PENDAL

Pendal Ethical Share Fund

ARSN: 096 328 219

Factsheet

Equity Strategies

October 2020

The future is worth investing in

About the Fund

The Pendal Ethical Share Fund (**Fund**) is an actively managed, high-conviction, values-orientated, concentrated portfolio of Australian shares. It seeks to invest in companies that enable, lead and participate in the transition to a more sustainable Australian economy, while avoiding those which cause significant harm, undermine a more sustainable economy, or that do not meet our minimum environmental, social and governance (ESG) performance standards. The investment process combines the potential to achieve strong performance over the long term through a diversified set of investment opportunities while also investing in companies whose practices and impacts are in our view 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 rolling 5 year periods. The suggested investment timeframe is five years or more.

Investment Approach

We adopt a principles-based approach in defining our investment opportunity set. We have a set of exclusionary screens (see PDS for full details) and a framework to identify companies which are aligned with our Fund priorities of supporting a more sustainable, future-ready Australian economy.

We seek companies involved in…

- ✓ Innovation & technological advances (including climate solutions)
- ✓ More sustainable resource consumption
- ✓ Sustainable & resilient infrastructure
- ✓ Quality education
- ✓ Meeting basic needs
- ✓ Health & wellbeing
- ✓ Social inclusion & diversity
- ✓ Low carbon transportation

We avoid companies involved in…

- x Fossil Fuels
- x Tobacco
- x Weapons
- x Alcohol
- x Gambling
- x Animal testing
- x Pornography
- x Predatory lending
- x Logging
- x Uranium

Investment Process

The Fund uses the same investment process as Pendal's flagship Australian equities funds with the additional application of exclusionary screens and a sustainability-focused framework.

1. The negative screening process effectively determines the investment universe of the Pendal Ethical Share Fund.
2. Investment ideas are generated through our proprietary framework, identifying companies which contribute to a more sustainable economy.
3. We construct a portfolio with stocks which we believe will generate alpha and at a minimum 'do-no-harm'.

We also actively undertake targeted engagement with companies to support a more sustainable economy and to ensure ESG risks are being appropriately managed.

Investment Team

Pendal's nineteen member Australian Equities team is one of the largest in the industry. The portfolio manager is Head of Equities, Crispin Murray, assisted by Elise McKay, Oliver Renton and Patrick Teodorowski on the application of the Fund's investment framework.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	2.75	2.83	1.89
3 months	2.89	3.13	1.22
FYTD	2.64	2.97	1.83
6 months	9.29	9.81	9.09
1 year (pa)	-4.92	-4.01	-7.91
2 years (pa)	4.94	5.94	4.90
3 years (pa)	3.98	4.97	4.22
5 years (pa)	6.34	7.35	6.89

Investment Guidelines

Ex-ante (forward looking) tracking error	3.0% - 8.0%
Min/max stock position	+/-10%
Min/max sector position	+/-10%

Management Costs[1]

Issuer fee[2]	0.95% pa

[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.

Other Information

Fund size (as at 31 Oct 2020)	$181 million
Date of inception	May 2001
Minimum investment	$25,000
Buy-sell spread[3]	0.50 (0.25%/0.25%)
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.

Signatory of:

PRI Principles for Responsible Investment

CERTIFIED RESPONSIBLE INVESTMENT ®

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.

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.

Sector Allocation (as at 31 October 2020)

Materials	16.4%
Industrials	8.8%
Consumer Discretionary	2.8%
Consumer Staples	1.2%
Health Care	16.7%
Information Technology	4.7%
Telecommunication Services	9.2%
Utilities	0.0%
Financials ex Property Trusts	26.8%
Property Trusts	5.8%
Cash & other	7.6%

Top 10 Holdings (as at 31 October 2020)

CSL Limited	11.4%
Commonwealth Bank of Australia Ltd	6.9%
ANZ Banking Group Limited	6.2%
Fortescue Metals Group Limited	5.1%
Macquarie Group Limited	4.8%
Telstra Corporation Limited	4.7%
Xero Limited	4.1%
Qantas Airways Limited	3.7%
National Australia Bank Limited	3.6%
Goodman Group	3.5%

Market review

The S&P/ASX 300 Accumulation index gained +1.9% over October; although -4% was wiped off the market during the last week of the month. Resources (-1.2%) continued to underperform Industrials (+2.7%) as performance miners and energy companies remained lackluster.

The continued surge in new Covid cases in the US and Europe led to the start of lockdowns in the latter. Meanwhile Pfizer announced that the interim results of its vaccine trial would be delayed. In the US there were some speculation that the election may be tighter than people expected a few weeks ago, while results season has been a touch disappointing thus far. The key issue is how the combination of the pandemic, US election and policy responses will impact on the potential for rotation within the market. The market is at historical extremes when it comes to the outperformance of growth over value and also on the latter's valuation premium.

Domestically, the Australian Federal budget was stimulatory, as expected. On balance, the scale of injection 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. The shift in mindset away from fiscal prudence and balance budgets is material and suggests that there is more the government can do if required.

Turning to sector performance, there were five sectors finishing the month in the red, led by Industrials (-3.5%). The rise in long-term bond yields – from 0.68% to 0.85% for the US 10 years – dragged on the infrastructure names. Transurban (TCL, -4.6%), Sydney Airport (SYD, -7.0%) and Atlas Arteria (ALX, -7.1%) were amongst the largest performance detractors within their sector. The acceleration in Covid cases and the newly declared lock-down in France also weighed on investor sentiment for ALX.

Elsewhere, Materials (-1.1%) and Energy (-1.0%) both pulled back, as some of the sector heavyweights such as BHP (-5.1%), Rio Tinto (RIO, -2.0%), Origin Energy (ORG. -7.0%) and Santos (STO -3.1%) all recorded losses. Partially offsetting some of these losses, markets approved of the intended merger of gold miners Northern Star (NST, +8.9%) and Saracen (SAR, +9.1%). The resulting company will be a clear number two in Australia behind Newcrest (NCM, -6.4%). Ampol (ALD, +8.3%) also outperformed following its announcement of a review of its refining operations, potentially with a view to closing the Lytton refinery in Brisbane. The notion that this would do more to encourage government support for remaining refining capacity in Australia also benefited Viva Energy (VEA, +7.2%).

On the other end of spectrum, Financials (+6.3%), Information Technology (+8.6%) and Consumer Staples (+4.6%) were the best performing sectors. Within Financials, the market had the first bank result from ANZ (ANZ, +9.2%) which was mixed. The good news was the bad and doubtful debts (BDD) provisions were lower, which helped drive a better capital position. However margins were softer and the cost outlook was a bit higher due to the need for investment in technology. Pre-provision profit forecasts were cut by 3-4%. There is a silver lining in that the company acknowledges the outlook for BDDs looks better than feared. This could lead to EPS and DPS upgrade in future years which saw the other "Big Four" also outperformed from +4.8% (NAB) to +8.5% (CBA).

Fund performance

The Fund outperformed its benchmark over the month of October.

Contributors

Overweight Nine Entertainment

Domestic cyclicals outperformed, as optimism over easing border restrictions continued to support expectation for earnings recovery. This saw Nine Entertainment (NEC, +19.2%) contribute the most to the fund's outperformance over the month. In addition, the latest SMI data also pointed to the ongoing improvement in TV markets.

Overweight Xero

The latest Australian Federal budget underpinned several growth stocks over the month, including our preferred growth exposure, Xero (XRO, +9.3%). The company will also benefit from the measures to help accelerate investment and stop small businesses from going under.

Detractors

Overweight Atlas Arteria

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

Does not hold Afterpay

The latest Australian Federal budget underpinned several growth stocks over the month, which saw market darling Afterpay (APT) record another double-digit gain of 20.9%; and not owning that weighed on our relative performance. That said, our preferred growth exposure, Xero (XRO, +9.3%) also benefited from the measures to help accelerate investment and stop business going under.

Strategy and outlook

The "Blue wave" did not emerge in the US election. While the Democrats seem set to take the White House, they underperformed expectations in both Houses. Their majority in the House of Representatives was reduced, while the Senate also looks set to retain a republican Majority. The Democrats have done worse than expected in the House of Representative, losing nine seats thus far. They should retain a majority, albeit smaller.

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 Biden is likely to plump for a more centrist cabinet, potentially taking some of the more left wing agenda off the table. It is also notable that 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 continue to deteriorate throughout Europe and the US, with increased test positivity indicating the momentum continues to rise.

Total US hospitalisations are up to 50k, versus the previous peak of 60K. 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 have reinstated lock downs. However the market seems to be taking a relatively sanguine view at this point and appears to be looking through this wave of Covid on a combination of:

- a better understanding of the virus,
- better healthcare system preparation,
- a view that lockdowns work within a reasonable time frame,
- that policy stands ready to plug the economic gap,
- that liquidity is so prevalent it means 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 – for example of low grade iron ore. At this point Beijing may be happy to have these additional threats in conversation without acting on them, but this is an issue which must be watched.

That said, we are mindful that there are several positives lining up which can support the market into the year's end. These include:

1. Supportive global markets
2. Fiscal stimulus from the budget flowing through
3. Melbourne re-opening, perhaps more quickly now 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 the still heightened uncertainty prevailing in the macroeconomic environment.

Carbon Footprint

The estimated weighted average carbon intensity (WACI) of the portfolio, using greenhouse gas emissions (scope 1 and 2[1]) data supplied by MSCI and weighted by the size of our holding in each company, is shown in the table below. In other words, this provides an indication of a portfolio's exposure to carbon intensive companies. We also compare this to the weighted average emissions for the companies in the aggregated ASX300 index.

We caution that there are limitations of using carbon footprinting measures as an indicator of a portfolio's overall exposure to climate-related risks. For example, not all companies report their emissions data and hence some of the below analysis includes estimates. Also, it does not include scope 3 emissions. Further, portfolio carbon analysis does not capture exposure to physical climate-related risks, or the unique transition risks some companies within the portfolio face. Nevertheless, the WACI metric is recommended by the Task Force on Climate-related Financial Disclosures (TCFD)[2], noting it supports greater comparability of investor reporting.

Carbon Intensity (tonnes CO2e / $M sales)

Pendal Ethical Share Fund	ASX 300	Relative to ASX300
116.4	201.4	-42%

Source: Pendal, MSCI as at 30 October 2020

[1] Scope 1 emissions result from sources directly owned or controlled by the company. Scope 2 accounts for GHG emissions from the generation of purchased electricity consumed by the company. Scope 3 emissions result from activities not directly owned or controlled by the company but are associated with its operation such as business travel, waste management, commuting, and the use of sold products and services. https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

[2] *Recommendations of the Task Force on Climate-Related Financial Disclosures, June 2017* https://www.fsb-tcfd.org/recommendations/

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.
- **Concentration 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 available on the Pendal's website.

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

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