

Pendal Ethical Share Fund

ARSN: 096 328 219

Factsheet

Equity Strategies

July 2020

About the Fund

The Pendal Ethical Share Fund (**Fund**) is an actively managed portfolio of Australian shares which seeks to ensure that funds are invested in an ethical and socially responsible manner. The investment process combines the potential to achieve strong performance over the long term while also investing in companies whose practices and impacts are aligned with an investor's own social, environmental and ethical preferences.

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.

Investment Approach

The Fund will not invest in companies which:

- produce alcohol or tobacco
- manufacture or provide gaming facilities
- directly mine uranium for the purpose of weapons manufacture
- manufacture weapons and armaments
- derive more than 10% of revenue from the manufacture or distribution of pornography.

In addition to the above ethical exclusions, the Fund also applies an exclusion screen based on companies who have been subject to environmental, workplace healthy and safety, anti-discrimination, equal opportunity, trade practices, or industrial relations prosecutions.

Investment Process

The Fund uses the same investment process as Pendal's flagship Australian equities products with the addition of ethical and social responsibility screens.

1. The negative screening process effectively determines the investment universe of the Pendal Ethical Share Fund
2. The Fund then applies a positive screen that seeks exposure to companies assessed as demonstrating and/or offering leading practices, products and services that provide a direct benefit to social or environmental outcomes (such as environmental management, energy efficiency, improved health & community well-being, business ethics and conduct or occupational health and safety).

Investment Team

Pendal's nineteen member Equity team is one of the largest in the industry. The portfolio manager for the Fund is Crispin Murray assisted by Rajinder Singh, who have a combined 46 year's 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%

Management Costs¹

Issuer fee ²	0.95% pa
-------------------------	----------



CERTIFIED BY RIAA

The Pendal Ethical Share Fund has been certified by RIAA according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsibleinvestment.org for details⁴.

Performance

(%)	Total Returns		Benchmark Return
	(post-fee)	(pre-fee)	
1 month	-0.24	-0.16	0.60
3 months	6.22	6.48	7.77
FYTD	-0.24	-0.16	0.60
6 months	-13.24	-12.83	-14.20
1 year (pa)	-8.26	-7.39	-9.74
2 years (pa)	-0.15	0.80	1.10
3 years (pa)	4.71	5.71	5.45
5 years (pa)	4.37	5.36	5.24

Sector Allocation (as at 31 July 2020)

Energy	5.3%
Materials	26.3%
Industrials	10.9%
Consumer Discretionary	1.7%
Consumer Staples	3.9%
Health Care	10.0%
Information Technology	3.3%
Telecommunication Services	7.3%
Financials ex Property Trusts	22.4%
Property Trusts	2.9%
Cash & other	6.0%

Top 10 Holdings (as at 31 July 2020)

BHP Billiton Limited	8.0%
CSL Limited	7.8%
Commonwealth Bank of Australia Limited	6.5%
ANZ Banking Group Limited	5.3%
Telstra Corporation Limited	5.1%
Atlas Arteria	3.6%
Metcash Trading Limited	3.4%
Xero Limited	3.3%
National Australia Bank Limited	3.3%
Amcort Limited	3.0%

Other Information

Fund size (as at 31 Jul 2020)	\$173 million
Date of inception	May 2001
Minimum investment	\$25,000
Buy-sell spread ³	
For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
Distribution frequency	Quarterly
APIR code	RFA0025AU

³ The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

¹ You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged. ² 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 Responsible Investment Certification Program does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Appropriate professional advice should be sought prior to making an investment decision. RIAA does not hold an Australian Financial Services Licence.

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

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, were 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

Not Held Westpac Banking Corporation (WBC, -4.79%)

The temporary exclusion of Westpac (WBC) on the basis of corporate governance failures has had a positive contribution to relative performance. The sector faces headwinds on several fronts, particularly around the potential for an increase in bad debts as a result of the Covid-19 situation, although we note that this is largely reflected in valuations.

Overweight Saracen Mineral Holdings Ltd (SAR, +10.70%)

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. This benefited the likes of Saracen Minerals. SAR remains well positioned given the opportunity to improve reserves and mine life in Kalgoorlie Super Pit, which it recently acquired in joint venture with Northern Star (NST).

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 Insurance Group Australia (IAG, -11.8%)

IAG outlined its FY20 results, which were somewhat 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. The insurance sector has seen increased provisioning for claims relating to the Covid-19 episode and resulting effects, although there have also been offsetting factors such as a fall in motor claims. The domestic industry structure for IAG is supportive, although its ability to increase prices to offset near term headwinds is one area to watch in our views.

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 plays 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 given 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

PENDAL

This factsheet has been prepared by Pental Fund Services Limited (PFSL) ABN 13 161 249 332, AFSL No 431426 and the information contained within is current as at the date of this factsheet. It is not to be published, or otherwise made available to any person other than the party to whom it is provided.

PFSL is the responsible entity and issuer of units in the Pental Ethical Share Fund (Fund) ARSN: 096 328 219. A product disclosure statement (PDS) is available for the Fund and can be obtained by calling 1800 813 886 or visiting www.pentalgroup.com. You should obtain and consider the PDS before deciding whether to acquire, continue to hold or dispose of units in the Fund. An investment in the Fund is subject to investment risk, including possible delays in repayment of withdrawal proceeds and loss of income and principal invested.

This factsheet is for general information purposes only, should not be considered as a comprehensive statement on any matter and should not be relied upon as such. It has been prepared without taking into account any recipient's personal objectives, financial situation or needs. Because of this, recipients should, before acting on this information, consider its appropriateness having regard to their individual objectives, financial situation and needs. This information is not to be regarded as a securities recommendation.

The information in this factsheet may contain material provided by third parties, is given in good faith and has been derived from sources believed to be accurate as at its issue date. While such material is published with necessary permission, and while all reasonable care has been taken to ensure that the information in this factsheet is complete and correct, to the maximum extent permitted by law neither PFSL nor any company in the Pental group accepts any responsibility or liability for the accuracy or completeness of this information.

Performance figures are calculated in accordance with the Financial Services Council (FSC) standards. Where performance returns are quoted "Post fees" then this assumes reinvestment of distributions and is calculated using exit prices which take into account management costs but not tax you may pay as an investor. Where performance returns are quoted "Pre fees and tax", they exclude the effects of management costs and any taxes. Past performance is not a reliable indicator of future performance.

If market movements, cash flows or changes in the nature of an investment (e.g. a change in credit rating) cause the Fund to exceed any of the investment ranges or limits specified, this will be rectified by PFSL as soon as reasonably practicable after becoming aware of it. If PFSL does so, it will have no other obligations in relation to these circumstances. The procedures, investment ranges, benchmarks and limits specified are accurate as at the date of this factsheet and PFSL reserves the right to vary these from time to time.