Pendal Monthly Commentary

Pendal Australian Shares Portfolio

October 2022

Market commentary

Australian equities rebounded in October with the S&P/ASX 300 up 6.0%.

There was some see-sawing during the month as the market grappled to interpret successive data prints from the US.

However ultimately equity markets were driven by the expectation that the Fed would respond to slowing growth and some signs of financial market strain with a "pivot" away from its hawkish path. The extremely bearish positioning on investors post the recent sell-off also played a role.

China's National People's Congress saw President Xi installed for a third term - and the degree to which he has quelled potential factional opposition caught most by surprise. The initial inference is that policies such as Covid zero and less appetite to use traditional stimulus to support the economy remain in place.

Gains were largely broad-based, with only Consumer Staples (-0.16%) and Materials (-0.18%) losing ground - and only marginally so.

Financials (+12.1%) was the best performing sector, driven by the banks, which are demonstrating the benefits of higher rates for net interest margins in their most recent updates. Insurers are also beneficiaries and also did well in October.

Real Estate (+9.3%) enjoyed relief after a torrid run, on the hope that a milder pace of rates hikes might see a headwind recede. Index heavyweight Goodman Group (GMG) was up 7.7%. The retail malls also continued to do relatively well, with Scentre Group (SCG) up 14.2% and Vicinity (VCX) up 12.1%. However the market continue to express more doubt around the outlook for office with Dexus (DXS) only gaining 0.5%.

The miners weighed on Materials as the outlook for Chinese growth - and for the property sector in particular, remains muted. BHP (BHP) fell -3.0%, Rio Tinto (RIO) -5.6% and Fortescue Metals (FMG) -12.6%. The lithium sector surged apace, with Pilbara Minerals (PLS) up 11.6%,

Consumer Staples underperformed as investors were less defensive. Woolworths (WOW) fell -2.7% and Coles (COL) - 0.6%. Metcash (MTS, +5.9%) bucked the trend.

Portfolio overview

Australian Shares Portfolio	
Investment strategy	The strategy employs a bottom up, fundamental approach to build a diversified portfolio of Australian shares where the majority of active risk and outperformance is driven by stock selection.
Investment objective	The objective of the Model Portfolio is to outperform the S&P/ASX 300 (TR) Index on a rolling 3 year period.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15-35 (31 as at 31 October 2022)
Sector limits	A-REITS 0-30% Cash 2-10%
Dividend Yield	4.34%#
Income target	No target

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	10.25%
CSL	CSL Limited	8.39%
STO	Santos Limited	7.58%
CBA	Commonwealth Bank of Australia	6.75%
TLS	Telstra Group Limited	6.62%
NAB	National Australia Bank Limited	5.98%
WBC	Westpac Banking Corporation	5.54%
QAN	Qantas Airways Limited	5.08%
XRO	Xero Limited	3.64%
QBE	QBE Insurance Group Limited	2.96%

Source: Pendal as at 31 October 2022

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
STO	Santos Limited	6.35%
QAN	Qantas Airways Limited	4.56%
TLS	Telstra Group Limited	4.46%
XRO	Xero Limited	3.12%
MTS	Metcash Limited	2.67%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WDS	Woodside Energy Group Ltd (not held)	-3.26%
ANZ	Australia and New Zealand Banking Group Limited	-2.49%
WES	Wesfarmers Limited (not held)	-2.46%
TCL	Transurban Group Ltd. (not held)	-1.94%
WOW	Woolworths Group Ltd (not held)	-1.91%

Source: Pendal as at 31 October 2022

#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 Shares Portfolio	6.33%	1.88%	-5.08%	-2.11%	6.95%	7.98%	8.90%
S&P/ASX 300 (TR) Index	5.96%	0.46%	-5.77%	-2.61%	4.86%	7.23%	7.30%
Active return	**0.37%**	**1.41%**	**0.69%**	**0.50%**	**2.09%**	**0.76%**	**1.60%**

Source: Pendal as at 31 October 2022

*Since Inception - 15 June 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
QAN	Qantas Airways Limited	0.44%
FMG	*Fortescue Metals Group Ltd (not held)*	*0.27%*
RIO	*Rio Tinto Limited (not held)*	*0.20%*
WOW	*Woolworths Group Ltd (not held)*	*0.18%*
WBC	Westpac Banking Corporation	0.15%

Top 5 detractors - monthly

Code	Name	Value Added
WDS	*Woodside Energy Group Ltd (not held)*	*-0.23%*
TLS	Telstra Group Limited	-0.19%
CSL	CSL Limited	-0.16%
CBA	Commonwealth Bank of Australia	-0.15%
ANZ	Australia and New Zealand Banking Group Limited	-0.14%

Top 5 contributors - 1 year

Code	Name	Value Added
BHP	BHP Group Ltd	1.18%
SQ2	*Block, Inc. Shs (not held)*	*1.00%*
STO	Santos Limited	0.78%
QAN	Qantas Airways Limited	0.51%
S32	South32 Ltd.	0.45%

Top 5 detractors - 1 year

Code	Name	Value Added
XRO	Xero Limited	-2.15%
WDS	*Woodside Energy Group Ltd (not held)*	*-0.96%*
JHX	James Hardie Industries PLC	-0.79%
JDO	Judo Capital Holdings Limited	-0.54%
NEC	Nine Entertainment Co. Holdings Limited	-0.48%

Source: Pendal as at 31 October 2022

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight Qantas (QAN, +16.3%)

QAN flagged that it expected underlying profit before tax in H1 FY23 between $1.2-$1.3bn, versus consensus expectations of ~$500m. It continues to rebound faster than the market expected. Business travel revenue is over 100% of pre-Covid levels and leisure revenue is ~130%. Group international capacity is expected to grow form 61% of pre-Covid in !h23 to 77% in 2H23, assisted by new planes coming on line.

Underweight Fortescue Metals (FMG, -12.6%)

The outlook for growth in the Chinese property sector - and the economy ore broadly - remains muted with nothing from the National People's Congress to suggest a change in path. Iron ore prices have continued to weaken as a result. This weighed on Fortescue, the largest pure-play iron ore miner in the index.

Three largest detractors

Underweight Woodside Energy (WDS, +13.6%)

Brent crude rose 7.8% for the month on the back of production cuts from the OPEC+ group, which sent a clear signal that they intend to support the oil price despite the US desire for lower prices to ease inflation. Woodside outperformed and the underweight dragged, although there was some offset from the position in Santos (STO).

Overweight Telstra (TLS, +1.8%)

As a more defensive exposure, Telstra underperformed as sentiment took a more positive turn. We continue to see the market in something of a holding pattern, with sentiment oscillating. We continue to see Telstra as in important defensive exposure in the event that the economy takes a material downturn as a result of tighter monetary policy. At the same time, it is benefiting from a return to profitability in the mobile phone segment.

Underweight Rio Tinto (RIO, -5.6%)

The lack of any meaningful change in policy direction from the Chinese National People's Congress weighed on sentiment in the commodity space. At this point Beijing appears unlikely to roll out any material stimulus measures or change to the Covid zero policy, with the economic outlook for the property sector and the broader economy remaining muted as a result. The portfolio is underweight in iron ore.

Overweight CSL (CSL, -1.6%)

CSL gave back some of its recent strong gains, although it was recovering into the end of the month. The update on the recently acquired Vifor business at its strategy day was well received. We continue to see the recovery in plasma supply as a decent tailwind for CDL, while an upcoming new product cycle can provide further upside catalysts.

Outlook

The market continues to oscillate between two potential scenarios.

At the benign end is the view that inflation continues to trend down, allowing the Fed to achieve its target rate and then start cutting rates towards the end of 2023. This results in a mild economic downturn and limited effect on earnings. In this scenario, further equity market downside is also limited.

The more bearish scenario is one where inflation remains stubbornly higher than the Fed wants, meaning that rates remain higher for longer. This, in turn, means a deeper recession and a significant earnings drop. In this scenario, the earnings effect takes markets a leg lower.

At the moment, the market seems to be bouncing between these poles, depending on the latest data prints or interpretation of statements from central banks. As a result, we see markets operating in a trading range for the time being.

The medium term market outlook remains dependent on the degree of economic downturn and the impact that has on earnings.

There is some debate about the degree of leverage earnings will have to the downturn. Historically, recessions have led to a 20% fall in earnings, on average. However this is often in a low inflation environment, when nominal GDP (a proxy for corporate revenue) is low.

In this instance, the bulls argue that there are three factors which may mitigate earnings decline;

1. Companies will benefit from higher nominal growth supporting revenue, helping cover fixed costs.
2. Materials and energy companies will see continued strong earnings, given lack of supply.
3. The potential re-opening of China may offset weakness in Europe and the US.

This degree of earnings leverage remains to be seen. However it is fair to say we are in a different type of cycle than those investors have grown used to.

The portfolio's performance is not predicated on which of these two scenarios wins out. If inflation remains high, prompting fear of higher-for-longer rates, it has exposure to domestic defensives and to companies with strong pricing power. If, on the other hand, the earnings outcome is milder than many fear, then the exposure to high quality cyclicals is expected to do well.

We continue to look for companies which combine the desired thematic exposures with a fundamental company-specific story that can provide an additional level of valuation support. Strong cash flow generation and the return of capital to shareholders remains attractive attributes in this environment.

We also remain mindful that the Australian equity market is relatively defensive in a global context. The combination of less inflationary pressure – particularly in wages, higher household savings, a more dovish central banks, strong terms of trade and the index construction have also seen the ASX hold up better than global peers.

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

No new stocks added or sold to zero during the month

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