PENDAL

Pendal Monthly Commentary

Pendal Australian Shares Portfolio

March 2024

Market commentary

Australian equities extended recent gains in March, with the S&P/ASX 300 finishing the month up 3.26%.

The RBA held rates at 4.35%, as expected. However its commentary took a more dovish turn, removing explicit reference to the possibility of further rate hikes and helping drive equity market gains.

The US Federal Reserve also left rates unchanged but, importantly, the “dot plots” of expected future rates continued to indicate three cuts before the year’s end. This is well down from the seven cuts the market was pricing at the start of the year and reflects some stronger-than-expected data on inflation and the view that the “last mile” of disinflation may be tougher to achieve.

US data continues to suggest that the economy is holding up. Likewise, Australian data painted a picture of an economy which is slowing, but still growing, albeit with some softer pockets. Australia’s GDP increased 0.24% in Q4 2023 and 1.55% for the year.

Real Estate (+9.21%) was the best performing sector in March. A more dovish view on Australian interest rates likely helped, given it is among the more highly-geared sectors, which drove broad-based strength. Goodman Group (GMG, +13.08%), the largest stock in the sector, continued to surge in the wake of a well-received result. It is also seen as a beneficiary of the AI-thematic given a pipeline of data centre developments.

Energy (+5.57%) rose on the back of a further 4.6% increase in the price of Brent crude, which was up 13.6% for the quarter. Woodside Energy (WDS) was up 3.54% and Santos (STO) gained 9.46%.

Communication Services (-0.78%) was the only sector to lose ground, driven largely by weakness in the online classifieds such as Car Group (CAR, -0.87%), REA Group (REA, -4.01%) and Seek (SEK, -3.79%). Telstra (TLS, +1.05%) bucked the trend.

Consumer Discretionary (+0.82%) also underperformed. Wesfarmers (+2.64%) lagged the market’s gain, while Aristocrat Leisure (ALL, -7.78%) fell after management sounded a note of caution about demand in their key US market.

Portfolio overview

Australian Shares Portfolio	
Investment strategy	Pendal 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. The portfolio will focus primarily on capital growth.
Investment objective	To deliver outperformance relative to the benchmark after fees over a rolling three year period.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15 - 35 (32 as at 31 March 2024)
Sector limits	Australian Shares 60 - 98% Australian Property 0 - 30% Cash 2 - 10%
Dividend Yield	3.46%#
Income target	No target

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	11.42%
CSL	CSL Limited	8.70%
CBA	Commonwealth Bank of Australia	6.47%
NAB	National Australia Bank Limited	6.22%
STO	Santos Limited	5.42%
TLS	Telstra Group Limited	5.13%
WBC	Westpac Banking Corporation	4.93%
XRO	Xero Limited	4.45%
QAN	Qantas Airways Limited	3.95%
GMG	Goodman Group	3.93%

Source: Pendal as at 31 March 2024

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
STO	Santos Limited	4.38%
XRO	Xero Limited	3.68%
QAN	Qantas Airways Limited	3.56%
TLS	Telstra Group Limited	3.28%
CSL	CSL Limited	2.94%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
ANZ	ANZ Group Holdings Limited (not held)	-3.66%
WES	Wesfarmers Limited (not held)	-3.21%
WDS	Woodside Energy Group Ltd (not held)	-2.40%
CBA	Commonwealth Bank of Australia	-1.88%
FMG	Fortescue Ltd (not held)	-1.80%

Source: Pendal as at 31 March 2024

#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	3.38%	5.43%	13.04%	12.98%	8.85%	10.07%	9.67%
S&P/ASX 300 (TR) Index	3.26%	5.43%	14.24%	14.40%	9.43%	9.15%	8.49%
Active return	**0.12%**	**0.01%**	**-1.21%**	**-1.43%**	**-0.58%**	**0.92%**	**1.19%**

Source: Pendal as at 31 March 2024

*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
STO	Santos Limited	0.26%
GMG	Goodman Group	0.16%
NST	Northern Star Resources Ltd	0.12%
QBE	QBE Insurance Group Limited	0.11%
QAN	Qantas Airways Limited	0.10%

Top 5 detractors - monthly

Code	Name	Value Added
ALL	Aristocrat Leisure Limited	-0.16%
LTM	Arcadium Lithium	-0.15%
NEM	*Newmont Corporation (not held)*	*-0.09%*
SEK	Seek Limited	-0.09%
TLS	Telstra Group Limited	-0.07%

Top 5 contributors - 1 year

Code	Name	Value Added
XRO	Xero Limited	1.10%
JHX	James Hardie Industries PLC	0.78%
GMG	Goodman Group	0.70%
NXT	Nextdc Limited	0.60%
WOW	*Woolworths Group Ltd (not held)*	*0.51%*

Top 5 detractors - 1 year

Code	Name	Value Added
QAN	Qantas Airways Limited	-1.50%
LTM	Arcadium Lithium	-1.03%
TLS	Telstra Group Limited	-0.75%
S32	South32 Ltd.	-0.72%
ANZ	*ANZ Group Holdings Limited (not held)*	*-0.71%*

Source: Pendal as at 31 March 2024

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight Santos (STO, +9.46%)

Santos recouped much of ground lost in February when it announced that the possibility of a potential merger with Woodside was off the table. The oil price rose 4.6% (Brent crude) in March and is up 13.6% for the year as concerns over supply disruption in the Middle East have intensified, at the same time that the US economy continues to hold up well.

Overweight Goodman Group (GMG, +13.08%)

Goodman Group develops, owns and operates industrial property globally and is benefiting from structural tailwinds of increased demand. More recently it has benefited from the prospect of lower interest rates and from the AI thematic via its data centre developments, given the intensity of data use underpinning the development of AI models. Data centres now accounts for 37% of GMG's work in progress.

Overweight Northern Star (NST, +13.37%)

Northern Star owns and operates gold mines in Western Australia and Alaska. Continued gains in the gold price drove it higher in March. Late in the month it announced the proposed extension of its existing expansion project for the Kalgoorlie Superpit which would effectively add seven years to the asset's mine life, keeping it operational to 2034.

Three largest detractors

Overweight Aristocrat Leisure (ALL, -7.78%)

Aristocrat fell after a management update which, while not making any changes to guidance and highlighting expectations for continued market share growth, also conveyed a relatively downbeat assessment of slot machine demand in their key US market.

Overweight Arcadium Lithium (LTM, -12.63%)

The lithium sector remains under pressure given continued uncertainty around how long Chinese battery makers will continue de-stocking inputs and around end demand for electric vehicles. There have been some green shoots with prices in the lithium complex showing some signs of stabilisation following large falls in 2023. However the combination of many moving parts and lack of visibility into key elements of the Chinese supply chain continue to see elevated uncertainty weighing on the sector. The company has adjusted its growth profile, both in response to more challenging market conditions and as it seeks to optimise its enlarged project suite following the Albermarle/ Allkem merger. While we view this as a logical and pragmatic step, it has seen growth expectations reduced.

Underweight Newmont Corporation (NEM, +17.71%)

Newmont is a US gold miner recently listed on the ASX following its acquisition of Newcrest Mining. It outperformed off the back of a 9.1% gain in the gold price, which was in turn helped by the prospect of lower US interest rates. The detraction from not owning NEM was offset by the position in Evolution (EVN), our preferred gold mining exposure.

Performance and outlook

Continued momentum in Goodman Group (GMG) and QBE Insurance (QBE) was helped performance in March, while Qantas (QAN) and Santos (STO) rebounded from weakness in February.

Multiple data points suggest the global economy is holding up and some recent inflation indicators have come in a touch above consensus which, in combination, have seen expectations for the number and timing of rate cuts tempered markedly.

ISM manufacturing purchasing managers indices (PMIs) are inflecting higher globally. This is supportive for global growth and strength in commodities, particularly when combined with a tighter supply environment.

The Atlanta GDPnow index is estimating that US GDP growth is tracking towards 2.5% for 1Q24 (as at 4th April 2024).

Meanwhile the Evercore ISI Trucking survey has improved to the highest level since October 2022 and is showing signs of stabilisation, although still at depressed levels by historical standard. There is usually good correlation between trucking survey and US real GDP growth.

On the inflation front, the US core personal consumption expenditures (PCE) index – the Fed's preferred measure of inflation – rose 0.26% in February and is tracking at +2.8% year-on-year.

Importantly, February's Prices Paid subindex of the ISM Services index dropped to a 4-yr low of 53.4 (from 58.6) suggesting that upward pressure on prices from labour costs is easing further. This has also been a good lead indicator for underlying core personal consumption expenditures (PCE) services ex. housing index, suggesting further downward pressure on inflation.

In the US average hourly earnings are continuing to trend downwards, but at 4.1% annual growth in March remain ahead of the 3.5% annual rate that is considered consistent with the Fed's 2% inflation target.

In Australia, inflation data for February came in below expectations, moderating to 3.4% (consensus at 3.5%) and unchanged from January which is the equal slowest since November 2021.

Stronger unemployment data offset the RBA's shift to a more neutral stance, with a full cut now not priced in until November (versus September previously). The RBA will also need to monitor the effect of tax cuts which begin to kick in from July.

While an environment of slowing inflation and economic resilience remains broadly supportive of equity markets, there are two risk scenarios to consider. The first is that we start to see a material deceleration in the economy as the lagged effects of monetary tightening take hold. This could potentially force central banks to cut rates, but would also come with material risk to earnings.

The second scenario is a rebound in inflation, which could see central banks delay rate cuts and comes with economic risk. We are mindful of these potential risks in the portfolio's construction.

New stocks added and/or stocks sold to zero during the month

Add new position in Technology One (TNE).

We are adding to the portfolio's quality growth exposure via a new position in Technology One (TNE).

TNE designs, builds and distributes software-as-a-service (SAAS) enterprise management products and services. Its key customers include the education, government, health and community services and financial services sectors in Australia, the UK and the Asia Pacific region. The company has existed since 1987 and in FY23 delivered total revenue of $441.4m and profit before tax (PBT) of $129.9m at an underlying PBT margin of 30%.

The company has several opportunities which we think can underpin mid-teens earnings growth on a relatively consistent basis for coming years.

Firstly, the company expects to see growth in the user base which is broadly in-line with population growth. In combination with CPI-linked pricing, this delivers mid-single digit revenue growth.

A key additional element is the conversion of existing customers to an enhanced, fully cloud-based product at a higher price point. We expect this to play out over several years. The company has a proven track record in this process, having spent recent years converting their customer base from a software licence to an SAAS model.

The build out of the localised product suite in the UK also offers greater opportunity for cross-selling and up-selling customers, which did not exist before.

There are further additional opportunities in other products and services which underpin the growth outlook.

At this point we see valuation as attractive given growth outlook. The stock has de-rated from mid-2023 onwards and is trading at a valuation discount to other major software and tech companies in Australia. In part, this is likely due to the tailwind from customer conversion from software licence to SAAS – which has been a key driver of the stock in recent years - coming to an end. However the company is indicating that the next stage of the strategy is the transition to the fully cloud-based product, which should provide additional revenue tailwinds. We note that TNE has a good record of execution in this process.

At the same time we are at or near a peak in interest rates and central banks are indicating a desire to start cutting. This would mean the headwind to valuations of long-dated growth companies from higher bond yields is also likely to dissipate.

Given this, we are taking the opportunity to add a high-quality growth company at reasonable valuation.

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key account manager or visit **pendalgroup.com**

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