Pendal MidCap Fund

ARSN: 130 466 581

Factsheet

Equity Strategies

July 2020

About the Fund

The Pendal MidCap Fund (**Fund**) is an actively managed portfolio of Australian mid cap shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Pendal MidCap Custom 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 portfolio of primarily 40-60 Australian mid cap shares and are prepared to accept higher variability of returns. Pendal defines the mid cap universe to include companies ranked between 51 and 150 of the S&P/ASX 200 Index. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange, 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).

The Fund may have assets denominated in foreign currencies. This means that changes in the value of the Australian dollar relative to foreign currencies may affect the value of the assets of the Fund. The Fund's foreign currency exposure may be hedged from time to time, in whole or part.

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.

Investment Team

Pendal's Equity team is headed up by Crispin Murray who has extensive experience and a strong record in equities research. Andrew Waddington is the portfolio manager for the Fund.

A combination of the Australian equities large cap and small cap teams' research is used to construct the Pendal MidCap Fund.

Investment Guidelines

Investable universe	ASX and NZX listed and soon to be listed companies, generally with a market capitalisation of A$0.5 billion to A$5 billion; derivatives; cash
Investment ranges	Australian shares 80 - 100% New Zealand shares 0 - 10% Cash 0 - 20%
Ex-ante tracking error	3 – 8%
Number of stocks	Typically 40 – 60
Absolute stock position	15%
Maximum active stock position	+/- 5%[1]
Maximum active sector position relative to index	+/- 10%[1]

[1] compared to benchmark.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.62	0.70	1.74
3 months	8.09	8.20	13.21
6 months	-5.89	-5.44	-7.73
1 year (pa)	-1.73	-0.82	-3.49
3 years (pa)	7.35	8.60	7.45
5 years (pa)	9.12	10.26	9.47
7 years (pa)	11.54	12.93	10.76
10 years (pa)	10.54	12.16	8.55
Since Inception (pa)	9.23	11.24	5.50

Sector Allocation (as at 31 July 2020)

Energy	1.5%
Materials	19.2%
Industrials	18.7%
Consumer Discretionary	9.4%
Consumer Staples	7.4%
Health Care	8.1%
Information Technology	8.3%
Telecommunication Services	6.3%
Utilities	0.0%
Financials ex Property Trusts	2.5%
Property Trusts	5.9%
Cash & other	12.7%

Top 10 Holdings (as at 31 July 2020)

Xero Limited	6.4%
Atlas Arteria	5.3%
Resmed Inc	5.1%
Metcash Trading Limited	5.0%
Seven Group Holdings Ltd	4.6%
Nine Entertainment Co Ltd	4.4%
JB Hi-Fi Limited	4.2%
Northern Star Resources	3.5%
Saracen Mineral Holdings Ltd	3.2%
Healius Limited	3.0%

Other Information

Fund size (as at 31 Jul 2020)	$441 million
Date of inception	June 2008
Minimum investment	$25,000
Buy-sell spread[2] For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
Distribution frequency	Quarterly
APIR code	BTA0313AU

[2] 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[3]

Issuer fee[4]	0.90% p.a.
Performance fee[5]	20% x the Fund's performance (before fees) in excess of the performance hurdle

[3] You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

[4] 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.

[5] The Fund's performance fee is 20% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (Pendal MidCap Custom Index) plus the issuer fee of 0.90% 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.

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. The S&P/ASX 51-150 Accumulation Index recorded better performance (+1.7%), with the help of mid-cap gold miners.

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, including Northern Star Resources (NST, +15.7%) and Saracen Minerals (SAR, +10.7%) outperformed strongly.

Turning to sector performance, Materials (+5.3%), Information Technology (+5.3%) and Utilities (+5.5%) were the best performing sectors over the month; whereas Financials (-3.1%), Energy (-5.6%) and Consumer Staples (-2.6%) finished the month in the red. Within Materials, some of the aforementioned gains by the gold miners were offset by Bluescope (BSL, -4.3%), Boral (BLD, -5.3%) as well as Alumina (AWC, -6.5%). Bluescope provided a market update, and management now expects earnings before interest and tax (EBIT) for FY2020 to be around $560 million, with an expected contribution in the June half of around $260 million. Steel spreads in North America and Asia remain lower for 1H21 than the previous half which dragged on investor sentiment. Similarly, AWC provided commentary on Alcoa's second quarter report, where combined bauxite and alumina division EBITDA came in at US$219m.

Elsewhere, some other companies that provided trading updates in July include AMP (-21.0%) and ALS (ALQ, +29.4%). AMP was the largest sector performance detractor from Financials over the month, following management's downgrade of 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. In contrast, mining services contractor ALS provided a well-received Q1 update. Whilst no guidance was provided for 1H21 due to Covid-19 uncertainty, total revenue performance improved by the end of the quarter as economies reopened and client activity increased. Group underlying EBIT margin also maintained for Q1 FY21 vs. Q1 FY20.

Fund performance

The Fund underperformed the benchmark over the month of July.

Contributors

Does not hold AMP Limited

The share price of AMP plunged in July, following management's downgrade of 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.

Overweight ALS Limited

Mining services contractor ALS provided a well-received Q1 update. Whilst no guidance was provided for 1H21 due to Covid-19 uncertainty, total revenue performance improved by the end of the quarter as economies reopened and client activity increased. Group underlying EBIT margin also maintained for Q1 FY21 vs. Q1 FY20.

Detractors

Overweight Monadelphous Group Limited

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.

Does not hold Afterpay Limited

Buy-now-pay-later (BNPL) leader Afterpay continued to gain attraction in July. Management provided a trading update, and some of the key highlights include: FY20 EBITDA (excluding significant items) is now expected to be between A$20-25M; Merchant revenue margins for FY20 are expected to be in line with or better than H1 FY20 and FY19; and Net Transaction Margin (NTM) for FY20 is expected to be approximately 2%.

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, with the midcap market (S&P/ASX 51-150) gaining 1.74% in July.

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.

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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