

Pendal Ethical Share Fund

ARSN: 096 328 219

Factsheet

Equity Strategies

August 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
	(post-fee)	(pre-fee)	Return
1 month	3.42	3.51	3.05
3 months	4.49	4.75	6.19
FYTD	3.18	3.34	3.67
6 months	-2.66	-2.19	-4.14
1 year (pa)	-2.61	-1.68	-4.82
2 years (pa)	1.10	2.07	1.92
3 years (pa)	5.63	6.64	6.24
5 years (pa)	6.98	8.00	7.58

Sector Allocation (as at 31 August 2020)

Energy	5.5%
Materials	25.3%
Industrials	10.9%
Consumer Discretionary	1.7%
Consumer Staples	4.0%
Health Care	10.3%
Information Technology	3.8%
Telecommunication Services	6.8%
Financials ex Property Trusts	21.5%
Property Trusts	3.0%
Cash & other	7.2%

Top 10 Holdings (as at 31 August 2020)

BHP Billiton Limited	9.2%
CSL Limited	7.9%
Commonwealth Bank of Australia Limited	6.0%
ANZ Banking Group Limited	5.1%
Telstra Corporation Limited	3.9%
Xero Limited	3.8%
Metcash Trading Limited	3.5%
Atlas Arteria	3.4%
Qantas Airways Limited	3.4%
National Australia Bank Limited	3.2%

Other Information

Fund size (as at 31 Aug 2020)	\$182 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

The Australian equities market performed strongly during reporting season, with the S&P/ASX 300 Accumulation index adding +3.0%. Whilst Industrials (+3.6%) outperformed, Resources (+0.9%) were the laggard as gold miners (-8.3%) retreated from the recent highs.

The Victorian lockdown continues to drag on the national economic pulse. The state's decision to pursue an effective elimination strategy is material – it means stricter restrictions for longer, with a greater impact on activity, the economy and budget deficits - Australia is a negative outlier in terms of global trends in industrial survey improvement as a result. This remains a headwind for the domestic equity market and specific companies within it.

In terms of sector performance, Consumer Discretionary (+9.7%), Information Technology (+15.2%), Real Estate (+7.6%) and Health Care (+4.0%) were the largest contributors to the headline index; whereas IT was also the best performing sector by absolute return. In contrast, Communication Services (-3.8%), Utilities (-4.8%) and Consumer Staples (-0.3%) finished the month in the red. Index heavyweights Materials (+1.2%) and Financials (+1.3%) also underperformed the index in August.

Turning to reporting season results, some of the well-received ones include:

- CSL (+5.9%). Provided FY21 guidance of 0-5% earnings growth. The "0%" scenario is one where the current run rate of plasma collection persists – which has been the market's key concern. Management did enough to allay market concerns about the potential downside of this issue.

- Afterpay (APT, +33.4%). Result itself was mixed; gross margin was good but there were some signs of momentum slowing in US - this could be a significant issue in next 3 months. However the stock continued its relentless re-rating, most recently driven by the acquisition of small European and Asian businesses which are being factored into a material uplift in "total addressable market (TAM)".

- Goodman Group (GMG, +8.2%). The stronger than expected order book of new developments demonstrates the current bifurcation in the REITs sector. While malls face challenges from foot traffic, soaring online sales is a stiff tailwind for GMG.

- Qantas (QAN, +22.0%). There was no much new information in the result, but it did provide some more detail about the rate of cash burn. A material proportion relates to shift in working capital – which should reverse as conditions normalise - while restructuring charges should also yield medium term benefits. The rate of cash burn from the operational business – particularly in the dormant international division – was better than the market expected.

On the other side of the tally board:

- AGL Energy (AGL, -7.9%). Management downgraded earnings based on weaker forward pricing trends for electricity. This is likely to be an ongoing issue.

- Telstra (TLS, -7.7%). Hit its FY20 numbers, but gave a disappointing outlook. There are two issues; first, the losses associated with the rump of its fixed line business, which the market expected to hit in FY22, are now likely to come through earlier, leading to a downgrade in FY21. Second, and more importantly, management have cut the return on capital target for FY23 from 10% to 7%. While consensus had not factored in a 10% return, this shift is seen as a signal that the environment is going to be tougher than management has previously indicated.

- Seek (SEK, -8.6%). Outlined a potential scenario for FY21 in which, if the environment remains as it is now, it will barely make a profit. This demonstrates the challenge for some of the recovery stocks where, having run hard from the rebound, it may transpire that they have run ahead of themselves.

Fund performance

The Fund outperformed its benchmark over the month of August.

Contributors

Overweight Qantas (QAN, +22.0%)

There was no much new information in the Qantas result, but it did provide some more detail about the rate of cash burn. A material proportion relates to shift in working capital – which should reverse as conditions normalise - while restructuring charges should also yield medium term benefits. The rate of cash burn from the operational business – particularly in the dormant international division – was better than the market expected.

Overweight Nine Entertainment (NEC, +22.5%)

The market's initial reaction to NEC's results was negative given a worse than expected update for TV ad numbers in July. However, signs of improvement are coming through, while the result delivered good cash flow. Potential structural improvements in revenue – from Stan subscriptions and social media payments – coupled with cost out, place NEC in a good spot when the cycle improves.

Detractors

Overweight Telstra Corporation Limited (TLS, -11.4%)

Telstra hit its FY20 numbers, but gave a disappointing outlook. There are two issues; first, the losses associated with the rump of its fixed line business, which the market expected to hit in FY22, are now likely to come through earlier, leading to a downgrade in FY21. Second, and more importantly, management have cut the return on capital target for FY23 from 10% to 7%. While consensus had not factored in a 10% return, this shift is seen as a signal that the environment is going to be tougher than management has previously indicated. We think the dividend is unlikely to be cut – and the degree of yield in the current environment should see the stock remain supported. However it also may mean that the implied upside case is now smaller.

Overweight Saracen Mineral (SAR, -13.0%)

Saracen Mineral, amongst other gold stocks consolidated over August after a strong period; despite the strong price of the precious metal. Most of the gold miners are flagging higher capex than the market expected and, while this is backed by strong cash flow, this is prompting some concerns of risks of capital wastage. Nevertheless, the sector should continue to do well while the gold price remains supported.

Strategy and outlook

The net result of earnings season is that earnings were down -38% for the second half of FY20 and -16% for the full year. Dividends fell 30% as companies took a prudent stance on capital management.

This was a worse result than the GFC, where earnings fell -20% in the second half of FY09. Nevertheless, the market continued to rally through August as investors proved willing to look through the near term impact of Covid-19. Instead, the focus was on how management are going about adapting to the new environment.

We saw strong performance from companies which have benefited from stimulus and which met already high expectations – such as JB Hi-Fi, James Hardie and Afterpay. However there was also some relief rallies in stocks which have been hit heavily, but where there is a sense that the worst may be over, including Nine Entertainment, Qantas, the REITs and Coca Cola Amatil.

Stocks which had been held for defensive qualities – but which did not live up to this billing were sold off. Examples included Telstra, APA Group and Transurban. Companies which are facing structural challenges such as low rates (eg Bendigo Bank,

Challenger) or lower power prices (eg AGL Energy) also underperformed.

Few sectors saw material earnings upgrades. Miners saw the largest ones, but had already done well and tended to lag in August. The largest downgrades were in telcos – which underperformed – but other sectors such as media, gaming and materials saw downgrades, but still outperformed.

Essentially, there are two widely divergent views on the broader equity market from this point. The bear case is that equity markets are overvalued and due for a prolonged correction driven by a combination of excess government debt, the ultimately deflationary effects of quantitative easing and the economic damage of risk aversion, bankruptcies and structural employment.

The bull case, in contrast, is that we are at the start of a cyclical recovery where sustained expansionary policies and significant surplus capacity, combined with a wave of pent up demand – potentially super charged by the advent of a vaccine – and a lengthy period of low rates continue to boost the equity market. In this vein, it is also important to note that the Australian equity market has lagged global indices – partly driven by a smaller exposure to technology stocks – and has reached nowhere near the same degree of relative valuations.

Uncertainty remains high. As well as questions over the pace of recovery, we must also contend with the run up to the US Presidential election and heightened tensions with China.

We note that the key factors in supporting equity markets – abundant liquidity, low interest rates, and a better than expected pace of economic recovery, remain in place. However, it is not the time to make a heroic call on the outcome. Our approach is to focus on stocks and invest where we can find limited relative downside risk, at the same time as building a balanced portfolio which has some protection against a material deterioration in conditions.

Reporting season highlighted the sometimes extreme divergence we are seeing between industries and between companies driven by a combination of cyclical and structural shifts behaviour and demand. This is proving to be constructive environment for active management.

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.