Pendal Monthly Commentary

Pendal Australian Shares Portfolio

April 2023

Market commentary

Australian equities responded well to the RBA pausing rate hikes, as expected, at its early April meeting.

The S&P/ASX 300 returned 1.85% for the month, led by sectors such as technology and real estate where higher rates have been a headwind.

In the US the market seemed inclined to a relatively benign outcome to stress in the banking system, implying that the issue was relatively contained and credit tightening would slow economic growth but not stall it.

Indicators of US inflation continues to ease, but labour market remained tight. Lead indicators of economic growth are slowing, but the economy remains robust, supported by consumer spending.

This has fed through to a US quarterly results season where the feared air-pocket in earnings did not eventuate. Aggregate earnings, while down in the quarter by low single-digits in terms of percentage growth, fell only half of the amount expected by consensus.

Real Estate (+5.01%) rose in response to the RBA's pause in hikes. Much of this was driven by strong gains in residential property stocks such as Stockland (SGP, +11.81%) and Mirvac (MGR, +15.87%), helped by some better data on prices and auction clearance in Sydney. Index heavyweights Goodman Group (GMG, +2.77%) and Scentre Group (SCG, +4.77%) also made gains.

Information Technology (+4.51%) also did well with Xero (XRO, +4.38%), Wisetech (WTC, +5.25%) and NextDC (+9.75%), the three largest technology stocks in the index, all outperforming. The latter was boosted by an update which confirmed it was contracting data-centre space at a faster pace than the market expected.

Materials (-2.57%) was the only sector to lose ground. Commodity prices continued to weaken on the expectation that the US economy would continue to slow into the second half of 2023, with material risk of recession. Steel production quotas in China are also expected to weigh on iron ore demand in the second half, with iron ore falling -17.2% over the month. Quarterly production reports were also generally soft, with all seeing rising costs. BHP (BHP, -5.99%), Rio Tinto (RIO, -6.57%) and Fortescue (FMG, -6.89%) all fell. The gold miners bucked the trend and posted good gains as the gold price held up well.

Utilities (+1.37%) also underperformed in an environment of improved sentiment.

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 30 April 2023)
Sector limits	A-REITS 0-30% Cash 2-10%
Dividend Yield	3.80%#
Income target	No target

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	11.31%
CSL	CSL Limited	8.81%
TLS	Telstra Group Limited	6.67%
STO	Santos Limited	6.49%
CBA	Commonwealth Bank of Australia	5.95%
NAB	National Australia Bank Limited	5.34%
QAN	Qantas Airways Limited	5.03%
WBC	Westpac Banking Corporation	4.74%
XRO	Xero Limited	4.04%
QBE	QBE Insurance Group Limited	3.87%

Source: Pendal as at 30 April 2023

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
STO	Santos Limited	5.44%
QAN	Qantas Airways Limited	4.49%
TLS	Telstra Group Limited	4.39%
XRO	Xero Limited	3.45%
QBE	QBE Insurance Group Limited	2.85%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
ANZ	ANZ Group Holdings Limited (not held)	-3.30%
WDS	Woodside Energy Group Ltd (not held)	-2.88%
WES	Wesfarmers Limited (not held)	-2.66%
WOW	Woolworths Group Ltd (not held)	-2.13%
TCL	Transurban Group Ltd. (not held)	-2.08%

Source: Pendal as at 30 April 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 Shares Portfolio	1.42%	0.32%	7.81%	2.33%	14.81%	8.38%	9.35%
S&P/ASX 300 (TR) Index	1.85%	-0.98%	8.38%	2.13%	13.97%	8.23%	7.92%
Active return	**-0.43%**	**1.30%**	**-0.57%**	**0.20%**	**0.84%**	**0.14%**	**1.43%**

Source: Pendal as at 30 April 2023

*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
RIO	*Rio Tinto Limited (not held)*	*0.17%*
QBE	QBE Insurance Group Limited	0.09%
NST	Northern Star Resources Ltd	0.09%
XRO	Xero Limited	0.09%
NXT	Nextdc Limited	0.08%

Top 5 detractors - monthly

Code	Name	Value Added
MIN	Mineral Resources Limited	-0.14%
ANZ	*ANZ Group Holdings Limited (not held)*	*-0.14%*
BHP	BHP Group Ltd	-0.10%
QAN	Qantas Airways Limited	-0.10%
S32	South32 Ltd.	-0.09%

Top 5 contributors - 1 year

Code	Name	Value Added
QAN	Qantas Airways Limited	0.65%
QBE	QBE Insurance Group Limited	0.57%
TLS	Telstra Group Limited	0.45%
NST	Northern Star Resources Ltd	0.44%
SQ2	*Block, Inc. Shs (not held)*	*0.22%*

Top 5 detractors - 1 year

Code	Name	Value Added
STO	Santos Limited	-0.59%
DOW	Downer EDI Limited	-0.58%
NEC	Nine Entertainment Co. Holdings Limited	-0.54%
EVN	*Evolution Mining Limited (not held)*	*-0.47%*
MTS	Metcash Limited	-0.45%

Source: Pendal as at 30 April 2023

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Underweight Rio Tinto (RIO, -6.57%)

Concern over an expected slow-down in economic growth in the US in the second half of 2023 – and the risk of recession - generally weighed on commodities. Chinese steel production quotas are also expected to weigh on iron ore demand in the second half. Iron ore was down sharply in April, which dragged on Rio Tinto. RIO's quarterly production report revealed strong iron ore sales, offset by weakness in copper and aluminium.

Overweight QBE Insurance (QBE, +5.07%)

QBE maintained momentum in the wake of its well-received result for CY 2022. It continues to benefit from improvements in insurance premium pricing, more than offsetting increases in claims inflation and reinsurance costs. Management have issued confident guidance for CY 2023, underpinned by continued improvements in the previously troubled US business.

Overweight Northern Star (NST, +9.34%)

A stronger gold price, helped by the prospect of an end to the US rate hiking cycle, the risk of recession and potentially a softer US dollar, has seen upgrades to the gold mining sector. NST's quarterly production report was slightly below expectations due to mill outages and slightly higher costs. However the issues are expected to be transitory and management maintained full year production guidance.

Three largest detractors

Overweight Mineral Resources (MIN, -8.57%)

News that initial drilling at its gas project off Western Australia yielded disappointing results – and that further development of its lithium assets would take longer than expected – weighed on MIN in April. These issue, in combination with higher costs and lower volumes at its iron ore services business, drove near-term downgrades. However the longer-term potential, linked to a good position with regard to lithium and a diversified suite of earnings drivers, remains attractive.

Underweight ANZ (ANZ, +6.19%)

Australian banks generally rebounded, having sold off over March in sympathy with US banks and on concern that the failure of several US banks might morph into a GFC0style contagion event. We see this as low risk, given both the nature of the issue in the US and the much better capital and liquidity positions of banks as a result of the GFC. That said, we remain underweight the banks – and ANZ – due to pressure on margins as mortgage competition and deposit costs rise.

Overweight BHP (BHP, -5.99%)

Concern over an expected slow-down in economic growth in the US in the second half of 2023 – and the risk of recession - generally weighed on commodities. Chinese steel production quotas are also expected to weigh on iron ore demand in the second half. Iron ore was down sharply in April, which dragged on BHP, although the portfolio is underweight iron ore in aggregate. BHP's quarterly production report was largely in line with expectations.

Outlook

Inflationary pressures may be easing, but not quickly enough for the Fed to feel comfortable.

The Cleveland Fed's inflation "now-cast" has not budged for two months, with Core Personal Consumption Expenditure (PCE) at 4.65% and core Consumer Price Index (CPI) at 5.6% for April. The Fed is looking for these numbers to move into the 3-4% range.

Economic indicators continue to give conflicting views on how weak the economy is.

Lead indicators are still deteriorating and the Conference Board US Leading Index has now reached a point which has signalled previous recessions.

The Continuing Jobless Claims index also continues to climb higher. Its absolute level remains low by historical standards, but this does signal some loosening in labour markets.

That said, there is some evidence that surveys in March may have overstated economic deterioration, on the back of the fear of a banking crisis which has thus far not materialised.

Equity market resilience in the face of the US banking shock has been driven by the prospect of US rates peaking, inflation softening and the economy remaining resilient, all combined with previously bearish positioning.

In sum, the market valuation discount rate effect from the prospect for lower rates has outweighed the negative impact from the financial sector.

This has been bolstered by receding fears of a bank-induced credit shock, retail sales holding up better than expected, bank deposit outflows settling down and a better-than-expected US reporting season.

There are two schools of thought for the economy and markets;

1. The successful soft landing - albeit potentially a mild recession.
2. A sharper economic downturn, driven by the shock to the banking system or the need for rates to be held high for longer as inflation remains sticky, leading to a more significant decline in corporate earnings.

The former scenario keeps the market at current levels with perhaps some upside to valuation rating. The latter sees the market returning towards lows.

In the near-term markets could well remain benign as we enjoy the phase where inflation continues to ease while the economy holds up. We also have the benefit of a reasonable liquidity environment. In this environment volatility stays muted and market focuses more on stock specifics.

Our view is that the risk increases as we approach the debt ceiling negotiations in July and August, which could coincide with emerging signs of the economy weakening more meaningfully.

Given this, we continue to balance the portfolio in terms of skew between cyclicals and defensives and focus on stocks with less exogenous risk and greater control over their outcomes.

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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