PENDAL

Pendal Monthly Commentary

Pendal Australian Tax Effective Income 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 Tax Effective 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 focuses on both capital growth and delivering higher than market yield with a particular consideration for CGT.
Investment objective	To deliver outperformance relative to the benchmark after fees on a rolling three year period while delivering a higher gross yield than the market.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15 - 35 (31 as at 31 March 2024)
Sector limits	Australian Shares 60 - 98%, Australian Property 0 - 30%, Cash 2 - 10%
Dividend Yield	3.92%#

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	11.33%
CSL	CSL Limited	8.24%
CBA	Commonwealth Bank of Australia	7.72%
NAB	National Australia Bank Limited	6.26%
TLS	Telstra Group Limited	5.50%
WBC	Westpac Banking Corporation	5.02%
QBE	QBE Insurance Group Limited	4.18%
MTS	Metcash Limited	3.74%
STO	Santos Limited	3.73%
QAN	Qantas Airways Limited	3.45%

Source: Pendal as at 31 March 2024

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
TLS	Telstra Group Limited	3.65%
MTS	Metcash Limited	3.56%
QAN	Qantas Airways Limited	3.06%
QBE	QBE Insurance Group Limited	3.06%
STO	Santos Limited	2.69%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WES	Wesfarmers Limited (not held)	-3.21%
ANZ	ANZ Group Holdings Limited	-1.72%
TCL	Transurban Group Ltd. (not held)	-1.70%
WOW	Woolworths Group Ltd (not held)	-1.68%
COL	Coles Group Ltd. (not held)	-0.94%

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 Tax Effective Income Portfolio	3.36%	5.76%	13.52%	13.22%	8.89%	9.91%	9.75%
S&P/ASX 300 (TR) Index	3.26%	5.43%	14.24%	14.40%	9.43%	9.15%	9.67%
Active return	**0.10%**	**0.33%**	**-0.72%**	**-1.18%**	**-0.54%**	**0.76%**	**0.09%**

Source: Pendal as at 31 March 2024

*Since Inception - 14 September 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	0.16%
QBE	QBE Insurance Group Limited	0.13%
GMG	Goodman Group	0.10%
QAN	Qantas Airways Limited	0.09%
TCL	*Transurban Group Ltd. (not held)*	*0.09%*

Top 5 detractors - monthly

Code	Name	Value Added
ALL	Aristocrat Leisure Limited	-0.10%
NEM	*Newmont Corporation (not held)*	*-0.09%*
TLS	Telstra Group Limited	-0.08%
RMD	*Resmed Inc (not held)*	*-0.06%*
WBC	Westpac Banking Corporation	-0.05%

Top 5 contributors - 1 year

Code	Name	Value Added
NXT	Nextdc Limited	0.64%
JHX	James Hardie Industries PLC	0.62%
DOW	Downer EDI Limited	0.53%
WOW	*Woolworths Group Ltd (not held)*	*0.51%*
QBE	QBE Insurance Group Limited	0.40%

Top 5 detractors - 1 year

Code	Name	Value Added
QAN	Qantas Airways Limited	-1.18%
TLS	Telstra Group Limited	-0.84%
S32	South32 Ltd.	-0.75%
WES	*Wesfarmers Limited (not held)*	*-0.69%*
ORA	Orora Ltd.	-0.59%

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 QBE Insurance (QBE, +7.84%)

QBE Insurance continued the strong gains made since December. The company is benefiting from twin tailwinds. At an industry level, inflation in the cost of insurance claims is rising at a lower rate than insurance premium increases. At the same time, the company is benefiting from self-help as non-core and unprofitable parts of the business are divested or run down, resulting in a higher quality company.

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.

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.

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.

Overweight Telstra (TLS, +1.05%)

Telstra made gains in late March and finished the month in positive territory, but lagged the broader market. We continue to like Telstra for its defensive qualities, underpinned by strength in its mobile phone franchise where it is winning subscribers and where pricing is linked to inflation. It continues to exercise discipline on costs and has largely returned to its role as a solid defensive yield stock, in our view.

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

Buy a new position in Scentre Group (SCG).

We are adding to the portfolio's position in rate-sensitives via the addition of Scentre Group (SCG). SCG owns and operates 42 Westfield shopping centres across Australia and New Zealand, a portfolio that delivered $28.4bn in retail sales in 2023.

Last year SCG faced twin headwinds from rising interest rates, which drove up interest costs as well as raised concern around a slowdown in consumer activity which saw the stock underperform. It is currently trading on 13.8x next-12-month price to earnings, which is attractive value compared to the broader AREIT sector.

We have now reached a point where rates appear to be at or near a peak, while the combination of population growth, a draw-down on savings, and additional hours worked have led to consumer resilience.

At the same time, SCG management have navigated the environment well, as demonstrated in its 2023 result where it generated 5.2% earnings growth.

This was driven by top line rental growth (as specialty store leases have annual inflation-linked increases), improved occupancy levels (occupancy rose +30bp to 99.2%) and positive leasing spreads (signing leases on expiring specialty leases +3.1% over expiring rents).

The group's strategy of reducing holdovers (occupied space but not secured with a lease) combined with the lack of new retail space has meant that there are limited amounts of space for tenants looking for better space/planning expansion. The resulting competitive tension has led to strong occupancy and rental growth.

Tenant sales continue to improve with specialty sales accelerating in 4Q23 +3.1%. In the medium term the group will be repurposing department store space (mostly David Jones) at significantly higher rents and better sales productivity.

Debt is elevated at 40% total debt to total assets. This remains something to watch, however management are confident that it can refinanced and/or repaid with asset sales.

The fundamental outlook looks good, while the headwinds of the macro environment also appear to be receding. As a result we are taking advantage of attractive valuation to add a high quality property exposure to the portfolio.

For more information contact your
key account manager or visit **pendalgroup.com**

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