PENDAL

Factsheet

Equity Strategies

January 2021

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 31 Jan 2021)	$1,085 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		Benchmark
	(post-fee)	(pre-fee)	Return
1 month	-0.61	-0.75	0.33
3 months	12.24	12.38	12.05
FYTD	14.96	15.56	14.10
6 months	16.11	16.64	13.42
1 year (pa)	0.25	1.33	-2.69
2 years (pa)	13.29	14.33	10.29
3 years (pa)	7.94	8.87	7.13
5 years (pa)	10.93	11.92	10.14

Sector Allocation (as at 31 January 2021)

Energy	5.0%
Materials	23.7%
Industrials	11.9%
Consumer Discretionary	6.6%
Consumer Staples	4.3%
Health Care	7.5%
Information Technology	5.8%
Telecommunication Services	9.0%
Financials ex Property Trusts	21.9%
Property Trusts	2.8%
Cash & other	1.5%

Top 10 Holdings (as at 31 January 2021)

BHP Billiton Limited	11.5%
CSL Limited	7.5%
Commonwealth Bank of Australia Ltd	6.3%
ANZ Banking Group Limited	6.1%
Westpac Banking Corporation	6.0%
Telstra Corporation Limited	5.3%
Metcash Trading Limited	4.3%
Qantas Airways Limited	4.1%
Xero Limited	4.0%
James Hardie Industries Plc	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

Global equity markets fell in January. The recent positive sentiment around vaccines wobbled, with concerns over mutated strains and worries over production issues. This was exacerbated by some selling by hedge funds forced to de-lever in response a squeeze on some heavily shorted stocks. This dragged on the US market, whilst dampening market sentiment around the world. Against this backdrop, the S&P/ASX 300 Accumulation index finished the month flat (+0.3%), as a result of a large unwind in cyclical stocks over the last week of the month. Industrials (+0.6%) also gradually outperformed their Resources (-0.6%) counterpart.

On the Covid/vaccine front in particular, there was a lot of new data to digest. The Novavax vaccine trial data showed efficacy as good as Moderna's, with better tolerance and has a great ability to quickly ramp up production. The 65% jump in Novavax stock reflected how well the trial was received. Australia has signed up for 51m doses of this vaccine.

Trials in the UK and South Africa showed that efficacy fell from 96% for the original strain, to 86% for the UK variant and 49% for the South African version (60% for patients without HIV). Their plan is to develop a booster to deal with this, likely to be available in Q3. The other point is that this partial immunity still gives protection against severe infections - even with the South African strain.

Lastly, Johnson and Johnson vaccine was more disappointing. Overall efficacy is around 66%; 72% for the original strain, down to 57% for the South African variant. Importantly, while it may be less effective than other vaccines at stopping infection, it is still very effective in preventing severe infections. As such, it will play a role in alleviating pressure on health care systems and reducing mortality. The company is also running two-dose trials which may lead to improved results. It is important in that it is a key part of the European supply and can be rolled out more easily.

There was some divergence in sector performance over the month, with Real Estate (-4.3%), Industrials (-3.1%), Health Care (-1.7%) and Materials (-1.0%) finishing the period in the red; whilst Financials (+2.3%), Consumer Discretionary (+4.8%), Consumer Staples (+2.0%) and Communication Services (+2.6%) recorded some gains.

Turning to company specifics, the market saw a few updates prior to February reporting season. Atlas Arteria (ALX, -2.6%) delivered a well-received update on traffic numbers for its French asset, APRR. Traffic was down -25% year-on-year for December – however this was half the effect of the 51% year-on-year fall of the previous lockdown. And heavy vehicle traffic, which provides a higher proportionate share of tolls, was only down -2%.

BlueScope Steel (BSL, -5.1%) also announced an upgrade on improved earnings and margins. The latter is particularly strong in the US, where mothballed steel capacity is yet to be brought back on line. Nevertheless, broader weakness in the materials sector dragged the stock down.

Fund performance

The Fund underperformed the benchmark over the month of January.

Contributors

Overweight Westpac

While the environment remains challenging for banks (+4.1%), several headwinds for the sector have diminished in recent weeks and months. At a macro level, an increase in nominal bond yields is beneficial for financials and has historically been correlated with the performance of banks. Bond yields are likely to remain low by historical standards – which will remain a persistent issue for banks – however the headwind of falling yields has dissipated. At the same time, mortgage volumes remain strong and the pressure on capital and bad and doubtful debts is diminishing. This has led APRA to roll back its restrictions on capital management and opens the door to the resumption of dividends. Wespac (WBC, +9.1%) performed strongly against this backdrop during January.

Overweight Telstra

Telstra (TLS, +4.7%) outperformed in January as a defensive yield play, without much more new company specific information. We continue to see TLS benefit from an improvement in cost control, capex discipline and improved industry structure in mobile, which in turn can help support pricing.

Detractors

Overweight Xero

Xero (XRO, -11.5%) was caught in the crosshairs of some hedge fund deleveraging during the month, after a year of strong outperformance. It is one of our preferred growth names, which we believe will be a beneficiary of digitisation of the economy and low interest rates. Despite some near-term headwinds on expected SME churn and failure rates, we believe that the structural shift to the cloud will be further accelerated as a result of COVID and that the relationship between accountants, SMEs and software has never been more important.

Overweight Qantas

Travel stocks responded negatively to the latest slew of vaccine data; in particular with concerns over mutated strains and worries over production issues. This saw Qantas (QAN, -7.2%) fall over the month. The key question is whether the lower efficacy to the South Africa variant and the manufacturing issues in EU will delay economic re-opening. In our view, whilst this is likely to cause a small delay – maybe 1-2 months - and may limit the level of international travel for longer; fundamentally, it does not prevent us from reaching herd immunity or diminishing the more serious effects of Covid.

Outlook

There are signs of excess in pockets of the market. It is showing up in the performance of concept stocks like Tesla, in IPOs, in renewable energy ETFs, in bitcoin – and in January, the surge in retail money designed to squeeze the shorts in certain stocks. This is likely a consequence of the combination of stimulus cheques, lockdowns, the Northern hemisphere winter and a lack of other spending options.

However in our view it does not necessarily signal that the market as whole is in froth territory. Valuations in growth stocks remain well above historical highs – but that is not the case for other parts of the market, or for markets in aggregate.

We are also mindful of the degree to which fiscal and monetary policy setting underpin equity markets. A Democrat administration in the US looks set to inject a massive stimulus package into the economy – at the point where vaccination programmes should start taking effect, paving the way for a reopening. This is likely to drive economic momentum and earnings growth.

At the same time, central banks are being extraordinarily accommodative. Rates are flagged to stay low until inflation and employment milestones are reached – which could still be some years away. They have also been quick to hose down any speculation over tapering – mindful of the 2016 taper tantrum. This abundant liquidity is supporting markets and increasing the relative attraction of equities.

In combination, we think it reduces the risk of a material drawdown – and could very well support further equity markets gains in 2021.

The key proximate risk is around vaccines. Optimism over vaccinations is a key facet of recent market strength. Any disappointment around vaccine efficiency could hurt sentiment. Mutated strains of Covid are key to watch in this regard. At the moment, while vaccine efficacy is lower against the South African variant, in particular, they still work to reduce severity and mortality.

Nominal bond rates continue to rise, driven largely by inflation expectations on the back of stimulus packages. Higher nominal yields are good for financials, while higher break-even rates (ie inflation expectations) are generally good for cyclicals. At the same time real rates, which are historically correlated with growth, look to have troughed for the moment.

This is driving a shift in market leadership from growth to cyclicals and financials - although it is not seeing a material sell down in growth. We are mindful of the material risks and maintain our balanced portfolio construction – however within this context we have recently been increasing the cyclical and financial exposure in the portfolio.

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

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