PENDAL

Factsheet

Equity Strategies

September 2020

Pendal Ethical Share Fund

ARSN: 096 328 219

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 Costs[1]

Issuer fee[2]	0.95% pa

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	-3.17	-3.10	-3.59
3 months	-0.10	0.14	-0.06
FYTD	-0.10	0.14	-0.06
6 months	16.03	16.58	16.73
1 year (pa)	-7.55	-6.66	-9.96
2 years (pa)	-0.15	0.81	0.67
3 years (pa)	4.41	5.40	4.94
5 years (pa)	6.73	7.75	7.42

Sector Allocation (as at 30 September 2020)

Energy	5.1%
Materials	25.1%
Industrials	10.9%
Consumer Discretionary	1.6%
Consumer Staples	3.9%
Health Care	11.9%
Information Technology	3.9%
Telecommunication Services	7.0%
Financials ex Property Trusts	21.0%
Property Trusts	3.1%
Cash & other	6.5%

Top 10 Holdings (as at 30 September 2020)

CSL Limited	9.5%
BHP Billiton Limited	8.9%
Commonwealth Bank of Australia Ltd	5.7%
ANZ Banking Group Limited	4.9%
Xero Limited	3.9%
Telstra Corporation Limited	3.8%
Qantas Airways Limited	3.5%
Metcash Trading Limited	3.4%
National Australia Bank Limited	3.2%
Atlas Arteria	3.2%

Other Information

Fund size (as at 30 Sep 2020)	$176 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.

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 details[4].

[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 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 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.

Overweight Qantas (QAN, +2.8%)

The travel stocks did well on the expectation of easing border restrictions. Qantas (QAN) gained +2.8% and is now trading ~18% above the price at which it raised equity capital. Whilst international travel likely to remain disrupted for an extended period, domestic travel - a larger and more profitable part of its business – could start to normalise sooner, with Virgin's restructure offering QAN the opportunity for greater market share.

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.