PENDAL

Pendal Monthly Commentary

Pendal Australian Shares Portfolio

October 2020

Market commentary

The S&P/ASX 300 rebounded from the previous month's weakness to post a 1.9% gain in October.

Returns would have been far greater, but for a sharp fall as polls narrowed in the US Presidential election and Covid cases jumped in the US and Europe.

Optimism at the relaxation of domestic restrictions, particularly in Victoria, helped support the local market.

The federal government delivered a stimulatory budget which emphasised the degree to which policy makers are determined to cushion the economic impact of Covid and support a recovery. This remains an important supporting factor for markets.

Technology (+8.96%) was the best-performing sector as growth stocks continued to surge domestically despite an uptick in US bond yields.

There was also life in Financials (+6.27%), which have been a laggard over the last year. The prospect of easing regulation around responsible lending laws – as well as bad and doubtful debts tracking towards the more benign end of expectations – helped support the banks. More broadly, the sector responded well to rising US bond yields.

Industrials (-3.48%) underperformed, dragged down by infrastructure stocks Transurban (TCL, -4.6%) and Sydney Airport (SYD, -7.0%) as US bond yields rose. A surge in international Covid cases suggested international travel is likely to take longer to normalise than other recovery trades, which weighed on transport-linked stocks.

The low cost of capital – and in some sectors low valuations – is driving some interest in mergers and acquisitions.

Coca Cola Amatil (CCL, +30.8%) provided a high profile example in October as it came under offer from Coca-Cola European Partners. We expect takeover speculation to remain a factor in near-term markets, providing an additional degree of support.

Portfolio overview

Australian Shares Portfolio	
Investment strategy	The strategy employs a bottom up, fundamental approach to build a diversified portfolio of Australian shares where the majority of active risk and outperformance is driven by stock selection.
Investment objective	The objective of the Model Portfolio is to outperform the S&P/ASX 300 (TR) Index on a rolling 3 year period by 3% per annum.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15-35 (34 as at 31 October 2020)
Sector limits	A-REITS 0-30% Cash 2-10%
Dividend Yield	3.59%#
Income target	No target

Top 10 holdings

Code	Name	Weight
CSL	CSL Limited	9.48%
BHP	BHP Billiton Limited	8.60%
CBA	Commonwealth Bank of Australia Ltd	5.37%
WBC	Westpac Banking Corporation	5.05%
XRO	Xero Limited	4.44%
TLS	Telstra Corporation Limited	4.19%
ANZ	ANZ Banking Group Limited	4.17%
EVN	Evolution Mining Limited	3.88%
JHX	James Hardie Industries Plc	3.77%
NEC	Nine Entertainment Co Ltd	3.31%

Source: Pendal as at 31 October 2020

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
XRO	Xero Limited	3.69%
EVN	Evolution Mining Limited	3.32%
NEC	Nine Entertainment Co Ltd	3.13%
MTS	Metcash Trading Limited	3.01%
JHX	James Hardie Industries Plc	2.87%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WES	Wesfarmers Limited (not held)	-3.05%
WOW	Woolworths Group Limited (not held)	-2.82%
NAB	National Australia Bank Limited	-2.44%
RIO	Rio Tinto Limited (not held)	-2.01%
GMG AE	Goodman Group (not held)	-1.79%

Source: Pendal as at 31 October 2020

#The Portfolio's dividend yield represents the weighted average 12-month forward-looking dividend yield of the portfolio holdings (excluding cash), as at the date of the Factsheet. Each individual security's dividend yield is calculated using market consensus Dividend Per Share (DPS) before tax and franking credits, collated by Pendal and divided by the closing market price of the security as at the date of the Factsheet. The portfolio dividend yield therefore is only an estimate, and does not reflect the actual returns of the Fund, which will be affected by market movements in the price of individual securities, the returns on other assets such as cash holdings and variances of individual security's actual dividends from the forecasted DPS.

Performance

	1 month	3 month	6 month	1 year	3 year	5 year	Since inception*
Pendal Australian Shares Portfolio	2.18%	3.04%	9.07%	-4.96%	4.48%	7.78%	7.25%
S&P/ASX 300 (TR) Index	1.89%	1.22%	9.09%	-7.91%	4.22%	6.88%	5.64%
Active return	**0.29%**	**1.82%**	**-0.02%**	**2.95%**	**0.26%**	**0.89%**	**1.62%**

Source: Pendal as at 31 October 2020

*Since Inception - 15 June 2015

Performance returns are pre-fee. Investors should contact their platform provider for applicable fee rates.

Past performance is not a reliable indicator of future performance

Top 5 contributors - monthly

Code	Name	Value Added
NEC	Nine Entertainment Co Ltd	0.49%
CCL	Coca-Cola Amatil Limited	0.38%
XRO	Xero Limited	0.26%
MTS	Metcash Trading Limited	0.14%
NCM	*Newcrest Mining Limited (not held)*	*0.13%*

Top 5 detractors - monthly

Code	Name	Value Added
ALX	Atlas Arteria	-0.25%
APT	*Afterpay Limited (not held)*	*-0.21%*
BHP	BHP Billiton Limited	-0.21%
EVN	Evolution Mining Limited	-0.20%
TLS	Telstra Corporation Limited	-0.13%

Top 5 contributors - 1 year

Code	Name	Value Added
XRO	Xero Limited	1.36%
EVN	Evolution Mining Limited	1.26%
JHX	James Hardie Industries Plc	0.87%
MTS	Metcash Trading Limited	0.70%
NEC	Nine Entertainment Co Ltd	0.66%

Top 5 detractors - 1 year

Code	Name	Value Added
STO	Santos Limited	-1.26%
QAN	Qantas Airways Limited	-1.12%
APT	*Afterpay Limited (not held)*	*-0.85%*
WES	*Wesfarmers Limited (not held)*	*-0.69%*
ALX	Atlas Arteria	-0.61%

Source: Pendal as at 31 October 2020

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight Nine Entertainment (NEC, +19.2%)

NEC continued its rebound as the market gained more confidence in the domestic recovery story and a return of advertising demand. The broadcaster and publisher has moved swiftly to reduce its cost base, helping offset this effect. Parts of its digital business such as streamer Stan have seen improving trends through Covid. The net effect is that NEC's outlook is much better than many feared.

Overweight Coca Cola Amatil (CCL, +30.8%)

CCL came under takeover offer from Coca Cola European partners, emphasising an emerging trend of M&A on the combination of low cost of capital and depressed valuations in some parts of the market. Our thesis has been built around an earnings recovery underpinned by domestic reopening and cost reductions. Our valuation landed close to the bid price, implying a relatively light takeover premium in this offer, in our view.

Overweight Xero (XRO, +9.33%)

Tech growth stocks such as XRO shrugged off higher bond yields and delivered another month of gains. We are wary of valuations among some of these stocks. However, we see fundamental support for XRO, particularly with federal Budget measures to accelerate investment and stop small businesses from going under.

Three largest detractors

Overweight Atlas Arteria (ALX, -7.1%)

A rise in long-term bond yields – from 0.68% to 0.85% for the US 10 years – dragged on the infrastructure names, including toll road operator Atlas Arteria (ALX, -7.1%). The market remains cautious over the acceleration of Covid cases and newly declared lock-down in France.

Underweight Afterpay (APT, +20.9%)

Afterpay (APT) is up more than 235% for the year. It has benefited from several near-term Covid-related tailwinds such as a shift to online shopping. However we see these receding. We think valuations do not reflect structural risks around margins as competition emerges. Our preference in the tech growth area remains Xero (XRO).

Overweight BHP (BHP, -5.1%)

BHP delivered a reasonable quarterly production report in October. Iron ore volume was up 7% year-on-year but copper production was down slightly due to the operational impact of Covid at BHP's Escondida mine. Its development program remains on track. However, there are signs the iron ore sector, having done so well over the year, is now a funding source for a recent rotation to the banks.

Market outlook

The “Blue wave” did not emerge in the US election. While the Democrats are set to take the White House, they underperformed expectations in both Houses. Their majority in the House of Representatives was reduced, while the Senate looks set to retain a republican majority. The Democrats have done worse than expected in the House of Representative but should retain a smaller majority.

The prospect of divided government means lower likely stimulus, but also less chance for some of the more contentious policy changes such as higher taxes. Without the control of Congress, Joe Biden is likely to plump for a more centrist cabinet, potentially taking some of the more left wing agenda off the table. Biden has a strong relationship with Republican Senate Leader McConnell, which may be constructive for some degree of cooperation. All in all, the outcome has been broadly welcomed by markets.

Covid cases continued to deteriorate throughout Europe and the US, with increased test positivity indicating growing momentum.

Total US hospitalisations are approaching the earlier peaks in the crisis. In this instance they are spread wider geographically and there are no signs of strain on the system as yet. However, this remains a key factor to watch.

Several European countries reinstated lock downs but the market seems to be taking a relatively sanguine view at this point and appears to be looking through this wave. Sentiment remains bolstered by a combination of:

- A better understanding of the virus
- Better healthcare system preparation
- A view that lockdowns work within a reasonable time frame
- Policy ready to plug the economic gap
- Liquidity so prevalent that any sell-off is quickly supported
- Optimism on positive vaccine developments

The prospect of further trade friction with China remains a risk to Australian equities. There has been speculation of additional measures on some goods such as low-grade iron ore. This is an issue that must be watched.

Several positives are lining up which can support the market into the year’s end. These include:

1. Supportive global markets
2. Fiscal stimulus flowing through from the Budget
3. Melbourne re-opening, perhaps more quickly than hoped
4. Borders re-opening
5. Pent-up demand, with more people than usual staying in Australia over Christmas
6. More stimulus from the RBA
7. Cautious positioning from investors
8. The potential for M&A activity

As a result, we remain reasonably constructive on markets near term. However, we retain our balanced portfolio construction, rather than making a binary call on the outcome of the health and economic issues. This reflects heightened uncertainty prevailing in the macroeconomic environment.

New stocks added and/or stocks sold to zero during the month

Sell to zero in Coles (COL)

The portfolio has held a position in Coles (COL) as part of its defensive segment. Its defensive earnings stream provided protection against the risk of prolonged recession or further material market downturn.

The position has served its purpose, helping the portfolio perform through periods of market stress and making a positive contribution to relative performance since it was added.

But recent data suggests COL is losing momentum on sales relative to its key competitor Woolworth (WOW). With no clear catalyst for a reversal in this trend, we see increased fundamental risks and are closing the position.

We retain exposure to the supermarket sector via the position in Metcash and its IGA franchise. This provides exposure to a defensive earnings stream, coupled with company-specific factors such as improvements in market share on the back of improved store formats and an increase in neighbourhood-style convenience shopping.

For more information contact your
key account manager or visit **pendalgroup.com**