PENDAL

Pendal Horizon Sustainable Australian Share Fund

ARSN: 096 328 219

Factsheet

Equity Strategies

31 December 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	-4.34	-4.26	-3.29
3 months	6.12	6.37	9.13
FYTD	6.51	7.02	9.62
6 months	6.51	7.02	9.62
1 year (pa)	-12.24	-11.40	-1.77
2 years (pa)	1.78	2.75	7.45
3 years (pa)	1.94	2.91	5.51
5 years (pa)	4.36	5.36	7.10

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 Dec 2022)	$311 million
Date of inception	May 2001
Minimum investment	$25,000
Buy-sell spread[3]	0.50 (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	RFA0025AU

[3] 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 December 2022)

Materials	14.8%
Industrials	10.1%
Consumer Discretionary	1.7%
Consumer Staples	2.5%
Health Care	12.5%
Information Technology	5.4%
Telecommunication Services	12.0%
Utilities	0.0%
Financials ex Property Trusts	29.5%
Property Trusts	3.9%
Cash & other	7.6%

Top 10 Holdings (as at 31 December 2022)

CSL Limited	10.4%
Telstra Group Limited	7.8%
Commonwealth Bank of Australia	6.7%
National Australia Bank Limited	6.2%
Qantas Airways Limited	5.9%
Westpac Banking Corporation	5.5%
QBE Insurance Group Limited	5.1%
Xero Limited	3.8%
Lynas Rare Earths Limited	3.0%
Macquarie Group, Ltd.	2.9%

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
117.07	231.91	-114.84

Source: ISS, Pendal holdings as at 31 December 2022. Report run on 09/01/2023 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

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.

Underweight BHP (BHP, +0.2%)

Iron ore prices rose 16.7% in December as Beijing rolled back Covid restrictions. This is likely to see significant near term economic disruption and presents a risk to health systems. Over the longer-term, it has prompted optimism that the disruptive effects of ongoing lock-downs will disappear. Iron ore miners such as Fortescue Metals, Rio Tinto and BHP outperformed as a result. BHP is excluded from the portfolio due to its coking coal exposure.

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.
- **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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