PENDAL

Pendal Monthly Commentary

Pendal Australian Specialised Retirement Income Portfolio

March 2021

Market commentary

The S&P/ASX 300 gained 2.3% in March. The market shrugged off concerns over another surge in US Covid cases, the high-profile collapse of a highly-levered hedge fund and underlying inflation concerns leading to interest rate increases.

At this point the prospect of a spectacular surge in stimulus-fuelled growth in the US is dominating sentiment and driving equities higher.

The market continues to grapple with a contradiction between the outlook for very strong economic growth in the US versus the Fed's stated intention of avoiding rate rises until 2023.

Scepticism that the Fed can maintain this stance is reflected in rising bond rates. The US 10-year Treasury yield rose 28bps in March. Australian 10-year bond yields fell 9bps, having already increased markedly in February.

The risk is that a sell-off in bonds becomes disorderly, driving yields higher and choking off the growth pulse.

However at this point inflationary pressure – particularly in wages – is not an issue in aggregate.

The US dollar continues to gently strengthen against most major currencies, backed by a strong outlook for growth.

This has been weighing on the price for commodities such as iron ore, which fell 5% for the month. Materials (-3.1%) was the weakest sector as a result, dragged down by the large cap miners.

Technology (-2.7%) also fell, although this was largely the result of a 15.1% fall in Afterpay (APT), the biggest stock in the sector. Other larger tech stocks such as Xero (XRO, +6.8%) and Computershare (CPU, +14.5%) rose.

Utilities (+6.8%) was the strongest sector, closely followed by Consumer Discretionary (+6.7%).

The latter continues to benefit from improving expectations or economic re-opening and ore activity as a vaccine becomes available.

Portfolio overview

Australian Specialised Retirement Income Portfolio	
Investment strategy	**Dual focus:** Deliver tax-effective capital & grossed-up income. **Broad hunting ground:** Core approach, drawing ideas from across the market cap spectrum. **Income focus:** Greater exposure to stocks with high grossed-up yield & dividend sustainability. **Higher turnover:** Takes advantage of lack of tax implications to pursue shorter-term opportunities
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 (28 as at 31 March 2021)
Sector limits	A-REITS 0-30%, Cash 2-10%
Dividend Yield	4.17%#

Top 10 holdings

Code	Name	Weight
BHP	BHP Billiton Limited	10.65%
WBC	Westpac Banking Corporation	7.48%
ANZ	ANZ Banking Group Limited	7.24%
CSL	CSL Limited	6.76%
TLS	Telstra Corporation Limited	6.19%
CBA	Commonwealth Bank of Australia Ltd	6.18%
NEC	Nine Entertainment Co Ltd	4.65%
MTS	Metcash Trading Limited	4.50%
QAN	Qantas Airways Limited	3.50%
STO	Santos Limited	3.44%

Source: Pendal as at 31 March 2021

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
NEC	Nine Entertainment Co Ltd	4.44%
MTS	Metcash Trading Limited	4.31%
TLS	Telstra Corporation Limited	4.15%
BHP	BHP Billiton Limited	3.90%
ANZ	ANZ Banking Group Limited	3.18%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WES	Wesfarmers Limited (not held)	-3.02%
WOW	Woolworths Group Limited (not held)	-2.62%
NAB	National Australia Bank Limited	-2.24%
TCL	Transurban Group (not held)	-1.85%
CBA	Commonwealth Bank of Australia Ltd	-1.55%

Source: Pendal as at 31 March 2021

#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	Since inception*
Pendal Australian Specialised Retirement Income Portfolio	2.60%	5.74%	23.13%	43.17%	10.55%	9.58%
S&P/ASX 300 (TR) Index	2.30%	4.15%	18.51%	38.34%	9.72%	8.74%
Active return	**0.30%**	**1.59%**	**4.62%**	**4.83%**	**0.83%**	**0.84%**

Source: Pendal as at 31 March 2021

*Since Inception - 20 August 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
TLS	Telstra Corporation Limited	0.31%
MTS	Metcash Trading Limited	0.28%
APT	*Afterpay Limited (not held)*	*0.25%*
ANZ	ANZ Banking Group Limited	0.16%
JBH	JB Hi-Fi Limited	0.16%

Top 5 detractors - monthly

Code	Name	Value Added
BHP	BHP Billiton Limited	-0.31%
FMG	Fortescue Metals Group Limited	-0.20%
NEC	Nine Entertainment Co Ltd	-0.19%
WES	*Wesfarmers Limited (not held)*	*-0.14%*
STO	Santos Limited	-0.12%

Top 5 contributors - 1 year

Code	Name	Value Added
NEC	Nine Entertainment Co Ltd	2.95%
STO	Santos Limited	1.56%
JHX	James Hardie Industries Plc	1.10%
SVW	Seven Group Holdings Ltd	1.03%
FMG	Fortescue Metals Group Limited	0.85%

Top 5 detractors - 1 year

Code	Name	Value Added
IAG	*Insurance Group Australia (not held)*	*-1.23%*
APT	*Afterpay Limited (not held)*	*-1.17%*
ALX	Atlas Arteria	-0.77%
TLS	Telstra Corporation Limited	-0.73%
NAB	*National Australia Bank Limited*	*-0.59%*

Source: Pendal as at 31 March 2021

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight Telstra (TLS, +10.4%)

The market welcomed the announcement of a legal restructure of TLS into three entities. Two parts will own and operate physical assets such as mobile towers and data exchanges. The third will own and operate its service offering. This allows the company to extract value via the full or partial sale of infrastructure assets.

Overweight Metcash (MTS, +9.2%)

The market took time to digest MTS's strategy update, but ultimately seemed to welcome it. The focus was on expanding the footprint in hardware and improving underperforming stores. The departure of Masters has left a stable, two-player structure in the hardware space and there is ample scope for MTS to continue its strong growth in this space.

Underweight Afterpay (APT, -15.1%)

Higher bond yields have been a headwind for growth stocks generally because they increase the discount rate used for valuation. Meanwhile a rash of new listings and entrants in the IPO space has emphasised the increasingly competitive nature of the buy-now-pay-later (BNPL) sector. We believe the likely impact on costs and margins has not been reflected in valuations for APT. Hence we prefer other tech growth names such as Xero (XRO).

Three largest detractors

Overweight BHP (BHP, -5.4%) and Fortescue Metals (FMG, -11.7%)

The iron ore miners underperformed in March as the iron ore price came off, with US dollar strength weighing broadly on commodities. We retain a positive outlook for iron ore, underpinned by a resumption in demand outside China. The price is likely to moderate over the year. But we expect it to settle at a point higher than consensus expectations, leaving the miners with pathway for further earnings upgrades. Strong cash flow is being channelled back to shareholders. Our preference is for BHP over RIO.

Overweight Nine Entertainment (NEC, -1.9%)

NEC gave back some of its recent gains, following strong momentum in the wake of deals for payments from online platforms that use its content. We maintain a positive outlook for NEC. Advertising revenues are picking up post-Covid. The company has taken out a material amount of costs, increasing its leverage to rising revenue.

Market outlook

The portfolio outperformed in March, with a diverse collection of contributors. Re-opening stocks such as Aristocrat (ALL) and ANZ (ANZ) made solid contributions. More defensive holdings such as Metcash (MTS) and Telstra (TLS) also did well, as did our preferred tech growth name, Xero (XRO).

The rise in US Covid cases presents a risk. Localised outbreaks have seen case numbers increase and hospitalisations tick up. There is a risk of restrictions resuming in some places. But at this point the market is looking through this and focusing instead on a huge surge in economic growth.

A couple of quarters of extremely strong growth are likely to result from large-scale stimulus pushed through by the Biden administration and re-opening as the vaccination program accelerates. This, coupled with accommodative monetary policy and a market awash with liquidity, is likely to remain supportive for equities.

Market breadth also remains a favourable factor. Almost 95% of stocks in the S&P 500 are above their 200-day moving average. This is more than at any point since May 2013.

This does not mean that we can't see a correction or consolidation. But it makes it less likely we are at a market top. Narrower and narrower market breadth tends to be a sign of extended markets – and we are clearly not at that point.

Inflation remains the key risk that can de-rail markets. There are signs of inflationary pressure in specific areas in supply chains. The issues is how quickly – and to what degree – this flows through to wages.

The link to wage inflation has not been present for 20 years and we are a long way from employment capacity. As a result we do not think inflation is a key issue in the near term. Nevertheless, this remains an important factor to watch. Should the economic rebound continue at the likely pace of the next couple of quarters, it will become harder for the Fed to maintain its stance of no rate hikes before 2023.

There is an interesting trade developing within the broad rotation from value to growth.

Within growth, large-cap tech stocks are outperforming smaller, more speculative names for the first time since April last year. It is important to remain mindful that today's market is not just a case of simply "buy value, sell growth".

Plenty of value companies are structurally challenged. There are also signs of a divergence between profitable growth companies with strong cash flow versus the longer duration, more speculative names. This is reflected in our preference for Xero, among others, in the growth part of the portfolio.

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

Sell Ampol (ALD) to zero.

The portfolio has sold out of its position in fuel distributor and retailer Ampol (ALD).

ALD provided a degree of exposure to economic recovery via improvement in fuel volumes as traffic picked up. There is potential for a further leg as demand for air travel resumes. But this is complicated by exposure to refining – where margins have collapsed – and by uncertainty over corporate actions.

ALD came under takeover offer from global conglomerate Aliment Couche-Tard, but the deal fell through. ALD retains some corporate appeal, but there is no visibility on the emergence of another suitor. We prefer Viva Energy (VEA) in this space and retain it in the portfolio.

At this point we see greater alignment with recovery and reopening via the portfolio's positions in companies such as Qantas (QAN), Tabcorp (TAH), Downer (DOW) and the banks. As a result we are liquidating the position in ALD.

This capital has been largely redeployed to existing positions in Westpac (WBC) and JB Hi-Fi (JBH).

The banks generally have seen stiff headwinds recede. They took a swift and conservative stance towards provisions in 2020, which weighed on capital and dividends.

Given a benign outcome on bad debts, they are now seeing pressure ease here. At the same time, higher nominal bond yields are relieving pressure on margins. Westpac remains our preferred bank, given it has greater scope to improve on costs.

JBH underperformed in the prior month despite yet another strong result, as momentum shifted from Covid beneficiaries to re-opening plays.

We still see it as the best exposure to Australian retail, with a strong management team, competitive position, cost control and cash flow. It is yielding 4.97%.

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