.2% over the year. Leading indicators registered small recoveries with an improvement in consumer confidence from 93.4 to 95.5 and uptick in business confidence by 1 point to -1. In contrast, retail sales slid 0.5% for the month.

Offshore, the spread of COVID-19 and increase in case numbers outside of China fanned investor fears in the second half of February. This followed a spike in patients diagnosed with the virus in South Korea, Iran and Italy. The prospect of a continued escalation damaged risk sentiment substantially and resulted in large falls in regional equity indices and a dramatic decline in sovereign bond yields. At month-end, the negative economic impact became more apparent after a gauge of Chinese manufacturing activity plunged to its lowest on record.

In the US, the Federal Reserve did not meet during the month and data from the world's largest economy was mixed. Markit's preliminary February composite PMI survey dipped into contractionary territory at 49.6 while advance retail sales registered a modest 0.3% increase. Labour market figures revealed 225K jobs were added for January and the unemployment rate climbed 0.1% to 3.6%.

Finally on market movements, Australian 3 and 10 year yields fell by 12bps and 16bps to 0.51% and 0.81% respectively. At the very front-end, 3 month BBSW dropped by 7bps to 0.81%. US moves were more sizeable. The 2 year fell 40bps to 0.92% and the 10 year declined by 36bps to 1.15%. Despite a narrower AU-US interest rate differential, the substantial deterioration in risk sentiment drove the Australian Dollar 2.6% lower versus its US counterpart.

Fears over the coronavirus outbreak spread across all risk assets, including credit markets. This resulted in a significant widening of credit spreads into month-end. Several large global corporates also warned of potential negative effects of the virus. This included domestically-listed and iTraxx constituents, BHP and Qantas. Virus headlines and the broader market reaction overshadowed the local half-year reporting season.

The Australian iTraxx index (Series 32 contract) traded in a wide 22bp range finishing the month 16bps wider to +69bps. Physical credit spreads were also 1bp wider on average. The best performing sectors were utilities and reits that tightening 3 and 2bps respectively, whilst the worst performing sector was resources that widened 24bps. Semi-government bonds also underperformed widening 1bp to commonwealth government bonds.

Fund performance and activity

The Fund returned 8 basis points (pre-fee) for the month and performed in line with the benchmark. Positive performance came from industrials, utilities and RMBS whilst financials detracted.

We de-risked some of the portfolio during the month on the back of the uncertainty related to the coronavirus. Activity included selling financials whilst increasing our cash weight.

As at the end of the month, the fund had a credit spread of 62bps over bank bills, interest rate duration of 0.12 years and credit spread duration of 1.70 years.

Outlook

The Reserve Bank performed a backflip that an Olympian would have been proud of. Their February statement and the forecasts contained in the Statement on Monetary Policy indicated an overly optimistic outlook with little chance of a change in monetary policy in the near term. At the end of February the market priced around a 15% chance of any change at their March meeting. At the Reserve Bank's meeting in early March they eased monetary policy by 25 basis points to 0.50%. In the United States the Federal Reserve eased intra meeting by 50 basis points in early March as fears over the coronavirus and its impact on economic growth weighed on markets and sentiment.

It won't be the last time the Fed eases this cycle and it is likely that the Reserve Bank eases further despite almost having run out of bullets. How effective will this latest bout of easing be? It is the effect on supply chains that will weigh on economic growth, not a lack of demand. The Reserve Bank can always reverse the policy easing moves once the fear over the virus subsides.

It is coming up to ten years since monetary policy was last tightened domestically so it is not unreasonable to expect that policy won't be reversed anytime soon. Fiscal policy also needs to provide support, something that the Government has been reluctant to do. How the Reserve Bank managed to forecast growth of 2.75% for 2020 is anyone's guess. It will come in well below that and rates are likely to remain low for the remainder of the year.

We have moved to a cautious stance on credit given the uncertainty related to the coronavirus and the flow on effect to the global economy and company earnings.

Global factors continue to offer the greatest guidance to domestic credit spreads. In this respect, the spread of COVID-19 has emerged as an overriding driver of short-term risk sentiment. We remain wary that the path and evolution of the virus across the globe is rapidly evolving and remains uncertain.

At this stage, the market's reaction has been influenced largely by this uncertainty, rather than by quantified impacts on economic activity. Economic projections continue to adjust as the situation develops with varying estimates of the negative impact to growth in 2020. Additionally, the duration of the drag on growth is unknown although most estimates suggest it will be contained to the calendar year.

In response to this uncertainty, we have seen relatively swift responses from policymakers, including interest rate cuts by the Federal Reserve and RBA. Easing is also anticipated by their global peers, including the ECB. This is a supportive measure for sentiment, however the benefits of lower rates and whether monetary accommodation can effectively mitigate the economic impact of COVID-19 is questionable.

Over the longer-term, we expect loose monetary policy settings to be supportive for risk assets. Policy easing in previous years had been the most significant driver of tighter spreads. Moreover, dovish messaging by global central banks buoyed risk appetite through the majority of 2019 and helped offset against trade related concerns.

Fiscal responses have also been witnessed and we expect additional government spending to be announced with magnitudes dependent on the escalation of the outbreak.

For global corporates, the extent of the impact on revenues, supply chains and ultimately earnings is yet to be quantified. Outsized effects are expected for those with supply chains most closely-linked to China or demand more sensitive to growth in the Asian giant. Warnings have already been issued by tech giant, Apple, flagship domestic carrier, Qantas, and mining heavyweight BHP. These may spread across a growing number of corporates and industries.

Overall, the COVID-19 outbreak remains a fluid and fast-evolving situation with an unknown outlook. While we expect a negative impact to economic growth and corporate earnings, the extent of that impact and how much will be mitigated by policymaker responses is unknown. We will continue to closely scrutinise relevant developments and assess the potential ramifications as they occur. Over the longer-term, policy measures should be supportive for risk sentiment. However, in the near-term we prefer to adopt a cautious stance.

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

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