Pendal Monthly Commentary

Pendal Australian Tax Effective Income Portfolio

May 2021

Market commentary

The S&P/ASX 300 gained 2.3% in May, much of it in the last week after a somewhat choppy month.

The key development was concrete evidence of inflation coming through in the US. The April consumer price index (CPI) was up 3% year-on-year and +0.92% versus March. This was stronger than expected.

This prompted some volatility in equity markets on fears that strong inflation would force central banks to raise rates sooner than planned, potentially choking off growth.

However central banks moved quickly to characterise current price spikes as transitory – receding once we pass through an initial phase of pent-up demand and current supply chain bottlenecks are addressed.

For the moment, this has satisfied markets. There was a rotation back to value and cyclicals which reflects confidence that near-term rate rises are off the cards. Late in the month the Fed was able to signal that they were “thinking about thinking about” Quantitative Easing tapering, without upsetting markets.

Elsewhere, there was some volatility in commodities and cryptocurrency markets as the Chinese government flagged high prices as an issue and warned against speculation.

The federal budget reflected an expansionary mindset now dominating Western governments. This is in contrast to the mantra of austerity and balanced budgets that dominated in the wake of the GFC.

Financials (+5.7%) was the best performing sector as the banks delivered updates that emphasised a more benign environment. Rising nominal bond yields eased margin pressure. The absence of a surge in bankruptcies means they are in a strong capital position. Cyclical Consumer Discretionaries (+3.2%) also outperformed.

Technology (-9.1%) underperformed as leadership shifted away from growth stocks. Heavyweight Afterpay (APT) fell 21.1% over the month. It faced headwinds from competition, reduced online purchasing and a thematic rotation away from growth.

Utilities (-6.6%) also fell, led by AGL Energy (-9.1%).

Portfolio overview

Australian Tax Effective 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.
Investment objective	The objective of the Model Portfolio is to outperform the S&P/ASX300 (TR) Index on a rolling 3 year period by 3% per annum, while delivering a higher gross yield than the market.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15-35 (25 as at 31 May 2021)
Sector limits	A-REITS 0-30%, Cash 2-10%
Dividend Yield	4.33%#

Top 10 holdings

Code	Name	Weight
BHP	BHP Billiton Limited	10.56%
CBA	Commonwealth Bank of Australia Ltd	8.01%
WBC	Westpac Banking Corporation	7.44%
ANZ	ANZ Banking Group Limited	6.99%
CSL	CSL Limited	6.75%
TLS	Telstra Corporation Limited	6.66%
NEC	Nine Entertainment Co Ltd	5.07%
MTS	Metcash Trading Limited	4.12%
NAB	National Australia Bank Limited	3.37%
QAN	Qantas Airways Limited	3.14%

Source: Pendal as at 31 May 2021

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
NEC	Nine Entertainment Co Ltd	4.86%
TLS	Telstra Corporation Limited	4.65%
MTS	Metcash Trading Limited	3.95%
BHP	BHP Billiton Limited	3.79%
ANZ	ANZ Banking Group Limited	3.07%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WES	Wesfarmers Limited (not held)	-3.01%
WOW	Woolworths Group Limited (not held)	-2.53%
TCL	Transurban Group (not held)	-1.82%
GMG AE	Goodman Group (not held)	-1.57%
NCM	Newcrest Mining Limited (not held)	-1.11%

Source: Pendal as at 31 May 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 (p.a.)	5 year (p.a.)	Since inception (p.a.)*
Pendal Australian Tax Effective Income Portfolio	3.20%	9.39%	16.23%	34.08%	11.32%	11.28%	11.10%
S&P/ASX 300 (TR) Index	2.31%	8.53%	11.95%	28.72%	10.09%	10.21%	10.64%
Active return	**0.89%**	**0.86%**	**4.28%**	**5.37%**	**1.23%**	**1.07%**	**0.46%**

Source: Pendal as at 31 May 2021
*Since Inception - 14 September 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
APT	*Afterpay Limited (not held)*	*0.32%*
EVN	Evolution Mining Limited	0.23%
WBC	Westpac Banking Corporation	0.16%
ALL	Aristocrat Leisure Limited	0.12%
NEC	Nine Entertainment Co Ltd	0.09%

Top 5 detractors - monthly

Code	Name	Value added
MND	Monadelphous Group Limited	-0.33%
QAN	Qantas Airways Limited	-0.21%
STO	Santos Limited	-0.13%
MTS	Metcash Trading Limited	-0.11%
WOW	*Woolworths Group Limited (not held)*	*-0.09%*

Top 5 contributors - 1 year

Code	Name	Value added
NEC	Nine Entertainment Co Ltd	2.83%
A2M	*The A2 Milk Company Limited (not held)*	*0.80%*
TAH	Tabcorp Holdings Limited	0.61%
FMG	Fortescue Metals Group Limited	0.61%
ANZ	ANZ Banking Group Limited	0.57%

Top 5 detractors - 1 year

Code	Name	Value added
EVN	Evolution Mining Limited	-1.04%
IAG	*Insurance Group Australia (not held)*	*-0.85%*
ALX	Atlas Arteria	-0.80%
AMC	Amcor Limited	-0.57%
MND	Monadelphous Group Limited	-0.54%

Source: Pendal as at 31 May 2021
Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Underweight Afterpay (APT, -21.1%)

Afterpay sold off along with most of the tech sector as leadership shifted away from growth to value and cyclicals. We see a role for quality growth stocks in the portfolio despite a less supportive macro backdrop. We continue to see APT as over-valued due to lower online spending as economies re-open and pressure on margins from competition.

Overweight Evolution Mining (EVN, +16.9%)

There was a rally in the gold price as inflation expectations rose, which fed through to miners such as EVN. EVN is among our preferred gold exposures given its relatively low cost base and growth opportunities in Canadian assets.

Overweight Westpac (WBC, +8.2%)

Westpac's result demonstrated that the environment continues to improve for banks. Capital positions are strong since provisions made against a sharp increase in bad debts have not been needed. Higher nominal bond yields have helped alleviate some margin pressure. Westpac has more scope to materially reduce costs than its peers and its management has indicated a strategy to do so.

Three largest detractors:

Overweight Monadelphous (MND, -22.5%)

Mining services company MND gave back the gains it made after April's news that it had settled out of court with Rio Tinto over liability for the Cape Lambert fire. The company continues to win new contracts and has a strong pipeline, but the market is focused on near-term pressure from higher labour costs on margins.

Overweight Qantas (QAN, -4.9%)

Covid outbreaks in Sydney and Melbourne weighed on travel stocks including QAN. The increasingly complex situation overseas has pushed back expectations of international travel. Australia's vaccination program should support the domestic market, which is more important to QAN's outlook.

Overweight Santos (STO, -3.0%)

Concerns about the impact of Covid outbreaks and Chinese tightening on global demand weighed on commodity stocks. For oil-related companies this was exacerbated by fears about additional Iranian supply. We maintain a positive outlook over the medium term. We believe demand will continue to revive. Coupled with tighter supply this should support oil prices.

Market outlook

The portfolio outperformed in May, helped by exposure to re-opening plays in Australia and the US. Several of the best performers were drawn from cyclical and value parts of the portfolio, in line with a broad rotation in the market.

Some of the growth names underperformed, notably Xero (XRO). But it held up better than other tech growth names. Not owning companies like Afterpay offset this drag on relative performance.

The gold price saw some relief as inflation expectations rose, driving the position in Evolution (EVN). The rest of the mining and resource sector tended to underperform.

The portfolio is broadly neutral on resources, but some interesting opportunities are emerging.

Recent commodity price weakness has been driven mainly by the view that slowing Chinese credit growth and effort by Beijing to curb speculation will drag prices down. However this view perhaps understates the demand side of the equation.

The Chinese economy recovery has been highly leveraged to exports, which have been running hot on pent-up Western demand. Applying the brakes to credit growth can help temper overall economic momentum. But it may not have as much of an effect on demand for exports, which is a key driver of commodity prices.

There is the additional factor that commodity demand from the rest of the world is also now coming through, potentially exacerbated by stimulus spending programs. This may moderate the effect of Chinese efforts to ease commodity prices.

We are mindful of some recent developments in the energy space. Renewed global Covid outbreaks and the potential for additional Iranian supply weighed on the oil price recently.

But several events are likely to constrain medium-term supply. This includes a ruling in the Netherlands that Shell must expand its plan to cut emissions; the election of new directors to Exxon's board; and the International Energy Agency's roadmap to net-zero by 2050. These are all indicators of an environment in which investment in new fossil fuel projects will become increasingly hard. As production rates decline at an accelerating rate (due to the proportion of shale energy in the mix) this is all supportive of much stronger energy prices in the medium term.

These are two of the macro factors we are considering in the portfolio's current construction. We also continue to monitor inflationary expectations, policy settings and recent Covid outbreaks in various parts of the world.

We are still reasonably sanguine on the outlook for Australian equities in the current environment. However a high degree of macro uncertainty emphasises the importance of maintaining a portfolio that can adapt to swift change in the underlying environment.

New stocks added or stocks sold to zero during the month

No new stocks added or sold during the month.

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

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