PENDAL

Factsheet

Equity Strategies

September 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 30 Sep 2020)	$774 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	-2.90	-2.83	-3.59
3 months	0.20	0.40	-0.06
FYTD	0.20	0.40	-0.06
6 months	17.20	17.60	16.73
1 year (pa)	-5.96	-5.00	-9.96
2 years (pa)	1.29	2.18	0.67
3 years (pa)	6.03	7.01	4.94
5 years (pa)	8.56	9.60	7.42

Sector Allocation (as at 30 September 2020)

Energy	4.9%
Materials	23.8%
Industrials	12.8%
Consumer Discretionary	6.1%
Consumer Staples	5.2%
Health Care	10.9%
Information Technology	4.6%
Telecommunication Services	7.7%
Financials ex Property Trusts	19.6%
Property Trusts	2.6%
Cash & other	1.8%

Top 10 Holdings (as at 30 September 2020)

BHP Billiton Limited	9.7%
CSL Limited	9.7%
Westpac Banking Corporation	5.3%
Commonwealth Bank of Australia Ltd	4.9%
Qantas Airways Limited	4.3%
Telstra Corporation Limited	4.3%
Metcash Trading Limited	4.2%
Xero Limited	4.1%
James Hardie Industries Plc	4.0%
Atlas Arteria	3.9%

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

The Australian equities market lost momentum during the last month of the quarter. The S&P/ASX 300 Accumulation index dropped by -3.6% in September; making its performance over the quarter flat (-0.1%). Resources (-5.2%) underperformed Industrials (-3.2%) as miners and energy companies retreated.

While the Covid situation in Australia continues to improve, deteriorating case numbers and softer macro data overseas weighed on the local market. The US equity market also reflected growing concerns on a number of fronts; including the lost momentum in further stimulus, and uncertainties around the upcoming US election.

In terms of sector performance, all 11 GICS sectors finished the month in the red, with the exception of Healthcare (+0.8%). CSL (+0.9%) managed to hold its ground this monthly after retreating from the recent highs previously during reporting season; and it was the largest contributor to the sector. Some of the other sectors that recorded losses but outperformed the headline index included Industrials (-0.3%), Real Estate (-1.3%), Communication Services (-2.1%), and Consumer Discretionary (-2.4%). In contrast, Energy (-10.7%) continued to underperform after the oil price further slid over the month, as markets tempered expectations of the rebound in demand. The impact of aircraft fuel is playing a role in this, however diesel demand has also been weaker than many would have expected by this point. Elsewhere, Consumer Staples (-6.6%), Information Technology (-6.4%) and Financials (-6.1%) also pulled back in September.

Turning to stock specifics, QBE Insurance (QBE, -18.9%) recorded a double-digit loss after its surprising announcement that its CEO was stepping down following a conduct issue. Whilst the Chair, who is an experienced insurance executive is taking the reins for the moment, investors sold on near-term uncertainties.

Also updating the market, there was a downgrade from management at A2 Milk (A2M), which fell -17.4%. The key issue is an inventory overhang in key channels, which is dragging on sales in Q1 FY21 and expected to continue into Q2. Earnings expectations were downgraded 15%, however management are pointing to near term factors such as the Victorian shut down and expect a rebound in the second half.

Last but not least, market darling Afterpay (APT, -12.5%) pulled back from its all-time highs. The fall in growth stocks was exacerbated by the news that PayPal is releasing a buy now pay later (BNPL) option as part of its existing service to customers. This implies a much lower margin for the PayPal product than APT's and emphasises the view that margins in the BNPL sector are unsustainably high at the moment. The question now is whether this impacts on APT's demand or whether there is a degree of brand awareness or loyalty to offset the competition.

On the other side of the ledger, Boral (BLD, +13.7%), James Haride (JHX, +7.5%), Aristocrat (ALL, +5.6%) and Transurban (TCL, +4.8%) were some of the best performing stocks inside ASX 100. For BLD and JHX, the ongoing strength in US housing continues to support their earnings expectation and share price momentum. Management changes at BLD's Board, where four new directors added also been well received by investors.

Fund performance

The Fund outperformed its benchmark over the month of September.

Contributors

Overweight James Hardie Industries (JHX, +7.5%)

Lower input costs and improvements in the US housing market have been providing cyclical tailwinds for the sector, which saw the likes of James Hardie (JHX, +7.5%) continue to outperform. In addition, investor sentiment has also been supported by the expectation that any housing-related stimulus in response to current economic conditions will also directly benefit the sector.

Overweight Nine Entertainment (NEC, +6.4%)

Domestic cyclicals, including Nine Entertainment (NEC, +6.4%) outperformed in September, driven by an expectation of further stimulus from the upcoming Federal budget, as well as optimism over easing border restrictions. NEC has returned to profitability under new management with strong cost control and better programming which has been taking share from rival networks. Covid-19 has had an impact on advertising, however NEC's merger with Fairfax has resulted in a more diversified business better set to weather the downturn.

Detractors

Overweight Santos (STO, -13.9%)

Oil continued to weaken during September as markets tempered expectations of the rebound in demand. The impact of aircraft fuel is playing a role in this, however diesel demand has also been weaker than many would have expected by this point. This has impacted on investor sentiment for the oil companies, including Santos (STO, -13.9%).

Overweight QBE Insurance Group (QBE, -18.9%)

QBE Insurance (QBE, -18.9%) surprisingly announced that its CEO was stepping down following a conduct issue. This may mean some near term uncertainty, but the company is well placed on a medium term view. It is in better shape than it has been for a while operationally, and is enjoying some cyclical tailwinds. The Chair is taking the reins for the moment and is an experienced insurance executive.

Strategy and outlook

The Australian Federal budget was stimulatory, as expected. On balance, the size of the total package was probably a touch larger than consensus was looking for. The scale of measures, which will drive the budget deficit close to 12%, demonstrates the willingness of policy makers to underpin the economy.

This is a material shift in mindset away from the fiscal prudence and balanced budgets that Western governments have generally adopted over the last three to four decades. It is an important factor at play in the determining the ultimate economic impact of Covid 19 and the speed of the recovery.

Both government and central bank rhetoric – in Australia and in many countries overseas – is emphasizing the determination to limit the structural economic and social damage from the virus and shutdowns. The outcome is likely to be loose monetary policy for some time – alongside large scale stimulus from the government.

At this point the constraint on fiscal stimulus is either rampant inflation of loss of confidence in government credit. Neither issue is in play at the moment. Over time, we think there is a chance of a period of negative real interest rates, as inflation expectations rise while nominal rates are kept low. This is one factor in the portfolio's exposure to gold miners – as real assets such as gold, commodities and property tend to do well in period of negative real rates.

We remain mindful of the resurgence of Covid cases in the US and, more recently, in Europe. The second wave in the US has thus far not stalled the economic recovery and the hospitalization and mortality rates remain far below the levels of the first wave. Likewise, in Europe, there has not been any material impact on economic activity so far.

In the US, the rate of the rebound is slowing as household income falls. However at this point it seems that accrued savings from the previous months – when the savings rate spiked – is helping offset the effect of previous support rolling off.

The impasse over the next stimulus package remains and it appears increasingly unlikely that an agreement will be reached prior to the Presidential election, with Senate Republicans focused instead on nomination of a new Supreme Court Justice. At this point the notion of a Democrat sweep of the White House and Senate – supported by current bookmaker odds – and therefore a larger package post-election is doing enough to calm market fears on this front.

We maintain the portfolio's balanced construction. While policy support is rendering the possibility of a double dip recession less likely, there is still the risk of a market downturn and hence we retain the portfolio's protection in the form of companies with defensive earnings and the exposure to gold. At the same time, there is a sense that perhaps the worst has passed for some domestic cyclicals – we have seen the portfolio's positions in Qantas and Nine Entertainment start performing over the last two months. There are still stocks that are trading well below pre-Covid highs and are in decent shape and aligned with the recovery. We have been adding here selectively in recent weeks.

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

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