PENDAL

Factsheet

Pendal Sustainable Australian Fixed Interest Fund

Class R

ARSN: 612 664 730

Income & Fixed Interest

30 June 2022

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 directly involved in either of the following activities:

- tobacco production; or
- controversial weapons manufacture (such as cluster munitions, landmines, biological or chemical weapons, depleted uranium weapons, blinding laser weapons, incendiary weapons, and/or non-detectable fragments).

The Fund will also not invest in issuers directly involved in any of the following activities, where such activities account for 10% or more of an issuer's total revenue:

- the production of alcohol;
- manufacture or provision of gaming facilities;
- manufacture of non-controversial weapons or armaments;
- manufacture or distribution of pornography;
- direct mining of uranium for the purpose of weapons manufacturing; or
- extraction of thermal coal and oil sands production.

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 Income & Fixed Interest team includes eight dedicated investment professionals. The team also draws on a wide range of knowledge resources including Pendal's other specialist investment teams: Equity and Multi-Asset. The portfolio manager of the Fund is George Bishay, who has more than 28 years industry experience.

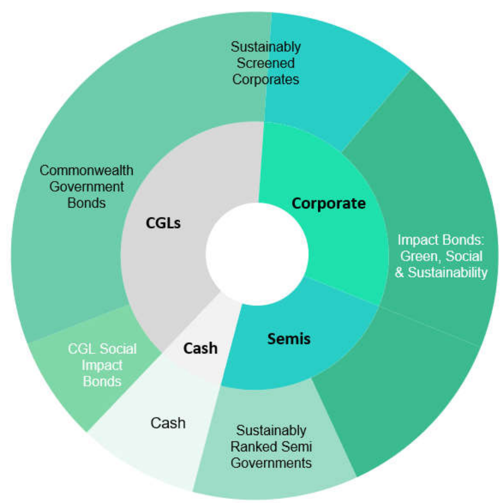
Performance

(%)	Total Returns (post-fee)	(pre-fee)	Benchmark Return
1 month	-1.73	-1.70	-1.48
3 months	-4.24	-4.15	-3.81
6 months	-10.25	-10.07	-9.46
1 year (pa)	-11.23	-10.87	-10.51
2 years (pa)	-5.51	-5.13	-5.80
3 years (pa)	-2.09	-1.70	-2.58
5 years (pa)	1.10	1.51	0.87
Since Inception (pa)	0.80	1.20	0.60

Sector Allocation (as at 30 June 2022)

Government bonds^	31.7%
Semi-Government bonds^	10.8%
Sustainability Screened Corporate bonds	8.8%
ESG Thematic bonds - Climate	19.3%
- Social	9.3%
- Sustainable	9.8%
Cash & other	10.2%

^ Ex Green, Social & Sustainable Bonds



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.

Portfolio Statistics (as at 30 June 2022)

Yield to Maturity#	3.85%
Running Yield*	2.29%
Modified duration	5.46 years
Credit spread duration	1.11 years
Weighted Average Maturity	5.59 years

* The portfolio running yield is calculated as the weighted average coupon rate of the physical portfolio assuming all securities are held at par or face value. Carry/interest income from synthetic positions are excluded from this calculation. Running yield does not reflect the actual income return of the portfolio.

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 30 Jun 2022)	$680 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 or withdraw funds, 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 Reserve Bank of Australia (RBA) raised the cash rate by 0.50% to 0.85%, their first 50 basis point hike since February 2000 and resulted in the market pricing in a cash rate closer to 4% by the end of the year. Expectations were pared back following comments from RBA Governor Lowe which indicated that moves of 25 or 50 basis points were more likely than 75 basis points. In a rare interview Governor Lowe stated that following the rise in commodity prices since the May release of the RBA's Statement on Monetary Policy that inflation is now seen as being at 7% by the end of 2022. The forecast in May was 5.9%.

The labour market continues to perform strongly. Employment grew by 60,600 jobs in May, with full time jobs adding 69,400 jobs and part time employment detracting slightly. The unemployment rate was unchanged at 3.9% due to the participation rate rising 0.3% to 66.7%. The minimum wage was increased during the month with the Fair Work Commission announcing a 5.2% increase, effective from 1st July. Other labour market indicators such as ANZ job ads and NAB's business survey continue to point to ongoing strength.

Despite the labour strength consumer sentiment fell sharply in May according to the Westpac-Melbourne Institute survey. The survey was weighed down by the 50 basis point rise in the cash rate during the month and made for concerning reading. The index has only been around current levels during major economic dislocations in its 46 year history, which included the Global Financial Crisis and recessions in the 1980's and 1990's. The 'time to buy a dwelling' index fell to a new post GFC low and the survey reflected that 58% of respondents expect rates to increase by more than 1% in the next year.

The NAB business survey painted a better picture despite business conditions and confidence easing slightly in May. Conditions remain well above the long term average and confidence is around long term averages. Forward looking indicators show capacity utilisation at near record high levels and forward orders remaining elevated. The survey indicated another elevated inflation outcome remains likely for the 2nd quarter. Most business are in a strong position and the economy has maintained momentum despite higher interest rates and global growth concerns.

The RBA released its review of the yield target during the month. Whilst initially seen as being successful when combined with other monetary policy measures in providing insurance against the effects from the pandemic the RBA acknowledged the exit from the yield target in late 2021 was disorderly and caused reputational damage following bond market volatility and market dislocation. The probability of using a yield target again is seen as low and would be of shorter tenor. The use of a bond purchase program rather than a yield target is seen as providing greater flexibility and would be the preferred option if non-conventional tools are required again. The RBA is undertaking a review of the bond purchase program later this year.

Bond yields moved higher over June. Australian three and ten year bond yields ended the month 28 and 31 basis points higher at 3.12% and 3.66%. US two and ten year bonds ended the month 40 and 17 basis points higher in yield at 2.96% and 3.02%. The larger than expected 50 basis point from the RBA saw the short end rates sell off further with three and six month yields 63 and 74 basis points higher at 1.81% and 2.67%.

Credit review

June saw credit spreads widen primarily driven by concerns that central banks would over-tighten and cause a recession. Markets aggressively increased expectations for future interest rate moves over the month on the back of 1) higher than expect inflation data, 2) hawkish central bank rhetoric, and 3) the growing risk of multi-year high inflation.

- **High inflation data** - Inflation prints globally continued to rise above expectations. The US CPI release was broad based across many categories. The headline level reached 8.6%, the highest level for 40 years. The Eurozone's inflation hit 8.8% for the month of May. In Australia, RBA governor Lowe revealed that he now expects Australian CPI to reach 7% later in the year.
- **Central banks responded hawkishly** to these inflation data points, reiterating their focus on controlling inflation with rate hikes as opposed to supporting economic growth. US Federal Reserve Chair Jerome Powell stated that his commitment to fighting inflation is "unconditional" and that the "only way" to ease inflation is to balance supply and demand.
- **The risk of persistently high inflation** also grew in the market's eyes given that materials & labour shortages are real world problems that are difficult to solve using just interest rates and could take years to remedy. The general public seems to be increasingly resigned to higher inflation, with its repercussions becoming embedded into greater wage expectations.

The net effect of these recent developments have lowered household confidence as seen by the poor US Consumer sentiment data, and led to investor caution in equity & fixed income markets. However in the latter part of the month, markets walked back some of their rate hike expectations as oil prices moved lower after a rally in the start of the month, allowing risk markets to benefit from a small relief rally.

Credit spreads underperformed over the month. The Australian iTraxx index (series 37) traded in a wide 37bp range finishing 35bps wider at 130bps. Australian physical credit spreads moved out a few basis points on average. The best performing sector was supranationals that tightened 1bp, whilst the worst performing sectors were utilities and industrials that widened 6 and 5bps respectively. Semi-government bonds also underperformed pushing out 14bps to commonwealth government bonds.

Fund performance

The portfolio underperformed the Bloomberg AusBond Composite Bond index by 0.22% (pre-fee) in June.

The duration component of the portfolio was a negative in June. The portfolio has a small long duration in the very front end given the view the RBA cash rate will end the year around 2.5%. After the Fed hiked 0.75% markets put in very aggressive hikes in Australia, at one point pricing in year-end rates nearer 4%. The RBA continues to expect rates to be 2.5% year end but given their poor record recently markets are still pricing in closer to 3.5%, causing the underperformance.

The physical portfolio underperformed the benchmark. The government sector positioning performed inline however the non-government portion of the portfolio detracted from performance. Supranational and financials sector positioning were a drag on performance.

Market outlook

The RBA is now on a determined path back to neutral cash rates. It has been vocal in viewing this as around the long term inflation target of 2.5%. Given it started June at 0.35% it now views 0.5% hikes as needed and will likely follow June's move with similar hikes in July and August. The Q2 inflation data at the end of July will justify these moves.

However from August onwards the scope and size of moves will be less clear. Emerging signs that improving supply chains may bring some commodity and global price relief will be watched closely. Adding to this is the fixed rate mortgage 'cliff' that begins in Q4. This will see over 30% of mortgages move from COVID low fixed rates of around 2% to floating rates closer to 5% by the end of 2023.

Markets for now have priced terminal rates at 3.5%, having briefly touched 4% in mid June. However this may come down further as the US economy eases and recession fears build. Our view is that any recession in the US will be more technical than anything and Australia will see lower growth but not enough to move unemployment higher. In this environment the RBA will be happy to let cash settle at 2.5% by year end with only modest hikes if any in 2023.

Credit outlook

We have been cautious on credit spreads since the start of the year with a view that we will see short-term volatility in markets due to the rising global inflation fears and upcoming withdrawal of money supply. This defensive positioning has assisted in reducing downside performance given the recent widening in credit spreads.

In the near term we continue to expect market volatility as global central banks tighten monetary policy to combat higher inflation. The lockdowns and continued zero-COVID policy in China will likely add to supply chain disruptions and inflationary pressures.

That said, we are still constructive on the medium-term outlook for credit spreads. Credit and broader risk assets will continue to benefit from sustained global stimulus and strong fundamentals. Pent-up consumer consumption continues to drive demand for goods and services which is supportive for economic growth, positive for company earnings and beneficial for credit fundamentals.

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.
- **Counterparty risk**: The risk of another party to a transaction failing to meet its obligations.

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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