PENDAL

Factsheet

Equity Strategies

May 2020

Pendal Australian Share Fund

ARSN: 089 935 964

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 May 2020)	$987 million
Date of inception	September 1992
Minimum investment	$25,000
Buy-sell spread[1] For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
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	4.87	4.93	4.58
3 months	-7.94	-7.77	-9.73
FYTD	-7.51	-6.84	-9.81
6 months	-13.10	-12.76	-14.44
1 year (pa)	-4.85	-4.10	-6.52
2 years (pa)	0.92	1.73	1.83
3 years (pa)	5.20	6.04	4.48
5 years (pa)	4.31	5.14	4.35

Sector Allocation (as at 31 May 2020)

Energy	6.3%
Materials	24.9%
Industrials	10.9%
Consumer Discretionary	7.2%
Consumer Staples	4.1%
Health Care	10.7%
Information Technology	3.7%
Telecommunication Services	6.4%
Financials ex Property Trusts	21.2%
Property Trusts	3.4%
Cash & other	1.2%

Top 10 Holdings (as at 31 May 2020)

CSL Limited	8.6%
BHP Billiton Limited	6.8%
Commonwealth Bank of Australia Ltd	5.7%
Telstra Corporation Limited	4.7%
Westpac Banking Corporation	4.1%
ANZ Banking Group Limited	3.0%
Amcor Limited	3.0%
Qantas Airways Limited	2.8%
Atlas Arteria	2.8%
James Hardie Industries Plc	2.6%

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

The Australian equities market recorded another strong month in May, with the S&P/ASX 300 Accumulation index adding another +4.6% over the period, following the +9% rise in the previous month. The index has now reduced its calendar year loss to -12.7% after this recent rally. There is a paradox in such strength in the face of heightened tension over Hong Kong and rioting in some US cities. However it demonstrates the current strength of optimism over a roll back in restrictions and the view that policy is “winning” the economic battle. In particular, the Fed has suggested that it will undertake another phase of policy – perhaps yield curve control or further asset purchases – but that it is willing to hold off for 2-3 months to see how the economic picture develops. The 2-year yields indicates that the market is confident that the current policy approach may be sufficient.

The EU also announced a EUR500bn recovery fund, which was significant both in its scale and its terms, which don’t requirement repayments until 2028 (with the possibility of potential deferment) and its targeting of weaker southern regions. Elsewhere, Japan announced an additional stimulus package equivalent to 6% of GDP. The key point is that the tide of policy support remains strong and is underpinning current market confidence, allowing people to look through the terrible near term economic data.

Geopolitical situation remains fluid. The US has dialled up the rhetoric around China’s role in the coronavirus pandemic and followed up with some restrictions around Huawei’s access to American technology. China, for its part, has been sending messages to Australia as various government officials have called for an inquiry into how China initially handled the outbreak. Sanctions have been announced against Australian barley and beef.

Turning to sector performance, most of the 11 GICS sectors recorded gains, with the exceptions of Consumer Staples (-0.5%) and Healthcare (-5.1%). Within the former, the largest detractors were the supermarket duo, Woolworths (WOW, -1.2%) and Coles (COL, -1.0%). Both have recently flagged the increase in costs associated with the surge in sales in March and April. And with consumers moving away from their panic hoarding behaviour, sales are expected to normalise again.

Weighing on Healthcare, sector heavyweight CSL (CSL, -10.7%) fell amid the market’s concerns over its plasma supply. There is some evidence that government handouts in the US have meant less motivation for people to supply blood, while social distancing requirements have also disrupted clinic operations. There is likely to be a 6-9 month lag before this affects plasma supply for CSL and there are several factors which could mitigate the impact. Nevertheless, given this risk, and CSL’s strong outperformance over the year-to-date, the stock sold off.

Some of the company updates provided during May included the ones from Xero (XRO, +7.2%), IAG (+5.7%) and Incitec Pivot (IPL, -15.9%). XRO delivered a decent half-yearly report, however there was little detail and still material uncertainty about the potential impact of current disruption on subscriber numbers and pricing. This saw its share price drop initially, before rebounding to end the month higher than the index.

IAG (IAG, +5.7%) stated that the hit to their investment book had been larger than consensus expectations. However, unlike some peers, IAG have not had to sell these assets. As a result, this may revert given the rebound in credit markets. There may be an impact on the near term dividend, but this is not capital which is extinguished.

Lastly, chemical company Incitec Pivot (IPL, -15.9%) raised $600m - effectively 18% of its previous market cap. There were signs that the company had been turning a corner as previous production issues subsided and the agricultural cycle in Australia turned in its favour as drought conditions eased. While it probably raised more capital than was necessary, this does shore up its balance sheet and position it well.

Fund performance

The Fund outperformed its benchmark over the month of May.

Contributors

Overweight James Hardie Industries (JHX)

As the US starts to ease on the COVID-19 restrictions and re-open the economy, more positive economic data is coming through the door, which has been supportive of sentiment for related companies. At this point data on housing continues to be upbeat with positive new home sales in April; whilst new home volumes in May are also set to be up in May. ~70% of James Hardie’s revenue comes out of the US, and its share price has benefited from the continuous improvement on US housing.

Overweight Evolution Mining (EVN)

Gold continues to climb higher in May. In some ways this is serving as an each-way bet. It is a hedge on central bank policy and the potential longer term risks which come with massively expanded balance sheets. However if it transpires that the policy response has not been enough and we start to see widespread bankruptcies, then it is also seen as a hedge in a risk-off environment. As such, gold miners including Evolution Mining (EVN, +19.4%) recorded strong gains over the month.

Detractors

Does not hold Afterpay (APT)

The share price of Afterpay (APT, +52.0%) broke to new all-time highs on the news of Tencent buying a stake of the company in May. We remain mindful that people may be using APT to help address near term cash flow issues while waiting for government payments. Looking through this, there is still the possibility that we see materially softer baseline of consumer demand, which may impact on APT’s volumes.

Overweight CSL (CSL)

CSL (CSL, -10.7%) fell as the market expressed some concern over plasma supply. There is some evidence that government handouts in the US have meant less motivation for people to supply blood, while social distancing requirements have also disrupted clinic operations. There is likely to be a 6-9 month lag before this affects plasma supply for CSL and there are several factors which could mitigate the impact. Nevertheless, given this risk, the fact that it is also the largest stock in the index, and its strong outperformance over the year-to-date CSL was a natural funding source for the rotation to banks over the month.

Strategy and outlook

The portfolio made solid gains in May, finishing ahead of the index. A combination of stocks drove returns. Gold continued to do well, helping Evolution Mining, while the iron ore price also remained resilient as the coronavirus disrupts Brazilian production, which meant that Fortescue Metals continued to do well.

Signs of a better than expected rebound in activity also saw James Hardie, Viva Energy and Atlas Arteria among the best performers.

The largest drag came from the underweight in Afterpay, which continued to surge from its lows. We believe that some key risks are not reflected in Afterpay’s valuation – particularly around the likely increase in costs to attract new customers. As a result we retain a preference for Xero among the tech growth stocks.

There are two forces at contention in the market. On one hand is the economic data, which is awful – albeit in some respects not as bad as many expected. On the other hand is the immense scale of the policy response, coupled with optimism in the initial phase of economic re-opening.

At this point, the latter is winning and markets continue to rise. One key point very recently has been the rotation from growth to value, cyclicals and other laggards. This is an important feature, as it demonstrates a greater breadth in the market recovery, which had previously been dominated by a few sectors and stocks.

While the market is optimistic at the pace of recovery as restrictions are rolled back, we are mindful that we don't yet know the level to which it will recover in the near term. It still seems unlikely that we return quickly to 100% of previous aggregate economic capacity.

Different industries will walk a different path. Some – such as tourism and entertainment – may only return to 80% or less of previous capacity. However there will be other industries which can quickly return to 100% - or even beyond. There seems to be resurgence in car traffic, for example, as people remain wary of public transport. This has implications for car sales and manufacturing, for steel, and for infrastructure.

We are spending a lot of time looking at the outlook for different industries and marrying that up with valuation. Just because an industry will be slower to recover does not mean there isn't opportunity. An industry which may recover to 80%, but is priced for recovery to 60%, can be an interesting prospect.

We are very optimistic about the opportunities that are emerging in this environment. Uncertainty creates mis-pricing, which creates opportunity. Today we have heightened uncertainty at three levels:

- Economic: How quickly does the economy recover & to what level? What are the risks of disappointment?
- Industry: How prolonged is the cyclical effect? What structural changes have emerged or accelerated? How is the structure changing?
- Company: What is management's strategy to deal with this environment? Is it credible and effective?

We are also mindful of the potential for people to latch onto obvious themes. At this point, despite the recent surge, overall market positioning remains very bearish in expectation of a material pullback. Ironically, this can make a major sell-off less likely. It is important to be looking at the economy and at companies – but also to be thinking about how the market is positioned.

We stick by our view that there are a range of possible scenarios on both the health and economic fronts and second order effects which are not yet visible. It is not the time to be taking a binary view of the environment. We continue to use our scenario framework, position for the likelier scenarios but have protection in the case of better or worse outcomes.

During the month we reduced the underweight in banks, although we remain cautious on the outlook given they remain challenged on several fronts. We also offset some of the bank underweight via an increased position in insurers, where we believe the market is over-estimating the scale of coronavirus-linked claims. We also added to BHP as disruption to Brazilian ore supply, coupled with resilient Chinese demand, is likely to see near term support for the iron ore price.

We see this phase as being very company-specific, as the market discovers which companies have been well placed and which have not – and to what degree the latter have been affected. There will be a high degree of differentiation between – and within – industries. This environment plays to our strengths.

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

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