PENDAL

Factsheet

Bond, Income & Defensive Strategies

January 2021

Pendal Sustainable Australian Fixed Interest Fund

ARSN: 612 664 730

About the Fund

The Pendal Sustainable Australian Fixed Interest Fund (**Fund**) is an actively managed portfolio of Australian fixed interest securities. Investments are selected based on a range of sustainable, ethical and financial criteria.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Bloomberg AusBond Composite 0+ Yr Index by 0.75% p.a. over rolling 3 year periods.

Description of Fund

The Fund offers investors access to a diversified portfolio of fixed interest securities and seeks exposure to issuers that demonstrate leading environmental, social and corporate governance (ESG) and ethical practices while avoiding exposure to issuers with activities that we consider to negatively impact the environment or society.

The Fund will not invest in issuers with material business involvement in the following activities:

- production of tobacco or alcohol,
- manufacture or provision of gaming facilities,
- manufacture of weapons or armaments,
- manufacture or distribution of pornography,
- directly mine uranium for the purpose of weapons manufacturing,
- extraction of thermal coal and oil sands production.

We consider that an issuer has a material business involvement in an activity if 10% or more of its total revenue is derived from that activity.

The Fund uses a security selection process that combines sustainable and ethical criteria with Pendal's credit analysis. Pendal's investment process for fixed interest aims to add value through multiple strategies and investment research. Pendal seeks to generate excess returns through strategies including active security (including Green, Social and Sustainable Bonds) and sector selection, duration, yield curve and credit management.

We believe our strategy is unique in the Australian marketplace due to our top down process which combines a large number of quantitative models, our qualitative overlay and technical analysis giving us a greater understanding of global forces that affect the domestic market and the opportunities it presents. This is a more robust process than focussing primarily on domestic economic factors when evaluating the opportunity set.

Our investment approach for credit management seeks to identify opportunities on a sector, issuer and security basis by incorporating top-down and bottom-up research. Top-down research includes analysis of economic and market data, along with macro credit fundamentals such as company earnings, balance sheet health, default rates and equity volatility. The bottom up research includes analysis of earnings and cashflow volatility, balance sheet, business diversity, industry and valuation.

Investment Team

Pendal's Bond, Income & Defensive team includes fifteen dedicated investment professionals. The team also draws on a wide range of knowledge resources including Pendal's other specialist investment teams: Equity Strategies and Multi-Asset Strategies. The co-portfolio managers of the Fund are George Bishay and Tim Hext, who have a combined 50 years of industry experience.

CERTIFIED RESPONSIBLE INVESTMENT ®
CERTIFIED BY RIAA

The Pendal Sustainable Australian Fixed Interest 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.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	-0.32	-0.29	-0.42
3 months	-0.11	-0.01	-0.80
6 months	1.09	1.29	0.12
1 year (pa)	3.39	3.80	1.68
2 years (pa)	6.55	6.97	5.30
3 years (pa)	5.96	6.39	5.36
Since Inception (pa)	4.02	4.43	3.62

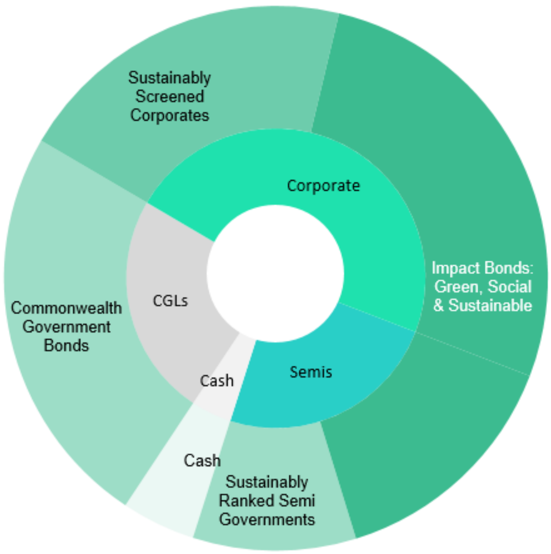
Portfolio Statistics (as at 31 January 2021)

Yield to Maturity[#]	1.06%

Sector Allocation (as at 31 January 2021)

Government bonds^	26.5%
Semi-Government bonds^	8.1%
Sustainability Screened Corporate bonds	16.7%
ESG Thematic bonds - Climate	25.0%
- Social	8.2%
- Sustainable	7.4%
Cash & other	8.0%

^ Ex Green, Social & Sustainable Bonds



[#] The portfolio yield to maturity is an estimate of the fund's internal rate of return. It is calculated as the yield to maturity of all securities comprised in the benchmark at the relevant time (sourced from Bloomberg), plus our estimate of the weighted average traded margin over the swap rate for each of those securities based on observed market prices. The portfolio yield to maturity does not represent the actual return of the fund over any period.

Other Information

Fund size (as at 31 Jan 2021)	$346 million
Date of inception	August 2016
Minimum investment	$25,000
Buy-sell spread[1] For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
Distribution frequency	Quarterly
APIR Code	BTA0507AU

[1] The buy-sell spread represents a contribution to the transaction costs incurred by the Fund, when the Fund is purchasing and selling assets. The buy-sell spread is generally incurred whenever you invest in the Fund, and may vary from time to time without notice.

Management Costs[2]

Issuer fee[3]	0.40% pa

[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.

Market review

The year started with headlines of lockdowns in Europe as coronavirus cases surged before the focus shifted onto the run-off elections in the US and who would have control of the senate. The Democrats ultimately won both elections, giving them 50 of the 100 senate seats, enough to give them control with Vice President Kamala Harris casting a deciding vote in the event of a deadlock along party lines. Inflationary concerns over the blue wave following the election result in turn saw bond markets retrace the earlier bond gains.

The Federal Reserve met late in the month and left their monetary policy settings unchanged with asset purchases of $80bn Treasury Bonds and $40bn Mortgage Backed Securities per month seen as remaining appropriate. Comments from the Fed Chair Powell did weigh on risk sentiment when he noted that the US economy is a long way from a full recovery, that the real unemployment rate is closer to 10% and on inflation that the Fed 'will be patient and not react if we see small, transient inflation increases'. Retail sales and employment data released earlier in the month were much weaker than expected, with retail sales exe-autos and gas falling by 2.1% (against consensus of -0.3%) and non-farm payrolls that fell by 140k jobs in December (consensus +50k).

The ECB left its policy unchanged at their January meeting. The ECB stated that asset purchase programs might not run all the way to completion 'if favourable financing conditions can be maintained', which in turn saw bond yields sell off. ECB President Christine Lagarde has stated that there could also be a case for additional purchases, which was seemingly ignored.

No Reserve Bank meeting in January with the main economic data being 4th quarter inflation released late in the month. Headline inflation rose by 0.9% for the quarter, which resulted in annual increase also of 0.9%. The trimmed mean rose by 0.4% for the quarter and 1.2% for the year whilst the weighted median rose by 0.5% and 1.4%. The Reserve Bank last November stated that it would not be increasing the cash rate until progress is being made towards full employment and actual inflation will be sustainably within the 2-3% target band, well above the inflation outcomes recorded.

The NAB business survey revealed business conditions rising to their highest level since late 2018. The report showed that most indicators are now broadly at or above pre-virus levels, with the exception being export conditions and capital expenditure. Employment conditions are now back in positive territory, with the improving labour market also reflected in the ANZ job ads that recorded an increase of over 9% in December.

Some of the recent stock price moves in the United States have been truly astounding. Media channels pointed the finger at a community of social-media driven investors whose concerted buying on names like GameStop (+1625%), AMC (+525%) and Blackberry (+113%) short-squeezed a number of prominent hedge funds. To cover mounting losses, affected managers offloaded other equity positions, prompting a broad-based sell-off across the market. The Darwin award belongs to those investors in Australia that thought they were buying Game Stop, whose equity code is GME in the United States. The locally listed GME (GME Resources) is a small gold, nickel and copper explorer with a market capitalisation of $40m. The Australian listed company was hit with a speeding notice when its stock rose 50% on one day, with investors seemingly under the impression that they were buying Game Stop.

Ten-year bond yields in the US traded in a 27 basis point range, reaching their low of 0.90% early in the month before selling off following the US election result. Concerns over the timing and ability of US President Biden to execute his stimulus package saw bond yields rally into month end. US equity market jitters late in the month did not however result in a flight to safety. Australian yields mirrored the moves in the US, with 10-year bond yields ending the month 13 basis points higher in yield at 1.11%.

Credit market performance was mixed in January.

The US Democrats unexpectedly secured both senate seats in the Georgia runoffs. The blue sweep with Democrats control of both houses of Congress as well as the Presidency should see greater fiscal stimulus, which is supportive for risk markets. The market expectation is that any new US banking regulation and higher taxes will take a backseat for now whilst the effects of covid-19 remain.

The Biden drive to roll out vaccines is also a positive as it will triggering pent up demand leading to strong economic growth and earnings growth.

Global new cases of Covid are improving, reflecting the impact of lockdowns, but may be sustained as the effects of immunising the most vulnerable kicks in.

Also supporting markets was FED Chair Powell's comments pushing back on tapering and allowing inflation to overshoot 2% for some time. He said, "this is not the time to think about exit" and that the FED "are strongly committed to our framework and using our monetary policy tools until the job is well and truly done". Powell noted that the FED would not hike unless they see troubling inflation and imbalances.

Late in the month, risk markets sold off in what started out as Reddit retail investor social media forum which saw a frenzy of buying US companies (eg GameStop) that had large short positions. This triggered a short squeeze, leading to hedge funds (who had the short positions) losing money and having to de-leverage, forcing the selling of other long stock market positions.

The Australian iTraxx index (Series 34 contract) traded in a 8bp range finishing the month 7bps wider to +63bps. Whereas physical credit spreads performed well tightening 3bp on average. The best performing sectors were offshore banks, infrastructure and real estate tightening 7, 7bps & 6bps respectively. The worst performing sectors were domestic banks and telcos that both only narrowed 2bps. Semi-government bonds tightened 3bps to commonwealth government bonds.

Fund performance and activity

The Fund performed well in January outperforming the Bloomberg AusBond Composite Bond Index by 0.13% (pre-fee).

The duration component had a small negative in January. The fund remains received in forward rates around four years as the RBA is expected to maintain rates at record lows. Optimism in the economy meant the yield on this position drifted higher in January.

The physical portfolio performed well outperforming the benchmark. Both the government sector positioning and the non-government sustainably screened portion of the portfolio outperformed. Industrials, infrastructure, real estate and supranationals sector positioning drove the performance.

Activity during the month including increasing exposure to supranationals, financials, commonwealth and semi-government sectors funded out of cash.

This month we bought the new Australian dollar Climate Awareness Bond from the European Investment Bank, the lending arm of the European Union funding renewable energy and energy efficiency projects. The proceeds will be used to fund projects across Europe. Examples include an offshore wind farm near Portugal, a battery factory in Poland that will produce lithium-ion batteries for electric vehicles, as well as the construction of an energy efficient shopping centre and railway station in Finland. We look at planned impact reporting as part of our due diligence process for investing in impact bonds; we want to make sure the use of proceeds continues to fund impactful projects. This Climate Awareness Bond will report renewable energy generated and carbon emissions avoided from each project funded so we know the impact of our investments.

We also added to our exposure to the NSW Treasury Corporation Green Bond which funds green projects across the state. This includes funding low carbon transport and buildings, renewable energy and land conservation. There is a rigorous process with external reviews for determining if projects are eligible for funding under this bond. The bond also has detailed reporting with key impact indicators across different sectors. For example, projects relating to energy efficiency report on energy savings and emissions avoided per year; whereas green building projects report on certification standards, energy and carbon performance, water efficiency and waste management.

Outlook

The Reserve Bank of Australia (RBA) left the cash rate unchanged at its meeting in early February. The contents of the statement were more dovish than what some in the market were expecting. Last November the RBA announced their Quantitative Easing program, buying $100bn of Government and Semi-Government bonds over 6 months. The market began to speculate as to whether the RBA would reduce the size of their purchases when the initial program is completed given the improving economic situation relative to their forecasts. The RBA emphatically knocked any speculation on the head – they announced that they would be purchasing an additional $100bn when the current program is completed in mid April. The currency and the actions of other central banks are key here. The Federal Reserve has indicated that it will not be tapering its purchases anytime soon. For the RBA to indicate that it would reduce the pace of purchases would in turn exert upward pressure on the currency, putting downward pressure on inflation and acting as a headwind to the recovery in economic growth.

The RBA will release its updated economic forecasts in its Statement on Monetary Policy in early February. These will reflect better economic conditions than previously expected, with the unemployment rate forecast to be revised down to 6% by year end 2021 and 5.5% by year end 2022, from 6.5% and 6%. This still a long way from full employment and will not produce any meaningful wage inflation. The RBA does not expect to see actual inflation sustainably within the 2 to 3% target range until 2024 at the earliest. They are on hold for an extended period.

We maintain our constructive view on credit markets on the back of significant global central bank and government support measures, vaccine rollouts and a more conciliatory new US government.

Whilst covid continues to impact global economic growth, policy makers will remain in a ‘whatever it takes mindset’ and will continue to support economies from both fiscal and monetary stimulus perspectives. This support will be a significant factor driving markets going forward.

Effective covid vaccines with high efficacy is incredibly important for the improvement of global economic growth. Once the vaccines are distributed, the world will hopefully be able get back to normal which will see a sharp recovery in economic growth supporting risk markets. A risk to markets lies with the efficacy of vaccines going forward.

The Biden victory in the US elections is also positive for markets as a Biden government should see an improvement in global trade talks moving away from the more aggressive Trump US-China trade wars.

The excess liquidity in the financial system and attractive credit spreads against a very low cash and bond rates will continue to attract buyers to the sector supporting credit markets.

Risks

An investment in the Fund involves risk, including:

- **Market risk**: The risk associated with factors that can influence the direction and volatility of an overall market, as opposed to security-specific risks. These factors can affect one country or a number of countries.
- **Security specific risk**: The risk associated with an individual security.
- **Interest rate risk**: The risk associated with adverse changes in asset prices as a result of interest rate movements.
- **Credit risk**: The risk of an issuing entity defaulting on its obligation to pay interest/principal when due.
- **Liquidity risk**: The risk that an asset may not be converted to cash in a timely manner.

Please read the Fund’s product disclosure statement (**PDS**) for a detailed explanation of each of these risks.

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

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