Factsheet

Equity Strategies

31 December 2022

Pendal Focus Australian Share Fund

ARSN: 113 232 812

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 31 Dec 2022)	$1,522 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

[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.

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 (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	-3.53	-3.47	-3.29
3 months	7.51	7.71	9.13
FYTD	7.40	7.80	9.62
6 months	7.40	7.80	9.62
1 year (pa)	-3.17	-2.45	-1.77
2 years (pa)	6.06	6.88	7.45
3 years (pa)	5.69	6.66	5.51
5 years (pa)	7.50	8.49	7.10

Sector Allocation (as at 31 December 2022)

Energy	8.8%
Materials	20.2%
Industrials	6.7%
Consumer Discretionary	1.9%
Consumer Staples	2.7%
Health Care	10.3%
Information Technology	5.2%
Telecommunication Services	9.0%
Financials ex Property Trusts	25.9%
Property Trusts	4.3%
Cash & other	5.0%

Top 10 Holdings (as at 31 December 2022)

BHP Group Ltd	11.9%
CSL Limited	9.3%
Commonwealth Bank of Australia	6.7%
Santos Limited	6.7%
Telstra Group Limited	6.6%
National Australia Bank Limited	5.9%
Westpac Banking Corporation	5.4%
Qantas Airways Limited	5.4%
QBE Insurance Group Limited	4.6%
Xero Limited	3.7%

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[2]	0.75% pa
Performance fee[3]	15% of the Fund's performance (before fees) in excess of the performance hurdle.

[2] 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.

[3] This is the fee we charge if the Fund's investment performance exceeds its performance hurdle, and any performance deficit has been recouped. The Fund's performance fee is 15% of the Fund's performance in excess of the performance return hurdle. The performance hurdle is the performance of the Fund's benchmark (S&P/ASX 300 (TR) Index) plus the management fee of 0.75% pa. If a performance fee is payable, it is charged in addition to the management fee. The performance fee is calculated in dollar terms 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

Australian equities finished the year on a softer note, as central banks maintained a hawkish tone on inflation into the end of the year.

The S&P/ASX 300 fell -3.3% in December, giving back some of the gains of the previous two months. However it still finished up 9.1% for the quarter and down only -1.8% for the year. The S&P 500 fell -17.9% for the year, in contrast, highlighting the ASX's defensive qualities in this environment.

The US consumer price index (CPI – a measure of inflation) print for November was 0.2% month-on-month. This was down from 0.3% in October and was the second consecutive month where the increase was lower than consensus expectations. This, along with other signals, suggests that inflation continues to moderate.

However the US labour market remains strong and continues to concern the Federal Reserve. They need to see more slack in labour markets to calm fears about persistent wage increases driving further inflation. As a result, Chair Powell's comments following the interest rate hike in December emphasised the need to continue hiking – and to potentially keep rates high for longer than the market currently expects – until the labour market starts to soften.

Elsewhere, Beijing rolled back the zero-Covid policy. This has prompted some optimism around commodity prices on the hope that the disruptive economic effect of recurring lock-downs will end. Iron ore rose 15.7% for the month. However it is also seeing substantial near-term disruption and risks to the health system.

Every sector lost ground in December. Materials (-1.1%) held up better than the broader index on the back of higher commodity prices and optimism about the medium-term outlook for improved Chinese demand. BHP (BHP, +0.2%) held its ground, while fellow iron ore plays Rio Tinto (RIO, +6.2%) and Fortescue (FMG, +5.8%) made solid gains.

Utilities (-1.2%) also outperformed, helped by corporate actions as Origin (ORG, -1.8%) remains under a non-binding, indicative takeover offer.

Consumer Discretionary (-7.0%) fell the furthest on broad concerns over the impact of an economic slowdown in 2023. Wesfarmers (WES) was down -5.5%, Aristocrat (ALL) -12.9%) and JB Hi-Fi (JBH) -6.1%.

Industrials (-4.9%) was also among the weaker sectors. A continued hawkish tone weighed on the infrastructure names such as Transurban (TCL, -7.3%) and Atlas Arteria (ALX, -6.0%).

Fund performance

The Fund underperformed the benchmark over the month of December.

Contributors

Overweight QBE Insurance Group (QBE, +4.4%)

Global insurer QBE maintained its recent positive momentum. It is a beneficiary of higher interest rates as it boosts returns on its investment portfolio. This tailwind was confirmed in a recent update, with fixed income yields running well ahead of consensus estimates. Revenue momentum remains strong and the stock is cheap compared to global peers.

Overweight Telstra (TLS, +0.3%)

Telstra's defensive qualities were rewarded in December as investor sentiment softened. News that the Australian Competition and Consumer Commission (ACCC) blocked TLS's deal with TPG Telecom to share regional network capabilities weighed on the stock in the month's second half, to see it end flat for the period. We continue to see further upside from improved free cash flow following cost reductions.

Detractors

Overweight Downer (DOW, -28.2%)

Contractor DOW downgraded FY22 net profit after tax (NPAT) by ~12%. This was driven largely by weather disruption and issues with workforce management. However 3% was due to an accounting irregularity which had overstated profits on one contract. The large market reaction as driven by concern that this could be a broader issue. The company has largely exited higher-risk, fixed-price construction contracts and believe the issue is not replicated, but is investigating. It has a good balance sheet, is buying back shares and should see a strong recovery in earnings in FY24. A strategic review could unlock further shareholder value.

Overweight Nine Entertainment (NEC, -12.4%)

Online real estate company Domain (DHG) downgraded earnings guidance for the half, citing a challenging environment and material declines in listing numbers. This weighed in turn on guidance on for NEC, which owns a 60% stake in the company. The broader business continues to perform well. There is some softening in the television advertising market, however this has largely been offset by gains in market share as programming performs well. We continue to see attractive valuation for a company with good free cash flow and further growth opportunities in its digital assets.

Market outlook

There are six key questions leading into 2023.

1. The persistence of inflation, which will determine how tight financial conditions need to be.
2. The scale of economic slowdown in the US and other developed markets.
3. The leverage of earnings to that downturn.
4. Whether markets have already priced in the downturn.
5. How China's economy performs as it exits covid-zero
6. Can the RBA engineer a soft landing in Australia.

Initial signs on the first three issues are positive. The first datapoints of the year suggest that inflation is lower than consensus expectations, which in turns requires less tightening, a milder downturn and a small hit to earnings.

The deceleration is wage growth is now evident. After December's pay roll print, three month annualised wage growth now stands at 4.2% and annual growth at 4.6%.

The Fed will still want to see these figures below 4%, but it is likely to lock in a 25bp rate hike in February unless we see a dramatic deterioration in CPI numbers this week,

This supports market in the near term. So too does the current outlook for China.

The consensus view has been for markets to re-test equity low points in the first quarter as earnings revisions turn negative. As a result investor positioning has been cautious, with the market braced for a poor reporting season. Ironically, this may lead to the market holding up better than expected.

That said, it is hard to see a sustained market move materially higher. The Fed is likely to rein in any substantially easing of total financial conditions – which includes equity markets. The economic downturn is still also likely, with earnings set to fall. A market multiple of 17x in the US does not provide much of a buffer to this.

It is important to note that, after persistent increases in the expected peak in Fed rates through most of 2022, the market has now stabilised at a ~5% level since October.

This coincided with the US market low and may suggest that the de-rating phase may be over, with economic downturn and the impact on earnings becoming the key issue from here.

There have been material earnings downgrades going into the US Q4 CY22 earnings season. Overall earnings per share (EPS) growth is expected to be flat year-on-year. But if the energy sector is stripped out, they are expected to be down 5%.

Usually when the market is braced for negative outcomes, it is in the price for the short term.

On the flip side, the market has held up better going into this reporting season compared to previous quarters, which suggests less scope for a relief rally.

All this is consistent with a US market trading towards the high end of recent ranges, but no break higher in short term.

The Australian market retains its defensive qualities in this environment, with China's re-opening potentially offering a further leg of support.

The portfolio has exposure to domestic defensives with predictable cash flows and strong industry positions which can protect against a weaker economic environment. Telstra is one example here. We also like companies such as Nine Entertainment where strong free cash flow is being returned to shareholders, with buybacks helping support stocks. The portfolio retains exposure to companies with pricing power supported by favourable industry structures, which can help protect margins against inflation risk. Qantas and QBE are examples of these.

We are also mindful that a new development could see a shift in policy and bond yields fall again. As a result we maintain exposure to growth stocks such as Xero and CSL, where we have good visibility on the growth opportunity and high incremental returns on invested capital.

Finally, we have selected high quality cyclical exposures. These are sensitive to the economic cycle, but are ultimately winners in their industry and provide portfolio protection against the risk of a milder economic cycle than consensus is currently pricing.

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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