PENDAL

Pendal Monthly Commentary

Pendal Australian Specialised Retirement Income Portfolio

February 2023

Market commentary

Further evidence of ongoing strength in the US economy and tight labour markets saw hopes of a dovish tilt from central banks recede.

Central bank rhetoric remains hawkish and the risk is that tighter-for-longer monetary policy pushes economies into a severe downturn, driving earnings lower.

The S&P/ASX 300 fell -2.55 as a result.

The broad theme of Australian reporting season was stronger revenue offset by weaker margins as costs rose.

Revenue for 1H FY23 has risen ~12% at an index level, with 38% of companies beating expectations and only 18% missing.

However this has not translated into operating leverage, as costs have risen ~15% at the index level. This meant a margin squeeze that saw 49% of companies miss EPS expectations, versus a historical average of 30%.

Companies have signalled that costs are decelerating - although they will need to, given that revenue will not be able to continue at this pace.

The net effect is that the misses have not flowed through to a spike in negative forward-year earnings revisions. The mix of upgrades and downgrades to forward-year EPS was in-line with historical trends.

Materials (-6.68%) fell furthest as the boost in sentiment from an end to zero-Covid waned and results told a consistent story of higher costs.

Financials (-3.31) also underperformed as the market expressed concerns that the margin tailwind from higher rates may have peaked and now come under pressure due to intensifying competition.

Utilities (+3.39%) did best, driven primarily by a revised bid for Origin Energy (ORG, +0.44%) from the Brookfield-led consortium, which was better than expectations.

Information Technology (+2.80%) also did well with Computershare (CPU, +5.74%) and Wisetech (WTC, +4.06%) delivering well-received results.

Portfolio overview

Australian Specialised Retirement Income Portfolio	
Investment strategy	**Dual focus:** Deliver tax-effective capital & grossed-up income. **Broad hunting ground:** Core approach, drawing ideas from across the market cap spectrum. **Income focus:** Greater exposure to stocks with high grossed-up yield & dividend sustainability. **Higher turnover:** Can pursue shorter-term opportunities in addition to core strategy
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 (30 as at 28 February 2023)
Sector limits	A-REITS 0-30%, Cash 2-10%
Dividend Yield	4.30%#

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	12.30%
CSL	CSL Limited	8.55%
TLS	Telstra Group Limited	6.89%
CBA	Commonwealth Bank of Australia	6.36%
NAB	National Australia Bank Limited	6.19%
WBC	Westpac Banking Corporation	5.29%
STO	Santos Limited	4.48%
QBE	QBE Insurance Group Limited	3.95%
QAN	Qantas Airways Limited	3.90%
MTS	Metcash Limited	3.49%

Source: Pendal as at 28 February 2023

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
TLS	Telstra Group Limited	4.71%
STO	Santos Limited	3.43%
QAN	Qantas Airways Limited	3.35%
MTS	Metcash Limited	3.31%
QBE	QBE Insurance Group Limited	2.94%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WES	Wesfarmers Limited (not held)	-2.48%
WOW	Woolworths Group Ltd (not held)	-2.03%
TCL	Transurban Group Ltd. (not held)	-1.97%
RIO	Rio Tinto Limited (not held)	-1.96%
ANZ	ANZ Group Holdings Limited	-1.56%

Source: Pendal as at 28 February 2023

#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 Specialised Retirement Income Portfolio	-2.39%	-0.17%	5.45%	5.77%	9.38%	8.07%	8.86%
S&P/ASX 300 (TR) Index	-2.55%	0.17%	5.92%	6.54%	7.94%	7.87%	8.43%
Active return	**0.16%**	**-0.34%**	**-0.47%**	**-0.78%**	**1.44%**	**0.20%**	**0.44%**

Source: Pendal as at 28 February 2023

*Since Inception - 20 August 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
QBE	QBE Insurance Group Limited	0.32%
ORA	Orora Ltd.	0.22%
TLS	Telstra Group Limited	0.20%
STO	Santos Limited	0.14%
QAN	Qantas Airways Limited	0.12%

Top 5 detractors - monthly

Code	Name	Value Added
DOW	Downer EDI Limited	-0.20%
NST	Northern Star Resources Ltd	-0.17%
BHP	BHP Group Ltd	-0.12%
TCL	*Transurban Group Ltd. (not held)*	*-0.10%*
MIN	Mineral Resources Limited	-0.10%

Top 5 contributors - 1 year

Code	Name	Value Added
QBE	QBE Insurance Group Limited	0.65%
QAN	Qantas Airways Limited	0.56%
VEA	Viva Energy Group Ltd.	0.36%
NST	Northern Star Resources Ltd	0.35%
SQ2	*Block, Inc. Shs (not held)*	*0.28%*

Top 5 detractors - 1 year

Code	Name	Value Added
NEC	Nine Entertainment Co. Holdings Limited	-1.17%
DOW	Downer EDI Limited	-0.90%
EVN	*Evolution Mining Limited (not held)*	*-0.76%*
JHX	James Hardie Industries PLC	-0.76%
XRO	Xero Limited	-0.29%

Source: Pendal as at 28 February 2023

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight QBE Insurance (QBE, +9.75%)

The market had been worried about inflation and reinsurance in the short term and franchise strength in the long term. But QBE delivered on CY22 expectations and issued confident guidance for CY23. The CEO believes volatility has been taken out of the business, which was further supported by a transaction removing 1.9bn of problematic US reserves. The message was therefore reduced risk plus expanding earnings, an attractive combination that should help the multiple recover.

Overweight Orora (ORA, +18.46%)

Packaging company Orora was a good example of a stock which surged during reporting season as the market's fears failed to materialise. Despite cost inflation and concerns over demand the company posted a 13.9% increase in revenue over the previous comparable period. Net profit after tax was up 7.8%> Importantly, the company flagged that it expect the North American business to continue growing over the remainder of the financial year.

Three largest detractors:

Overweight Downer (DOW, -16.18%)

DOW delivered a second downgrade in 3 months, which triggered a major management shake-out. The CEO was already leaving, but in addition the CFO will leave and the Chair stepping down with immediate effect. The new CEO outlined high level plan to cut $100m costs out of the business and drive cultural change to extract more appropriate margins out of what should be a quality contract book. FY23 should get a bounce back assuming weather improves notably in the road maintenance business. The company will also likely be in the focus of PE.

Overweight Northern Star (NST, -17.37%)

More hawkish rate expectations and a stronger US dollar weighed on the gold price and on gold miner NST. Beyond this, the company's' reported financials for the half-year were in-line with expectations. A decision on the ~A$1bn KCGM expansion is due in mid-2023.

Overweight Telstra (TLS, +1.96%)

TLS's EBITDA came in just above consensus and suggested that the company is on track to reach the high end of guidance range for FY23, There are a few items that will result in the 2H being sequentially better than the 1H. International roaming is also coming back with $100m of revenue growth. It is back to 70% of pre-Covid levels. 70% recovered vs pre-covid. The revenue outlooks remains defensive, give the linkage to CPI. Even though the mix of business, quality of business and industry structure are much better than in the past, TLS is still trading on an old EBITDA multiple of 7.5x, suggesting there is room for a re-rate higher.

Overweight BHP (BHP, -8.46%)

BHP reported a slightly weaker-than-expected HY result with EBITDA 5% below expectations. This miss was primarily driven by higher copper costs, net debt also came in US$1.5bn higher. BHP also announced it has put two coking coal mines up for sale. Higher cost growth has been a feature of most mining results. The resource space was also weaker on some moderating of sentiment towards a recovery in Chinese demand.

Outlook

Recent strong economic data from the US has puts paid to theories that the strong reading in January data was an aberration. It reinforces the issue that the US economy remains too strong to enable inflation to slow sufficiently at the current rate setting.

The rally earlier in 2023 was driven by signs inflation and wages are easing, without any signs this is associated with a sharp slowdown in the economy.

The "soft landing"/"narrow path"/"immaculate disinflation" scenario is the most bullish of the three broad outcomes possible from the current position. The market likes the idea of a limited earnings downturn combined with falling rates.

There are two other, more bearish, scenarios.

- One is structural inflation where some combination of limited commodity supply, structural constraints on labour, re-arming of nations, re-shoring of supply chains and de-carbonising power and energy infrastructure all contribute to inflation remaining higher for longer.
- The other is where policy is already too tight and the lagged effect – currently hidden – will see a recession in the second half of 2023.

We are in a better place than we were three months ago, but material risks remain. We need to regularly gauge the scale and direction of economic data to get a better read on which scenario is playing out.

The Chinese National People's Congress, which officially starts Xi's third term and sees a slew of news faces at top posts, announced a target of 5% GDP growth for this year. This is down on last year's 5.5% target – although up from the 3% growth that was actually achieved.

There had been hope of a higher target – somewhere near 6% - to reflect the re-opening of China's economy. The 5% target, in an environment in which "revenge spending" by the Chinese consumer is likely to be strong, suggests that Beijing will not be making material change in policy to stimulate growth, particularly in housing and infrastructure. This may be prompted by fears around inflation. This is consistent with local government bond quotas, which are traditionally used to fund investment and are lower than last year. As a result, some of the optimism around the outlook for commodity pricing has faded.

For the moment, equities appear range bound, having absorbed a material rise in bond yields without breaking down through technical support levels.

The recent decline in equity markets has helped tighten the Total Financial Conditions index and possibly allows the Fed to be more balanced in their comments. This suggests the market should be reasonably well supported for now, as long as growth and inflation don't continue to surprise to the upside.

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**

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