Pendal Monthly Commentary

Pendal Sustainable Future 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

Sustainable Future Australian Shares Portfolio	
Investment strategy	To deliver outperformance relative to the benchmark before fees over a rolling five year period. The portfolio excludes companies which are deemed to detract from the transition to a more sustainable economy. It seeks to increase exposure to companies deemed to be leaders and enablers of that transition.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15-40 (29 as at 30 April 2023)
Sector limits	Cash 2-10%
Dividend Yield	3.72%#

Top 10 holdings

Code	Name	Weight
CSL	CSL Limited	10.60%
CBA	Commonwealth Bank of Australia	6.80%
TLS	Telstra Group Limited	6.65%
NAB	National Australia Bank Limited	6.55%
QBE	QBE Insurance Group Limited	5.41%
QAN	Qantas Airways Limited	4.69%
RIO	Rio Tinto Limited	4.26%
WBC	Westpac Banking Corporation	4.06%
MQG	Macquarie Group, Ltd.	3.97%
SCG	Scentre Group	3.11%

Source: Pendal as at 30 April 2023

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
QBE	QBE Insurance Group Limited	4.39%
TLS	Telstra Group Limited	4.37%
QAN	Qantas Airways Limited	4.15%
CSL	CSL Limited	4.07%
ALQ	ALS Ltd.	2.76%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
BHP	BHP Group Ltd (not held)	-10.13%
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.)	Since inception (p.a.)*
Pendal Sustainable Future Australian Shares Portfolio	2.80%	0.85%	8.33%	1.15%	13.89%	9.15%
S&P/ASX 300 (TR) Index	1.85%	-0.98%	8.38%	2.13%	13.97%	7.89%
Active return	**0.95%**	**1.83%**	**-0.05%**	**-0.97%**	**-0.09%**	**1.26%**

Source: Pendal as at 30 April 2023
*Since Inception - 16 June 2018
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
BHP	*BHP Group Ltd (not held)*	*0.86%*
PLS	Pilbara Minerals Limited	0.19%
NST	Northern Star Resources Ltd	0.15%
QBE	QBE Insurance Group Limited	0.14%
NXT	Nextdc Limited	0.12%

Top 5 detractors - monthly

Code	Name	Value Added
RIO	Rio Tinto Limited	-0.16%
QAN	Qantas Airways Limited	-0.09%
FMG	Fortescue Metals Group Ltd	-0.08%
TCL	*Transurban Group Ltd. (not held)*	*-0.07%*
NCM	*Newcrest Mining Limited (not held)*	*-0.06%*

Top 5 contributors - 1 year

Code	Name	Value Added
QBE	QBE Insurance Group Limited	0.89%
NST	Northern Star Resources Ltd	0.70%
QAN	Qantas Airways Limited	0.67%
TLS	Telstra Group Limited	0.47%
CSL	CSL Limited	0.37%

Top 5 detractors - 1 year

Code	Name	Value Added
DOW	Downer EDI Limited	-1.33%
BHP	*BHP Group Ltd (not held)*	*-1.18%*
NEC	Nine Entertainment Co. Holdings Limited	-0.60%
WDS	*Woodside Energy Group Ltd (not held)*	*-0.52%*
EVN	*Evolution Mining Limited (not held)*	*-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 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, which is excluded from the portfolio due to its exposure to metallurgical coal.

Overweight Pilbara Minerals (PLS, +7.61%)

The lithium sector continued to rise, helped by Albermarle's bid for Liontown (LTR) as evidence of potential sector consolidation after a period of soft performance. PLS's Q3 report was a touch weaker than consensus expectations, but was the best among the larger lithium players in the Australian market. Overall production was in-line with consensus, but sales were lower on the timing of shipments. This is expected to catch back up in the June quarter. Net cash rose over the period despite the company paying its inaugural interim dividend.

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 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 Qantas (QAN, -0.30%)

Qantas shares were broadly flat in a rising market, with little stock-specific news although there was speculation ahead of the announcement of a new CEO. This has subsequently been confirmed as the previous CFO, considered a safe pair of hands which does not indicate a fundamental change in strategy away from the disciplined approach that has underpinned the company's approach to costs and capital in recent years.

Overweight Fortescue Metals (FMG, -6.89%)

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 Fortescue Metals, although there was an offset from the portfolio's underweight in BHP. Fortescue's quarterly production update was good, with shipments a fraction ahead of consensus and strong cost performance again a feature.

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

Sell to zero in Oz Minerals (OZL)

The portfolio is selling out of copper miner Oz Minerals, which has made a positive contribution to relative performance in recent years.

Oz Minerals has come under takeover offer from BHP, a deal endorsed by OZL shareholders and now approved by the Federal Court. As a result, OZL will be delisted.

The capital will be deployed into existing positions in Rio Tinto (RIO) and Pilbara Minerals (PLS), maintaining the portfolio's exposure to resources.

Rio is a diversified miner, offering copper exposure alongside iron ore and aluminium. In terms of copper, it owns and operates the Kennecott mine outside Salt Lake City in Utah. The mine life extends to 2032, with feasibility studies underway to potentially increase this.

In 2019 this mine retired its coal-fired power plant, switching power to renewable energy certificates, primarily from wind and solar resources, reducing the operation's carbon footprint by up to 65% annually.

The company is also developing the Oyu Tolgoi underground copper mine in Mongolia. When operational, it will be the fourth largest copper mine in the world.

Pilbara Minerals is a lithium miner that owns and operates the Pilgangoora project in the Pilbara region of Western Australia, one of the world largest hard-rock lithium deposits in the world.

It is a well-managed company with strong cash flow and has just implemented its first dividend. It is also looking at various measures to capture a greater share of the downstream value of lithium.

Lithium prices have been elevated at unsustainable levels and have been softening in recent months. Part of this is due to weaker Chinese demand for electric vehicles (EVs) as well as Chinese battery makers running down inventory of lithium products.

We expect demand for EVs to pick up again, while demand in the US is also robust. This should help support lithium prices at a level which remains very cash generative for PLS.

There is also some medium-term risk around supply, however the likelihood of large upside surprise in supply is low.

Concern over these issues has weighed on lithium miners, which provides the opportunity to add to our exposure in this space.

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 Sustainable Future Australian Share Portfolio	ASX 300	Relative to ASX300
122.41	172.12	-49.71

Source: ISS, Pendal holdings as at 30 April 2023. Report run on 04/05/2023 using latest ISS data. Currency AUD

[1] Scope 1 emissions result from sources directly owned or controlled by the company. Scope 2 accounts for 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/

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