PENDAL

Factsheet

Equity Strategies

July 2020

Pendal Focus Australian Share Fund

ARSN: 113 232 812

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 Jul 2020)	$720 million
Date of inception	April 2005
Minimum investment	$25,000
Buy-sell spread[1] For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
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	-0.99	-0.93	0.60
3 months	5.35	5.47	7.77
FYTD	-0.99	-0.93	0.60
6 months	-13.66	-13.12	-14.20
1 year (pa)	-7.77	-6.84	-9.74
2 years (pa)	0.59	1.44	1.10
3 years (pa)	5.94	6.94	5.45
5 years (pa)	5.98	6.99	5.24

Sector Allocation (as at 31 July 2020)

Energy	5.0%
Materials	24.0%
Industrials	13.7%
Consumer Discretionary	5.5%
Consumer Staples	4.2%
Health Care	9.5%
Information Technology	4.6%
Telecommunication Services	8.2%
Financials ex Property Trusts	20.5%
Property Trusts	2.6%
Cash & other	2.3%

Top 10 Holdings (as at 31 July 2020)

BHP Billiton Limited	10.1%
CSL Limited	7.8%
Telstra Corporation Limited	5.8%
Commonwealth Bank of Australia Limited	5.7%
Westpac Banking Corporation	5.6%
Atlas Arteria	4.7%
Evolution Mining Limited	4.4%
Metcash Trading Limited	4.2%
Xero Limited	4.0%
ANZ Banking Group Limited	3.7%

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

Performance of the S&P/ASX 300 Accumulation index (+0.6%) was somewhat muted in July. Whilst Resources (+4.5%) continued to gain on the back of the elevated iron ore and gold prices; Industrials (-0.4%) offset these gains. The development of a viable vaccine remains the most important medium term issue for both the economy and markets.

Sector performance was divergent over the month. Materials (+5.9%), Information Technology (+4.8%) and Communication Services (+3.5%) recorded the largest gains; whereas Energy (-6.3%), Healthcare (-3.8%) and Industrials (-3.8%) finished the period in the red. The gold price continued to edge higher on the back of geopolitical uncertainty around China-US relations; as well as the emergence of negative real yield – the precious metal acts like a two-way hedge against any risk-off events or an unexpected spike in inflation. As such, gold miners (+10.7%) led the gainers within Materials. Similarly, iron ore miners, including BHP (+2.6%), Rio Tinto (RIO, +4.1%) and Fortescue Metals (FMG, +25.7%) also outperformed as demand for iron ore remains strong from China. In particular, FMG provided its quarterly update for 4QFY20, where both production shipment and costs beat market expectations. Management also provided guidance for FY21, with 175-180Mt shipments, and C1 costs of US$13-13.5/wmt. Capital expenditure is expected to come in at US$3.0 - US$3.4b, including investment in growth projects and energy infrastructure.

On the other side of the tally board, Qantas (QAN, -17.0%) detracted from sector performance for Industrials, as the shutdown in Victoria is set to push back any meaningful revenue recovery for the national airliner on the domestic travel front. In a similar vein, Sydney Airport (SYD) also dropped by -7.8%. Within Financials (-1.0%), AMP (-21.0%) was the worst performing stock, as management downgraded FY20 results in the pre-release. All three divisions recorded weaker earnings. For its Australian wealth management business, management expected an average AUM of A$126b, which was -6% lower compared to H2 FY19. Net cash outflows were estimated to be -A$4.4b, impacted by the government's early release of superannuation scheme of A$900m, as well as the loss of corporate super mandates of A$1.3b.

Elsewhere, there were some key updates from the insurance sector, with updates from both IAG (-11.8%) and QBE (+11.9%). IAG's was disappointing. While it has benefited even more than expected from a drop in motor insurance claims during the Covid period, this has been more than offset by greater provisioning against a weaker economic backdrop and higher costs than expected.

QBE provided more detail around the scale of Covid-19 claims for business interruption which, while large, where well short of the top of the range that management first indicated in April. A key difference between the two insurers is that QBE has been able to push through stronger pricing than IAG, despite the global insurance market being more fragmented than the domestic insurance sector. This divergence is probably at least partly driven by political considerations in Australia.

Fund performance

The Fund underperformed its benchmark over the month of July.

Contributors

Overweight Telstra (TLS, +7.0%)

The share price of Telstra gained in July as comments from key rival Optus suggested that they are unlikely to lift prices in the near-term, despite TLS's recent increase. We continue to see TLS as a turnaround story, benefiting from an improvement in cost control, capex discipline and a reduction in competitive intensity in the mobile sector due to consolidation, which can help support pricing.

Overweight Fortescue (FMG, +25.7%)

Fortescue provided its quarterly update for 4QFY20, where both production shipment and costs beat market expectations. Management also provided guidance for FY21, with 175-180Mt shipments, and C1 costs of US$13-13.5/wmt. Capital expenditure is expected to come in at US$3.0 - US$3.4b, including investment in growth projects and energy infrastructure.

Detractors

Overweight Qantas (QAN, -17.0%)

The share price of Qantas fell over the month, as the shutdown in Victoria is set to push back any meaningful revenue recovery for the national airliner on the domestic travel front. We retain conviction in QAN, despite large near term negative impact from travel restrictions. Management have moved quickly to cut costs and underpin liquidity and balance sheet strength. Whilst International travel likely to remain disrupted for an extended period. Domestic travel - a larger and more profitable part of its business - should start to normalise sooner, with Virgin's restructure offering QAN the opportunity for greater market share. Management are using this episode to rebuild the airline on a structurally lower cost base, underpinning very attractive medium term valuation.

Overweight Monadelphous Group Limited (MND, -17.65%)

Mining service contractor Monadelphous (MND) pulled back in July without any specific new news. However in the first week of August it was revealed that Rio Tinto lodged a $360m claim for rebuild facility & business interruption after fire at Cape Lambert, where MND was responsible for maintenance.

Strategy and outlook

July saw the swift spread of the second wave of Covid-19 infections in the US and an outbreak in Victoria which has led to a reinstated lockdown. This has derailed the view the more optimistic expectations for the economic outlook, as it seems that the virus - and the restrictions to curtail it - will have a social and economic impact for longer than some might have expected a few months ago.

Despite this, markets have managed to hold up reasonably well.

There have been two key reasons for this. The first is the nature of the second wave. In the US, case load numbers have more than doubled from the previous peak in April but hospitalisation rates only reached the same peak levels. This suggests under-reported levels of cases in April, but also the current skew towards cases among younger age cohorts.

Mortality rates, while still tragic, have been much better than in April – around half the previous peak. This is again down in part to the age skew – but also to the broader geographical spread, which has allowed hospitals to cope better, as well as a better understanding of how to treat the virus.

All three rates have declined in the last couple of weeks as the health situation shows signs of improvement. Looking forward, we expect to see a Swedish-style outcome in the US, where cases remain persistently high but as long as people are confident that it won't lead to a third major surge and acute cases are being managed better, then activity will start ramping up again, supporting markets.

This is different to Australia, where reinstatement of the lockdown in Victoria demonstrates that authorities are prepared to accept more near-term economic damage in order to achieve effective elimination. This should ultimately allow a larger part of the economy to return to normal.

The Victorian lockdown is likely to take several weeks to show effects, although at this point there is little reason to fear that it won't succeed based on prior experience. Small outbreaks in NSW bear watching – but at this point swift identification and contact tracing are helping the state "hold the line" in terms of overall cases.

The second key factor supporting the markets is the ongoing scale of policy response.

In Australia the Federal government extended support packages and emphasised the point that it intends to absorb as much of the economic impact of the virus as possible. This was echoed by comments from the RBA, which said that the social costs and degradation from recession and persistent unemployment are too high to allow the normal clearing mechanism of labour and capital markets. Instead, policy makers must do everything in their power to mitigate the effects of this crisis.

This shift in thinking away from a more free market approach may be driven by considerations around the social effects of income inequality and/or by a view that labour markets are too rigid to react in a timely fashion to a shock of this nature. Regardless, it suggests that policy makers will continue to shore up growth, which is helping support markets.

In the US, there is some risk around the negotiations of the next tranche of fiscal support. Resolution is expected, however a prolonged delay could start to hurt market sentiment.

One important aspect of policy support is that much of it is designed to support the economy until a vaccine is available which can help normalise economic activity. The development of a viable vaccine remains the most important medium term issue for both the economy and markets.

Recent trials remain encouraging, however the widespread delivery of an effective vaccine is still not expected until some time in 2021.

In light of all this, we believe that portfolio construction remains critical. The high degree of uncertainty – at an economic, industry and company level – means that it is important to have a portfolio which can perform across a range of outcomes. We maintain a portfolio with different kinds of exposures, rather than making a binary call on the pace of recovery.

We have recently been adding to the "Policy beneficiary" segment of the portfolio, primarily through the exposure to miners. The iron ore price remains well supported, helped by very strong demand from China and supply disruption from Brazil. More recently there have been signs that other commodity prices may have troughed and we may see improvements as demand picks up in other parts of the world.

We have also been adding to the gold exposure. This play several roles in the portfolio. It provides some protection against a risk-off scenario – either driven by economic or geopolitics. It should also be well supported by policy settings in the US, which are likely to see an extended period of low real rates as inflation expectations pick up. This is typically good for real assets such as gold. Some near term consolidation in gold is likely give the strong run, but we see it as well supported over the medium term.

Stock selection remains crucial. The upcoming reporting season will provide some concrete data around the impact this far of COvid-19, but the outlook remains highly uncertain. Management quality and strategy, as well as industry structure, are key differentiating factors in this environment. Differentiating at this level – and identifying the mispricing that occurs in environments of such high uncertainty – plays to the strengths of our research team.

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

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