Pendal Focus Australian Share Fund

ARSN: 113 232 812

Factsheet

Equity Strategies

30 June 2022

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 31 years' industry experience. Crispin is also Head of Equity.

Other Information

Fund size (as at 30 Jun 2022)	$1,478 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	3.0% - 6.0%
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	-9.60	-9.55	-8.97
3 months	-11.36	-11.20	-12.22
FYTD	-7.61	-6.92	-6.78
6 months	-9.84	-9.51	-10.39
1 year (pa)	-7.61	-6.92	-6.78
2 years (pa)	10.06	11.07	9.45
3 years (pa)	5.09	6.08	3.44
5 years (pa)	7.90	8.92	6.90

Sector Allocation (as at 30 June 2022)

Energy	10.2%
Materials	20.6%
Industrials	7.3%
Consumer Discretionary	3.8%
Consumer Staples	3.0%
Health Care	9.6%
Information Technology	6.3%
Telecommunication Services	8.9%
Financials ex Property Trusts	23.7%
Property Trusts	2.8%
Cash & other	3.8%

Top 10 Holdings (as at 30 June 2022)

BHP Billiton Limited	12.6%
CSL Limited	9.0%
Santos Limited	7.1%
Telstra Corporation Limited	7.0%
Commonwealth Bank of Australia Limited	5.9%
Qantas Airways Limited	4.7%
National Australia Bank Limited	4.6%
Westpac Banking Corporation	4.3%
QBE Insurance Group Limited	3.7%
Xero Limited	3.7%

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 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 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.

Market review

The US Federal Reserve's determination to bring inflation under control is stoking fears of recession. This was exacerbated in June by a CPI print which came in slightly higher than expected and showed inflation broadening across categories.

The Fed hiked rates 75bps in June and indicated that they could do the same again in July. They are now signalling that they could end the year at 3.4%, according to the "dot plot" of expected moves. Three months ago, this figure was 1.9%.

Other central banks are striking a similarly hawkish tone with regard to the pace of rate hikes. The Reserve Bank of Australia hiked 50bps.

This saw sharp falls in equity markets, as investors start to factor in the risk of earnings downgrades. It also saw a rotation away from value and the more cyclical sectors.

Australia underperformed as a result, with the S&P/ASX 300 off -9.1%. The S&P 500 fell -8.4% and the Euro Stoxx -8.8%. However the Australian market has still outperformed over the calendar year to date.

The two largest sectors of the Australian market – which had held up well thus far – were both hit hard. Materials fared worst as commodity prices tumbled and dragged on the miners. Iron ore fell -11.9% and copper -12.6%. BHP (BHP, -7.5%) held up better than most of the other miners, which saw double digit falls. The copper and lithium miners underperformed, having been among the sector better performers previously.

Financials fell as the RBA's rate hike triggered fears of domestic recession and saw some shorting of Australian banks, particularly by international investors. ANZ (ANZ, -12.0%) held up best of the Big Four, while Westpac (WBC, -18.3) fared worst. The insurers held up much better, with QBE (QBE, +1.0%) managing a small advance.

Consumer Staples held up well as investors sought defensive pockets. Woolworths (WOW, +2.7%), Coles (COL, +1.6%) and Endeavour (EDV, +4.3%), the three largest stocks in the sector, all made gains.

Energy also outperformed and held up well despite Brent crude oil falling -6.5%, thermal coal -9.6% and natural gas -23.2%. This was largely due to strength in the newly re-christened Woodside Energy (WDS, +7.0%), the largest stock in the sector. It did well in the wake of the tie up with BHP's oil and gas assets. Other energy producers such as Santos (STO, -9.5%) were softer. The fuel retailers such as Ampol (ALD, +2.6%) and Viva Energy (VEA, +1.8%) did well on the back of recovering volumes and strong refining margins.

Fund performance

The Fund underperformed the benchmark over the month of June.

Key contributors

Overweight Telstra (TLS, -0.8%)

Telstra held up much better than the broader market in June as investors sought defensive exposure. The company announced price increases across mobile phone contracts, to take place from July. Improvement in this division underpins a more predictable outlook for the company's earnings and cash flow, which should be seen favourably in the current environment.

Overweight QBE Insurance (QBE, +1.0%)

The insurance sector has generally outperformed in the last few months, as higher bond yields should provide a tailwind for margins. At the same time, premium pricing have been rising, helping offset rising claims inflation and structural issues posed by higher provisioning and reinsurance costs for weather-related events. QBE has done better than the domestically-focused insurers, where the market has been concerned about exposure to recent flooding events.

Key detractors

Overweight Evolution Mining (EVN, -38.0%)

Gold miners are faced with a squeeze as cost inflation – for labour, diesel and power – continues to rise while the price of gold has remained steady. This has dragged on the gold mining sector as a whole, though EVN took an additional hit as management downgraded production guidance as Covid has disrupted labour supply. EVN remains among the lowest cost gold producers.

Overweight Qantas (QAN, -18.9%)

Concerns that the tightening cycle could drive the US economy into recession weighed on cyclicals in S&P 500, including on airline stocks and travel-related Australian stocks such as Qantas followed suit. A trading update from QAN late in the month Confirmed that demand remains strong. It reduced capacity in order to offset high fuel prices and continued to reduce debt ahead of schedule.

Outlook

We maintain a cautious near term outlook for equities. It is increasingly hard to see how the US avoids a recession from here.

First the lagged effect of inflationary pressures means we are unlikely to see much relief on this front given the fuel, food, and shelter components are still rising. This gives the Fed little room to back off hikes. Second, while overall economic activity remains reasonable, the lead indicators are deteriorating.

These include the "rule of ten" observation of mortgage rates and petrol prices - which has a good track record of predicting recessions – and falling house prices which can affect consumption. This is feeding through to a fall in the Altanta Fed's GDP tracker and other GDP forecasts rolling over.

This economic risk has implications for the market. The market is currently discounting a material drop in earnings, while the latter continue to hold up. Since 1987 we have only seen this disconnection twice, in 2002 and 2011, where markets overstated risk.

However in 2000, 2008 and 2020 the earnings caught up with the market and therein lies the risk if the US and global economy go into a recession.

Valuations in the markets other than the US - including Australia - are lower and provide some protection. But we remain wary of how the market performs as downgrades come through.

While the risk is material, this bearish scenario is not a certainty. Factors which could see a better outcome include:

- Inflation momentum slows more quickly than now expected. There are some signs of hope with higher inventory at US retailers and evidence of discounting appearing. The fall in the oil price is a very important lead if sustained.
- Labour markets loosen up sooner. We have seen announcements from the tech sector on layoffs, but collectively this is not sufficient. On the supply side perhaps inflation and the crypto bust help drive participation higher.
- Supply chains begin to ease up as China re-opens and demand softens.

Should these factors start to play out we may see the Fed swerve again and not be as aggressive on rates. It would still be unclear whether this is enough to avoid a recession; but in the market's eyes it would at least signal the depth of the downturn could be lower.

One flag which is likely to mark the low in this cycle is the passing of time. This market looks closer in nature to 2000 and 2008 where the market had to consolidate near its lows for a number of months before sentiment improved – unlike the sharp policy-driven bounce of 2020.

This is a challenging environment for portfolio construction, however we believe it plays to the strength of our approach.

Our strategy is underpinned by identifying mis-priced stocks by "anticipating change," and building a portfolio that manages thematic risk and is primarily dependent on stock-specific alpha – rather than a particular macro pathway or outcome – to perform.

Both elements can be seen in the way we approach portfolio construction in this environment. We have a range of thematic exposures, such that performance is not dependent on a particular outcome or pathway in terms of the key macroeconomic uncertainties currently at play.

Within this framework, we are finding stocks which have a company-specific aspect which can support valuation and/or drive outperformance. A key element of this at the moment is an emphasis on pricing power and of cash flow that has resilience even if we do see economic momentum start to slow.

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.

For more information please call **1300 346 821**,
contact your key account manager or visit **pendalgroup.com**

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