PENDAL

Factsheet

Bond, Income & Defensive Strategies

June 2020

Pendal Dynamic Income Fund

ARSN: 622 750 734

About the Fund

The Pendal Dynamic Income Fund (**Fund**) is an actively managed portfolio of fixed income securities, Australian and global credit indices and emerging market sovereign issuers.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the RBA Cash Rate by 2-3% p.a. over the medium term. The suggested investment timeframe is three years or more.

Description of Fund

The Fund is designed for investors who seek income from a portfolio of fixed income securities across a range of market conditions and are prepared to accept some variability of returns.

The Fund is an actively managed portfolio that invests primarily in Australian issued investment grade corporate bonds[#]. The Fund may also invest in Australian and global credit indices and emerging market sovereign issuers to provide portfolio diversification and enhance returns when we believe market conditions are supportive. The Fund also has the ability to decrease its allocation to credit and invest in cash and interest rate duration strategies when we expect volatility to increase.

Pendal uses a combination of quantitative modelling and qualitative research to construct the Fund's portfolio.

The Fund's portfolio is constructed using the following three step approach:

1. Generate investment themes through quantitative models
2. Reaffirm investment themes with qualitative research
3. Asset Allocation

Investment Team

Pendal's Bond, Income & Defensive team comprises thirteen dedicated investment professionals with both global and domestic experience, invested across Income, Composite, Pure Alpha, Global and Australian Government strategies. The team also draws on a wide range of knowledge resources including Pendal's other specialist investment teams: Equity and Multi-Asset.

The Fund is managed by Vimal Gor, Head of Bond, Income & Defensive Strategies who has more than 24 years industry experience and 9 years at Pendal.

Other Information

Fund size (as at 30 Jun 2020)	$85 million
Date of inception	December 2017
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	BTA8657AU

[1] The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.85	0.90	0.02
3 months	2.68	2.82	0.06
6 months	-1.71	-1.44	0.22
1 year (pa)	-0.26	0.29	0.67
2 years (pa)	2.85	3.27	1.08
Since Inception (pa)	2.56	2.95	1.17

Asset Allocation (as at 30 June 2020)

Australian Credit	84.28%
Emerging Market Credit	15.26%
Cash	15.09%

Allocations may not add to 100% due to the use of derivatives to obtain credit exposure.

Top 10 Issuer Exposure

Macquarie Bank Limited	7.5%
National Australia Bank	4.3%
ConnectEast Finance Pty Ltd	4.2%
Pacific National Finance	4.0%
AusNet Services	3.9%
Brisbane Airport Corporation Ltd	3.6%
Wso Fin Westlink M7	3.4%
TORONTO-DOMINION BANK	3.4%
ANZ Banking Group Limited	3.0%
Ausgrid Finance Pty Ltd	2.9%

Key Fund Metrics

Average Australian Credit Rating	A

Portfolio Characteristics

Benchmark	RBA Cash rate
Liquidity	Daily

Management Costs[2]

Issuer fee[3]	0.55% p.a.

[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.

[#] Corporate bonds held within the Fund are required to be rated investment grade at the time of investment. Downgraded securities can continue to be held up to 15% of the Fund (in aggregate). Investment grade bonds refer to securities that are expected to have a high probability of payment of interest and repayment of principal.

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 security.
- **International investments risk** – The risk arising from political and economic uncertainties, interest rate movements and differences in regulatory supervision associated with international investments.
- **Interest rate duration 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.
- **Emerging markets risk** – The risk of asset price volatility and higher currency, default and liquidity risk from investments in emerging markets
- **Liquidity risk -** The risk that an asset may not be converted to cash in a timely manner.
- **Derivatives risk** – The risks arising from use of derivatives to manage exposures to investment markets.
- **Counterparty risk -** The risk of another party to a transaction failing to meet its obligations.

Please read the Fund's Product Disclosure Statement (**PDS**) for a detailed explanation of each of these risks.

Market review

Credit markets had another strong month in June. Supportive actions from central banks, a very strong US payrolls number, a slowdown in death rates related to Covid-19 and strength in commodity prices all drove the positive sentiment.

In a bullish dynamic for investment grade credit, during the month the US Federal Reserve announced it would start to buy individual US company bonds under its Secondary Market Corporate Credit Facility, specifically tracking a broad market index of bonds that have been issued by US companies that satisfy the facility's minimum investment grade rating as at the 22nd March this year and maximum 5 year remaining maturity. Notably, issuers of bonds acquired through this program don't need to provide self-certify that they were in compliance with restrictions outlined for the program, unlike the previous announcements where issuers had to opt in.

From a fundamental perspective, we saw a continuation of companies across the globe improve their credit quality by raising equity to support their balance sheets.

The Australian iTraxx index (Series 33 contract) traded in a wide 22bp range finishing the month 14bps tighter to +88bps. Physical credit spreads were also narrower, on average tightening 8bps for the month. The best performing sectors were telcos, resources and utilities narrowing 20, 18 & 16bps respectively, whilst the worst performing sector was supranationals that only tightened 5bps. Semi-government bonds performed well narrowing 6bps to commonwealth government bonds.

In emerging markets, sovereign bonds rallied over June due to a confluence of factors, including a more favourable prospects of a global growth recovery, highly accomodative fiscal and monetary policies from emerging market countries and a continued recovery in the oil price. EM Sovereign bonds have underperformed other fixed income asset classes since March lows and continue to play catch up with June seeing record inflows into EM assets.

Fund performance

The portfolio returned 0.90% (pre-fee), which was an outperformance of 0.88% versus the benchmark.

Driving the returns were solid positive returns for both EM and Australian Physical credit over June, there was also a small positive return from both the US and Australian rates positions. EM Sovereign bonds returns over 2.9% for the month enjoying their best two months weeks since the start of the Covid crisis as liquidity has started to find its way to higher yielding markets like EM.

The fund has benefited from its exposure to infrastructure given its strong comparative accrual. As information risk subsides and the market is more able to determine the future solvency of infrastructure issuers we expect the spreads in this sector to contract. Infrastructure bonds are increasingly buoyed by increased information provided to the market on their liquidity and operations whilst also gaining a bid from optimistic expectations on lock-downs dissipating.

Over the month, the Bloomberg Credit Index tightened 9bp on a spread-to-swap basis. Building on the contraction in May, the month of June saw both the Infrastructure and Utilities sectors spread rally in the mid-teens, outpacing the other sectors. These sectors represent nearly 33% of the portfolio and the exposure was increased in March and April as the market levels had widened to compelling levels. The performance in these sectors was supported by price discovery in the primary issues of Brisbane Airport and WSO Finance, the finance entity for Transurban's part owned Westlink M7 toll road.

As mentioned in the prior month the infrastructure sector has the largest amount of latent performance potential but has been a relative laggard due to uncertainties regarding the timing of a return to greater economic activity. In coming to the market to issue new bonds issuers such as Brisbane Airport have provided greater detail to the market to show they are well prepared to financially endure a slow return over the next few years. In addition, Westlink M7 disclosed that traffic levels on the 22nd of June were 97% of the prior periods levels, showing activity has been very quick to recover.

Outlook

We continue to have a constructive stance on credit markets given the 'whatever it takes' mantra by global Central Banks and governments, a more educated/experienced global community to better manage any potential second wave of Covid-19, and finally from a fundamental perspective, companies across the globe improving their credit quality by raising equity to support their balance sheets.

There are also some technical dynamics that will continue to support credit markets in Australia. These include the excess liquidity in the banking system and wider credit spreads against a 0.25% cash rate is attracting buyers.

In relation to the Corona virus, the world has a greater understanding of how to better manage virus outbreaks by more physical distancing, wearing of face masks and better medical treatments. This can be seen by the reduction of death rates globally. This has reduce the stress on the hospital system and build confidence in the ability to re-open economies.

However, we still have concerns around the uncertainty related to the flow on effect to the global economy and company earnings of Covid-19. We will continue to closely scrutinise developments and assess the potential ramifications as they occur. We are also focused on the US-China tensions on the follow on effect of global trade. Over the longer-term, policy measures should be supportive for risk assets which leaves us with a constructive stance on credit markets.

There has been continued stellar recovery in EM sovereign spreads over the past month, and the performance has been broad based. This is in contrast to April, when more idiosyncratic factors played out more between the haves and have-nots.

Despite the strength of the recovery, when we look at more medium term recovery growth prospects of EM versus developed markets, as indicated by consensus market growth forecasts over the next one to three years, emerging market sovereign spreads still look inexpensive. The market has also been re-risking back into EM assets, as the flow data over recent months clearly indicates.

Whilst EM spreads today look less of a slam-dunk than two months ago, the arguments for having a manageable EM allocation in portfolios have not changed. These include the diversification benefits that sovereign credit brings to most portfolios that are corporate risk-heavy. Also, bear in mind that very wide spreads only ever look attractive through the rear view mirror. What's more important going forward is that even at lower spreads than prior months, EM sovereigns as an asset class may present a higher Sharpe in future returns.

The stability brought to global credit spreads by the policies of major central banks act as a strong pillar of indirect support behind EM spreads as well. Moreover, whilst concerns about EM's management of the COVID-19 outbreak will continue to percolate, that EM's less advantageous position versus developed markets in this regard is now well understood and also reflected in relative pricing. To that end, not all developed economies have managed the crisis well, and not all emerging economies have done badly. On aggregate, the market's concern will likely drift towards funding and debt sustainability for EMs over the medium term, and away from the near-term headlines of localised outbreak resurgence.

The potential fly in the ointment will be driven by political and geopolitical concerns, such as US elections later this year, and the development of US-Sino relations. To the extent that either of these concerns result in another fillip for the US dollar, the outcome for EM assets as a whole will likely be adverse, even if temporary.