

### Pendal Fixed Interest Fund

ARSN: 089 939 542

Income & Fixed Interest

29 February 2024

#### About the Fund

The Pendal Fixed Interest Fund (**Fund**) is an actively managed portfolio of primarily Australian fixed interest securities.

#### Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Bloomberg AusBond Composite 0+ Yr Index over the medium term. The return is expected to be comprised primarily of income. The suggested investment timeframe is three years or more.

#### Investment Approach

This Fund is designed for investors who want income, diversification across a broad range of cash and fixed interest securities and are prepared to accept some variability of returns. The Fund aims to take advantage of investment opportunities primarily within the Australian fixed interest market by investing in a combination of Commonwealth-government, semi-government and corporate debt and short-term money market securities.

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 and sector selection, duration, yield curve and credit management. 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.

Derivatives may be used to reduce risk and can act as a hedge against adverse movements in a particular market and/or in the underlying assets. Derivatives can also be used to gain exposure to assets and markets.

#### Investment Team

Pendal's Income & Fixed Interest team is a large team of dedicated investment professionals. The team also draws on a wide range of knowledge resources including Pendal's other specialist investment teams: Equity Strategies and Multi-Asset Strategies. The portfolio manager of the Fund is Tim Hext who has more than 34 years industry experience.

#### 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 <sup>1</sup>	0.45% pa
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<sup>1</sup> 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 29 February 2024)	\$267 million
Date of inception	August 1992
Minimum investment	\$25,000
Buy-sell spread <sup>2</sup>	
For the Fund's current buy-sell spread information, visit <a href="http://www.pendalgroup.com">www.pendalgroup.com</a>	
Distribution frequency	Quarterly
APIR code	RFA0813AU

<sup>2</sup> 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.

#### Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	-0.24	-0.21	-0.30
3 months	2.68	2.80	2.59
6 months	2.27	2.50	2.11
1 year	3.78	4.25	3.51
2 years (p.a)	-1.58	-1.13	-1.55
3 years (p.a)	-1.29	-0.83	-1.40
5 years (p.a)	0.41	0.90	0.31
Since Inception (p.a)	5.37	5.92	5.58

Source: Pendal as at 29 February 2024

"Post-fee" returns assume reinvestment of distributions and is calculated using exit prices. "Pre-fee" returns exclude the effects of management costs and any taxes. Returns for periods greater than one year are annualised. Fund inception: August 1992.

Past performance is not a reliable indicator of future performance.

The benchmark for this Fund has changed over time. The benchmark performance shown is that of the combined benchmarks that the fund has aimed to exceed over time.

#### Sector Allocation (as at 29 February 2024)

Government bonds	27.5%
Semi-Government bonds	24.5%
Corporate bonds	30.5%
Cash & other	17.5%

#### Portfolio Statistics (as at 29 February 2024)

Yield to Maturity <sup>#</sup>	4.43%
Running Yield <sup>*</sup>	3.71%
Modified duration	4.99 years
Credit spread duration	0.96 years
Weighted Average Maturity	5.52 years

<sup>#</sup> 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.

<sup>\*</sup> 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.

## 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 asset.
- **International investments risk** – The risk arising from political and economic uncertainties, interest rate movements and differences in regulatory supervision associated with international investments.
- **Currency risk** - Currency exchange rate fluctuation risk arising from investing across multiple countries.
- **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.
- **Derivative risk** – The risk arising from use of derivatives to manage exposures to investment markets.
- **Counterparty risk** – The risk of another party to a transaction failing to meet its obligations.

Please read the Fund's Product Disclosure Statement (**PDS**) for a detailed explanation of each of these risks.

## Market review

Yields were higher over the month, driven by better-than-expected economic data and central bankers continuing to push back against the market pricing of rate cuts. The common theme was central bankers preferring to wait and see that inflation is easing further before reducing policy rates. The easing of financial conditions from lower bond rates and higher equity markets was not seen as helpful.

Fed Chair Jerome Powell noted the 'danger of moving too soon is that the job's not quite done, and that the really good readings we've had for the last six months somehow turn out not to be a true indicator of where inflation is heading'. The RBA minutes for their February meeting noted that 'inflation had moderated but was still high', further noting 'it was not yet possible to rule in or out further increases in interest rates.'

The Reserve Bank of Australia (RBA) left the cash rate unchanged at 4.35%. The RBA also provided an updated set of economic forecasts in their quarterly Statement on Monetary Policy. Economic growth was revised down by 0.2% to 1.8% for 2024 with both household consumption (-0.4%) and dwelling investment (-1.5%) key drivers for the downward revision. Inflation is forecast to be back within the target range by the end of 2025 and back to around the mid-point by mid-2026. Nearer term, however, inflation is forecast to be lower than previously expected with trimmed mean for the year ended June 2024 and December 2024 expected to be at 3.6% and 3.1%.

Employment grew by a weaker than expected 500 jobs in January, resulting in the unemployment rate increasing from 3.9% to 4.1%. The participation rate was unchanged at 66.8%. This is the first time unemployment has been above 4% since January 2022.

The 4th quarter wage price index rose by 0.9%, resulting in an annual gain of 4.2% (consensus of 0.9% and 4.1%). Enterprise agreements indicate that 4% wage growth will be the pace of rises across early 2024 before potential moderation in the second half.

Australian three year bonds finished February at 3.70%, against a January close of 3.56%. 10 year bonds finished at 4.15% against 4.02%.

## Credit review

February was a positive month for credit spreads as US company earnings provided a positive back drop, as did the supportive US economic data.

4th quarter US company reporting was a tailwind for markets. By the end of February, 98% of companies had reported with 76% beating earnings expectations by 7% on average. Sales grew 4% whilst earnings growth was 8% compared to the prior corresponding period.

US economic data continues to show a resilient economy with payrolls, jobless claims and manufacturing all printing better than expected during the month. We saw a further easing of bank lending standards in the US which is also a bullish sign for markets as this eases the ability of companies to access their bank funding requirements.

Credit spreads narrowed over the month. The Australian iTraxx index (series 40) traded in a 9bp range finishing 4bp tighter to close at 64bps. Australian physical credit spreads tightened 3bps on average. The best performing sectors were infrastructure and domestic banks that both narrowed 5bps, whilst the worst performing sector was industrials that only tightened 1bp. Semi-government bonds underperformed widening 2bps to commonwealth government bonds.

## Fund performance

The Fund had a small negative performance in February as yields moved higher after a strong finish in January. The moves were led by US markets selling off on stronger inflation data. Locally, the data was mixed to slightly weaker. The fund outperformed the benchmark. Outperformance came from duration and offshore bond positions.

The fund was at benchmark for duration at the start of month. Whilst we like bonds medium term, we believe yields will trade in a range near term as markets respond to mixed data. The easy part of the inflation fall is now over so markets will be more mixed. The early to mid-February selloff in bonds saw better pricing given the outlook. We added modest duration to the fund. This worked well, although we exited at the end of month as yield rallied again.

The fund added value in February through participation in a new New Zealand 30 year bond. The fund can hold up to 20% in foreign currency bonds, with the FX risk hedged. We usually take risk offshore via derivatives, but the new bond yielded above 5%. We believe in the current environment this is attractive to offshore investors and offered cheap levels at issue. The bonds had a good rally post the issuance and by the end of month we had sold down our holdings.

The fund is a small overweight in semi governments but will add to risk through expected new issuance in March.

The fund increased its weight to credit early in February to take advantage of rare issuance from some infrastructure and utility names. Medium term the economic outlook remains friendly for credit as modest growth and lower inflation supports risk. We will keep a close eye on our leading signals if this were to change.

Finally, the global overlay had a flat month. The long Yen position, through options, continues to be in place as a cheap defensive measure against the US slowdown turning into a sharper contraction. The Yen is extremely cheap on all longer-term measures. We also think there is a chance the Bank of Japan starts a modest tightening cycle in the months ahead that will support the Yen.

## Market outlook

The mild selloff in February has seen more realistic rate expectations priced into markets. The US now has slightly over three cuts this year priced in and Australia slightly less than two. We expect cuts and in the case of the US at least four, so pricing now favours long duration positions.

The important point to note is that price cuts are not dependent on weak growth, rather inflation staying around current levels. In the US this should happen as rents moderate. In Australia we expect inflation to move close to the 3% level in the quarters ahead.

Accommodative fiscal policy in the US and in Australia (from mid year) will see the economy continue to grow, but importantly at a below trend pace. This should help create some excess capacity which in turn takes pressure off inflation and wages.

Overall we remain favourable to overweight or long duration positioning, although we are adjusting the positions based on market pricing.

## Credit outlook

We are positive on credit spreads given the continued fall in US core inflation and the resilience of the consumer. This easing of inflation concerns will see central banks cut policy rates which will likely see a soft economic landing as opposed to a hard landing and in turn would be positive for risk assets.

The data on credit lending globally shows that the tightening of lending standards is easing which is a great sign for corporates, economic growth and markets.

We are still keeping a watchful eye on global labour market and services inflation given this will be a driver of Central Bank policy.

Higher oil prices, a slowing China and geopolitical concerns remain a risk for markets.

For more information please call 1300 346 821,  
contact your key account manager or visit [pendalgroup.com](https://www.pendalgroup.com)

**PENDAL**

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