PENDAL

Pendal Ethical Share Fund

ARSN: 096 328 219

Factsheet

Equity Strategies

January 2021

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	-1.11	-1.03	0.33
3 months	8.90	9.16	12.05
FYTD	11.78	12.40	14.10
6 months	12.05	12.58	13.42
1 year (pa)	-2.78	-1.86	-2.69
2 years (pa)	10.00	11.05	10.29
3 years (pa)	5.59	6.60	7.13
5 years (pa)	8.84	9.87	10.14

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 Jan 2021)	$213 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 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 January 2021)

Materials	17.5%
Industrials	9.0%
Consumer Discretionary	2.7%
Consumer Staples	1.2%
Health Care	14.9%
Information Technology	5.2%
Telecommunication Services	10.7%
Utilities	0.0%
Financials ex Property Trusts	28.5%
Property Trusts	5.8%
Cash & other	4.5%

Top 10 Holdings (as at 31 January 2021)

CSL Limited	9.0%
Commonwealth Bank of Australia Ltd	7.2%
ANZ Banking Group Limited	6.7%
Fortescue Metals Group Limited	5.9%
Telstra Corporation Limited	5.7%
Macquarie Group Limited	4.0%
National Australia Bank Limited	3.9%
Xero Limited	3.8%
Qantas Airways Limited	3.6%
James Hardie Industries Plc	3.3%

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 Pro Medicus

Pro Medicus (PME) provides a range of radiology information technology software and services to hospitals, imaging centres and health care groups. PME signed a 7-year, A$40M deal with Intermountain Healthcare during the month, which is the largest healthcare provider in the Intermountain West US.

Overweight Domain Holdings

Property listings have been strong going into the new year and this helps to underpin the strong fundamentals of Domain Group (DHG). In addition, the NSW State Government has proposed a reform to the property tax regime, which based on their research suggests the number of property transactions would increase by ~50% in the long run after the stamp duty's removal. This has helped investor sentiment for the property online listing group.

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.

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
119.7	205	-85.3

Source: Pendal, MSCI as at 31 January 2021

[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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