# Pendal Horizon Sustainable Australian Share Fund

ARSN: 096 328 219

Factsheet

Equity Strategies

31 July 2022

The future is worth investing in

### About the Fund

The Pendal Horizon Sustainable Australian Share Fund (**Fund**) is an actively managed, high-conviction, values-orientated, concentrated portfolio of Australian shares. It seeks to invest in companies that enable, lead and participate in the transition to a more sustainable Australian economy, while avoiding those which cause significant harm, undermine a more sustainable economy, or that do not meet our minimum environmental, social and governance (ESG) performance standards. The investment process combines the potential to achieve strong performance over the long term through a diversified set of investment opportunities while also investing in companies whose practices and impacts are in our view aligned with an investor's own social, environmental and ethical preferences.

### Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 (TR) Index over rolling 5 year periods. The suggested investment timeframe is five years or more.

### Investment Approach

We adopt a principles-based approach in defining our investment opportunity set. We have a set of exclusionary screens (see PDS for full details) and a framework to identify companies which are aligned with our Fund priorities of supporting a more sustainable, future-ready Australian economy.

We seek companies involved in…

- ✓ Innovation & technological advances (including climate solutions)
- ✓ More sustainable resource consumption
- ✓ Sustainable & resilient infrastructure
- ✓ Quality education
- ✓ Meeting basic needs
- ✓ Health & wellbeing
- ✓ Social inclusion & diversity
- ✓ Low carbon transportation

We avoid companies involved in…

- x Fossil Fuels
- x Tobacco
- x Weapons
- x Alcohol
- x Gambling
- x Animal testing
- x Pornography
- x Predatory lending
- x Logging
- x Uranium

### Investment Process

The Fund uses the same investment process as Pendal's flagship Australian equities funds with the additional application of exclusionary screens and a sustainability-focused framework.

1. The negative screening process effectively determines the investment universe of the Pendal Horizon Sustainable Australian Share Fund.
2. Investment ideas are generated through our proprietary framework, identifying companies which contribute to a more sustainable economy.
3. We construct a portfolio with stocks which we believe will generate alpha and at a minimum 'do-no-harm'.

We also actively undertake targeted engagement with companies to support a more sustainable economy and to ensure ESG risks are being appropriately managed.

### Investment Team

Pendal's nineteen member Australian Equities team is one of the largest in the industry. The portfolio manager is Head of Equities, Crispin Murray, assisted by Elise McKay, Oliver Renton and Patrick Teodorowski on the application of the Fund's investment framework.

### Performance

| (%) | Total Returns (post-fee) | Total Returns (pre-fee) | Benchmark Return |
|---|---|---|---|
| 1 month | 6.82 | 6.90 | 5.95 |
| 3 months | -8.64 | -8.42 | -6.21 |
| FYTD | 6.82 | 6.90 | 5.95 |
| 6 months | -3.45 | -2.99 | 1.50 |
| 1 year (pa) | -7.70 | -6.82 | -2.31 |
| 2 years (pa) | 8.49 | 9.53 | 12.32 |
| 3 years (pa) | 2.59 | 3.57 | 4.43 |
| 5 years (pa) | 6.21 | 7.22 | 8.15 |

### Investment Guidelines

| | |
|---|---|
| Ex-ante (forward looking) tracking error | 3.0% - 8.0% |
| Min/max stock position | +/-10% |
| Min/max sector position | +/-10% |

### Fees and costs

You should refer to the latest Product Disclosure Statement for full details of the ongoing fees and costs that you may be charged.

| | |
|---|---|
| Management fee[1] | 0.95% pa |

[1] This is the fee we charge for managing the assets and overseeing the operations of the Fund. The management fee is deducted from the Fund's assets and reflected in its unit price.

### Other Information

| | |
|---|---|
| Fund size (as at 31 Jul 2022) | $306 million |
| Date of inception | May 2001 |
| Minimum investment | $25,000 |
| Buy-sell spread[2] | 0.50 (0.25%/0.25%) |
| Distribution frequency | Quarterly |
| APIR code | RFA0025AU |

[2] 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.

Signatory of: PRI Principles for Responsible Investment

CERTIFIED RESPONSIBLE INVESTMENT — CERTIFIED BY RIAA

The Pendal Horizon Sustainable Australian Share 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.

**Sector Allocation** (as at 31 July 2022)

| | |
|---|---|
| Materials | 16.5% |
| Industrials | 10.4% |
| Consumer Discretionary | 0.9% |
| Consumer Staples | 1.1% |
| Health Care | 13.0% |
| Information Technology | 7.9% |
| Telecommunication Services | 13.4% |
| Utilities | 0.0% |
| Financials ex Property Trusts | 27.9% |
| Property Trusts | 4.2% |
| Cash & other | 4.7% |

**Top 10 Holdings** (as at 31 July 2022)

| | |
|---|---|
| CSL Limited | 10.8% |
| Telstra Corporation Limited | 8.0% |
| Commonwealth Bank of Australia Ltd | 6.5% |
| National Australia Bank Limited | 6.3% |
| Westpac Banking Corporation | 4.9% |
| Xero Limited | 4.6% |
| Qantas Airways Limited | 4.3% |
| QBE Insurance Group Limited | 4.1% |
| Downer EDI Limited | 4.0% |
| Macquarie Group Limited | 3.8% |

## Carbon performance

The estimated weighted average carbon intensity (WACI) of the portfolio, using greenhouse gas emissions (scope 1 and 2[1]) data supplied by ISS and weighted by the size of our holding in each company, is shown in the table below. In other words, this provides an indication of a portfolio's exposure to carbon intensive companies. We also compare this to the weighted average emissions for the companies in the aggregated ASX300 index.

We caution that there are limitations of using carbon metrics as an indicator of a portfolio's overall exposure to climate-related risks. For example, not all companies report their emissions data and hence some of the below analysis includes estimates. Also, it does not include scope 3 emissions. Further, portfolio carbon analysis does not capture exposure to physical climate-related risks, or the unique transition risks some companies within the portfolio face. Nevertheless, the WACI metric is recommended by the Task Force on Climate-related Financial Disclosures (TCFD)[2], noting it supports greater comparability of investor reporting.

**Weighted Average Carbon Intensity (tonnes $CO_2e$ / $M revenue)**

| Pendal Horizon Sustainable Australian Share Fund | ASX 300 | Relative to ASX300 |
|---|---|---|
| 107.94 | 220.14 | -112.20 |

Source: ISS, Pendal holdings as at 31 July 2022. Report run on 08/08/2022 using latest ISS data. Currency AUD.

[1] Scope 1 emissions result from sources directly owned or controlled by the company. Scope 2 accounts for GHG emissions from the generation of purchased electricity consumed by the company. Scope 3 emissions result from activities not directly owned or controlled by the company but are associated with its operation such as business travel, waste management, commuting, and the use of sold products and services. https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

[2] *Recommendations of the Task Force on Climate-Related Financial Disclosures, June 2017* https://www.fsb-tcfd.org/recommendations/

**Market review**

The market took a positive turn in July. Signs that inflation may be peaking and that growth is slowing is seen as opening the door to the Fed scaling back the speed and scale of interest rate hikes. In this environment, bad news on the economic front is being seen as good news.

The S&PASX 300 gained 6.0% with every sector apart from materials (-0.4%) making gains. This rebound was seen across international markets more broadly with the MSCI World Index returning 6.4% and the S&P 500 7.6% in AUD terms. Emerging markets lagged far behind the rest of the world. China was in the red as the economy had its smallest growth rate since the beginning of 2020. A weakening property market alongside new lockdown measures in several cities were some of the primary factors.

We saw central banks again hike rates this month – the Fed up 75 bps, the ECB and RBA both up 50 bps. Softer US economic data, particularly in housing activity suggests a slowdown which saw bond yields fall. This alleviated some pressure seen year-to-date as investors considered less intense rate rises a possibility in the future. In response, the Australian and US 10-year bond yields fell 60 bps to 3.06% and 33 bps to 2.64%, respectively.

The market generally saw a sharp rotation away from areas which had been doing well to those which have previously lagged. As a result, small caps outperformed, as did growth.

Information Technology (+15.4%) did well on the back of this and was the best performing sector. Computershare (CPU), now the largest tech stock in the index, only ground out a 1.38% gain as beneficiaries of higher rates underperformed. However, Xero (XRO, +20.83%) and Wisetech (WTC, +32.36%) were some of the top performers. Additionally, financial software provider Iress Limited (IRE, -1.39%) was down after announcing its CEO of 13 years will be leaving the company.

Real Estate (+12.0%) also saw a solid rebound. This was across the board - although retail mall owners did particularly well, office, residential and industrial were also strong. Goodman (GMG), the largest REIT in the index, was also up 16.0%.

Materials underperformed as commodity prices were generally softer. This was driven by the large miners, with BHP (BHP) off -6.23%, Rio Tinto (RIO) -4.74% and South32 (S32) -3.30%. Fortescue Metals (FMG, +4.62%) managed to buck the trend. This offset strength in the lithium sector, with Mineral Resources (MIN) up 11.33% and Pilbar Mineral (PLS) up 20.96%. The rest of the sector, including the packaging companies and chemical producers, was generally stronger.

Energy (2.2%) also lagged the index. The price of Brent crude oil fell -4.2%, however thermal coal rose 5.7% and natural gas 28.2%. The oil and gas players were generally softer; Woodside Energy (WDS) rose only 0.44% while Santos (STO) fell -1.6%. However, the pure coal names such as Whitehaven (WHC, +28.31%) were strong. WHC also benefitted from an upgrade from brokers, citing significant cash flow generation and a positive Q4 update.

Within Financials (9.4%), BNPL stocks had one of its strongest months of the year, with Zip Co (ZIP, +157.96%) and recent owner of Afterpay; Block (SQ2, +19.87%) recouping some losses from previous months.

**Fund performance**

The fund outperformed its benchmark over the month of July.

**Contributors**

**Underweight BHP (BHP, -6.2%)**

China's near-term economic outlook is clouded by the ongoing effects of Covid restrictions and concerns over the property sector. At this point, Beijing has introduced policies to try and stem further deterioration, but has not launched a widespread stimulus. This is against a broader background of concerns about the impact of higher rates on global economic growth. This is weighing on commodity prices, with iron ore and copper prices both falling just over 4% in July, weighing on the miners.

**Overweight Xero (XRO, +20.8%)**

A more positive tone in markets, on the view that slower growth and some signs of inflation rolling over opens the door to the Fed scaling back tighter policy, was accompanied by a rotation from value to growth stocks. Xero benefited from this trend. We continue to see a material fundamental growth opportunity for XRO in the UK, where regulatory changes are forcing small to medium business to complete tax on-line.

**Detractors**

**Overweight QBE Insurance (QBE, -5.1%)**

The shift in market sentiment saw rotation away from the beneficiaries of higher rates which had previously been doing well, such as QBE. We continue to see opportunity in QBE as part of our preferred exposure to financials. It gains a margin benefit from higher rates, while at the same time the insurance sector is benefiting from higher premium prices.

**Overweight Telstra (TLS, +1.0%)**

There was little company-specific news to shift TLS's stock price in July. It had enjoyed strong outperformance in the second quarter as investors had sought defensive exposure and is likely to have lagged on the rotation to growth in July. It remains among our preferred defensives, underpinned by good cost-pass through and better profitability in the mobile phone segment.

**Market Outlook**

The big debate is whether July's rebound is a bear market rally or whether we have put in the lows for this cycle.

At this point, the rebound is almost bang on the average bear market rally – in terms of rebound and length - in the S&P 500 since 1950.

The market breadth of the rally is not yet consistent with a change in trend. The rule of thumb is you need to see 90% of stocks above the fifty day moving average to signal a change in market direction. We are at 73%. However this could continue to climb.

The yield curve is also sending a negative signal. Its inversion is signalling recession, which would lead to a decline in earnings and pull the markets lower. The challenge to this perspective is the unusual speed and scale of the increases and the market's current confidence that inflation will be brought back down, which is reflected in long bond yields.

On the other hand, the bull case for equity markets is that;

1) The S&P 500 has bounced off long term technical support levels
2) Oil prices have peaked, with demand weakening
3) Bond yields have peaked, helped by lower commodity prices

The positive case is underpinned by the view that oil prices won't bounce back. We see this as a potential negative surprise for markets. There are several reasons why oil could behave differently in this cycle.

1) Inventories are low, despite tapping the US Strategic Petroleum Reserve (SPR). The latter probably has capacity for three more months of contributions to supply, with the run rate falling in that time.
2) Spare capacity is very limited, as shown in OPEC's only increasing output by 100,000 barrels per day (bpd) in September. There is no buffer for demand recovering, nor for any geopolitical shock.
3) Europe plans on tightening sanctions on Russian oil in December, which could limit access to .01 to 1.5m bpd
4) China at some point will re-open its economy, increasing oil demand by 500k – 1m bpd
5) Oil demand may surprise on the upside due to fuel oil. This is the first downturn where alternate fuel prices –notably gas and coal - are far higher than oil. This is likely to see some substitution to oil – not away from it as is normally the case. The US gas market has remained surprisingly tight despite the closure of the Freeport LNG export facility.

We are mindful that this may not play out for a few more months, given SPR still being released, China is set to run with zero Covid for another few months and the global economy is slowing.

So for time being, the weaker oil/lower bond signal could remain in place, but it is something to watch.

It is also important to remember that equity markets form part of the overall total financial conditions index which has an impact on the pace of economic growth.

The Fed's plan is firstly to slow growth below trend, which in turn should loosen the job market, leading to lower wage growth and inflation.

The Fed had shifted this sufficiently to be consistent with 1% GDP growth, in-line with the aim of a soft landing.

However the reaction to Chair Powell's press conference in July meant total financial conditions were beginning to ease. The Fed needed to check that move to keep conditions conducive to below trend growth.

All in all, at this point it is too early for a heroic call either way with regard to the near-term outlook. We maintain our balanced portfolio positioning, which is not dependent on a binary call on the outcome.

**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.
- **Concentration 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 available on the Pendal's website.

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

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