PENDAL

# Factsheet

Income & Fixed Interest

31 December 2022

# Pendal Sustainable Australian Fixed Interest Fund

Class W

ARSN: 612 664 730

### 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 of the Fund

| (%) | Total Returns | | Benchmark |
|---|---|---|---|
| | (post-fee) | (pre-fee) | Return |
| 1 month | -1.99 | -1.96 | -2.06 |
| 3 months | 0.58 | 0.66 | 0.38 |
| 6 months | 0.00 | 0.16 | -0.27 |
| 1 year (pa) | - | - | - |
| Since Inception (pa) | -7.36 | -7.12 | -7.08 |

Please note that the performance returns shown are for the period from the fund's inception and are short term in nature. Performance may therefore not reflect the longer term performance of the fund.

### Historical simulated returns – Class W

Pendal Sustainable Australian Fixed Interest Fund - Class W has been operating since March 2022. To provide a simulated longer term view of the estimated performance for Class W, we have based the estimated returns for Class W using the **Pendal Sustainable Australian Fixed Interest Fund - Class R**, given the identical investments, and have then adjusted the returns to reflect the fee differences between Class W and Class R.

| (%) | Total Returns (simulated) | | Benchmark |
|---|---|---|---|
| | (post-fee) | (pre-fee) | Return |
| 1 year (pa) | -10.58 | -10.32 | -9.71 |
| 3 years (pa) | -2.44 | -2.14 | -2.87 |
| 5 years (pa) | 0.81 | 1.13 | 0.54 |

Past performance is not a reliable indicator of future performance.

### Portfolio Statistics (as at 31 December 2022)

| | |
|---|---|
| Yield to Maturity[#] | 4.40% |
| Running Yield[*] | 2.76% |
| Modified duration | 5.16 years |
| Credit spread duration | 0.99 years |
| Weighted Average Maturity | 5.41 years |

[#] 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.

[*] 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.

CERTIFIED BY RIAA

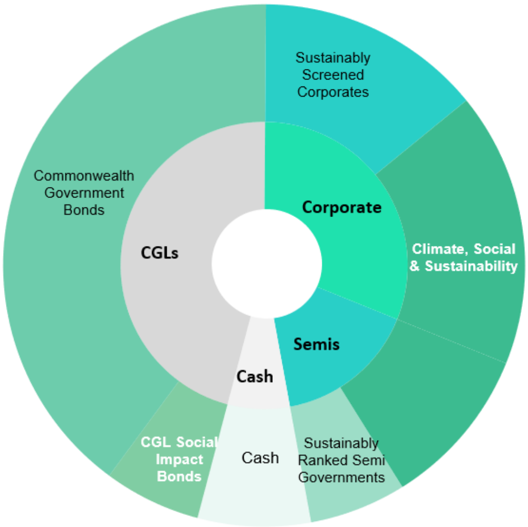
The Pendal Sustainable Australian Fixed Interest Fund has been certified by RIAA according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsibleinvestment.org for details.

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.

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

| | | |
|---|---|---|
| Government bonds^ | | 38.9% |
| Semi-Government bonds^ | | 6.1% |
| Sustainability Screened Corporate bonds | | 14.2% |
| ESG Thematic bonds | - Climate | 16.9% |
| | - Social | 7.9% |
| | - Sustainable | 7.8% |
| Cash & other | | 8.2% |

^ Ex Green, Social & Sustainable Bonds




**Other Information**

| | |
|---|---|
| Fund size (as at 31 Dec 2022) | $112 million |
| Date of inception | 8 March 2022 |
| 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 | PDL3438AU |

[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.

**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] | 0.32% pa |

[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.

**Market review**

The Reserve Bank of Australia (RBA) raised the cash rate in early December by a further 0.25% to finish the year at 3.10%. The RBA believes that the 3% of cash rises since May should begin to have a decent effect on economic activity into 2023, citing that the "full effect of the increases in interest rates is yet to be felt in mortgage payments." Inflation should also begin to moderate in the first quarter of 2023 after a high energy driven number for Q4 2022 is released in late January.

However, the RBA also maintained the line that they expect to "increase interest rates further over the period ahead", although not on a "preset course". Markets now expect the RBA cash rate to hit 4% by late 2023, with a hike priced in for each quarter. We expect two further hikes but that the fixed rate mortgage 'cliff' in 2023 will mean further hikes are not necessary.

Forward looking indicators are quite pessimistic on the Australian economy. Purchasing Manager Indices remain below 50 and consumer confidence is near all-time lows at 80. Business confidence is also now falling with the NAB survey now –4. However, nearly all current indicators remain healthy. NAB Business Conditions remain near all-time highs at 20, unemployment is at 3.4% and Q3 GDP was a respectable 0.6%. This all shows that the savings boom through COVID has underwritten a strong economy for now but that rate rises are making people very concerned about the future. Added to the international volatility it makes it difficult waters for a central bank to navigate.

Bonds had a modest rally over the first part of December on the back of lower US inflation numbers. However, 2022 had one last bearish surprise in store for bonds as a hawkish US Fed followed by a widening of the Bank of Japan Yield Curve Control saw a steep selloff over Christmas. Three year Australian bonds finished the month at 3.50%, from 3.16% at the start of month. 10 year bonds finished the month at 4.05% from 3.53% at the start. They sold off 0.5% in five trading sessions, highlighting that the skittishness and uncertainty of markets is alive and well into 2023.

**Credit review**

Credit spreads ended mixed in December.

News of the easing of China's zero covid policy and corresponding China re-opening story was initially viewed positive for markets on the back of improved future global economic growth, however later in the month concerns grew that the end of China's zero-Covid policy could lead to a spike in global covid cases as the infection will spread as Chinese passengers return to international travel.

Strong data out of the US (average hourly earnings, ISM services & producer prices) at the start of the month saw risk markets weaken on the fear of higher inflation, however mid-month we had the US CPI print which was the 2nd consecutive positive (lower) surprise on US inflation which gave the market a lift.

Both the US Federal Reserve and European Central Banks provided some quite hawkish rhetoric in December. As expected, the FOMC raised their cash rates by 50bps, however they also revised higher their interest rate forecasts (dots) and said that ongoing increases in the funds rate are likely appropriate. The ECB also hiked by 50bps as expected, however they said interest rates will need to rise significantly at a steady pace to reach sufficiently restrictive levels.

The Bank of Japan broadened the tolerance for its yield curve control target band on the 10yr JGB yield from 25bps to 50bps, this leaves the YCC now +/- 50bps around 0%. The BoJ messaged this decision around removing yield curve shape distortions and providing more flexibility around achieving their inflation target of 2%. However, the move surprised the market driving yields higher globally as the expectation is now that the BOJ will need to hike rates to curb their rising inflation.

Credit spreads were mixed over the month with synthetic credit underperforming whilst physicals spreads performed. The Australian iTraxx index (series 38) traded in a 14bp range finishing 3bps wider to close at 93bps. Australian physical credit spreads ended the month 3bp narrower on average. The best performing sectors were infrastructure and utilities which tightened 12 & 6bps respectively, whilst the worst performing sector was supra-nationals that only narrowed 1bp. Semi-government bonds underperformed widening 2bps to commonwealth government bonds.

**Fund performance and activity**

The Fund outperformed the Bloomberg AusBond Composite Bond index by 0.10% (pre fee) in December.

The domestic duration component of the fund was flat in December. Short end rates once again started to discount further rate hikes in early December which looks premature. We continue to target buying 3 year bonds at 3.6%, which is where we think cash will likely peak in early 2023. Markets were nearing that level again by month end. We still expect markets to range trade in the first quarter of 2023.

The physical portfolio outperformed the benchmark. Both the government sector positioning and the non-government portion of the portfolio performed well. Supra-nationals, financials and industrials sector positioning added to performance.

Activity during the month included reducing exposure to financials sub debt.

**Market outlook**

The Australian bond market finished 2022 on a poor note, with 10 year yields just shy of the yield highs of the year in June and October of 4.2%. They began 2022 below 2%.

Whilst the worst of the inflation fears seem to have passed and expectations are now for inflation to move back towards 4% over the next year, markets are sceptical about further improvements from there. The RBA's own forecasts do not see inflation back in the 2-3% band until 2025. This backdrop, combined with pressure on real rates to move higher, mean bond markets are struggling to hold on to any rally.

However, the battleground for 2023 will move from supply led inflation to wages. We are in new territory here as the race to increase labour supply through immigration hits up against current shortages across multiple industries. By 2024 there should be more balance in many sectors but this may come too late to prevent outsized increases in 2023. The minimum wage decision in Q2 alone should see an outcome nearer 6%, adding to recent double digit outcomes in a number of areas like aged care workers. Overall wages should push higher than the RBA comfort zone of 3.5-4%.

We expect markets are entering an extended period of range trading as competing influences buffet the market. Activity data should remain strong into the end of 2022 but start to turn down by Q2 2023 and struggle in the second half of 2023 as higher mortgage rates bite. However, services inflation and higher wage outcomes will limit any chances of RBA rate cuts although the market may speculate.

Real yields remain a big question mark. 10 year real yields rallied from 2% to 1% from September to November but gave back over half in December up to 1.6%. With productivity forecast around 1.2% over the medium term that provides some sort of signpost. Against this are central banks globally who are determined to crush inflation and may see the need for higher real cash rates in the near term.

**Credit outlook**

We continue to be cautious on credit spreads as markets are likely to remain volatile given the uncertainty around global inflation and Central Banks' resolve to fight it. However, the two most recent consecutive months of softer than expected US CPI prints gives us hope that inflation may have peaked. Another concern we have is around Central Banks maintaining restrictive monetary policy for longer which may lead to a deeper recession in the future.

With China now easing its zero covid policy restrictions, this would alleviate supply chain disruptions and inflation pressures, however will take some time to filter through.

Over the medium term we are more sanguine on the outlook for credit spreads. Given China re-opening, the strong labour markets globally, consumer consumption will continue 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.
- **Class risk**: The Fund has been established as a separate class of units in the Scheme. As the assets are held on trust for all investors, there is a risk that investors of one class, may be exposed to liabilities of another class of units and they could lose some or all of their investment in the Fund. There is also a risk that in the event of an insolvency, the assets of the Fund could be made available to creditors of another class of units of the Scheme.

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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