Pendal Australian Share Fund

ARSN: 089 935 964

Factsheet

Equity Strategies

June 2019

About the Fund

The Pendal Australian Share Fund (**Fund**) is an actively managed portfolio of Australian shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 (TR) Index over the medium to long term. The suggested investment timeframe is five years or more.

Description of Fund

This Fund is designed for investors who want the potential for long term capital growth and tax effective income, diversification across a broad range of Australian companies and industries and are prepared to accept higher variability of returns. The Fund may also hold cash and may use derivatives.

Pendal's investment process for Australian shares is based on our core investment style and aims to add value through active stock selection and fundamental company research. Pendal's core investment style is to select stocks based on our assessment of their long term worth and ability to outperform the market, without being restricted by a growth or value bias. Our fundamental company research focuses on valuation, franchise, management quality and risk factors (both financial and non-financial risk).

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. Derivative can also be used to gain exposure to assets and markets.

Investment Team

Pendal's nineteen member Equity team is one of the largest in the Australian fund's management industry. The portfolio manager for the Fund is Crispin Murray, who has more than 28 years' industry experience. Crispin is also Head of Equity.

Investment Guidelines

Ex-ante (forward looking) tracking error	2.0% - 6.0%
Min/max stock position	+/-4%
Min/max sector position	+/-8%

Other Information

Fund size (as at 30 Jun 2019)	$977 million
Date of inception	September 1992
Minimum investment	$25,000
Buy-sell spread[1]	0.50% (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	RFA0818AU

[1] The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Management Costs[2]

Issuer fee[3]	0.79% pa

[2] You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

[3] This is the fee we charge for overseeing the operations of the Fund and managing the assets of the Fund. The Issuer fee is paid from the assets of the Fund and is reflected in the unit price of your investment.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	2.87	2.94	3.64
3 months	6.80	7.02	8.05
FYTD	7.87	8.74	11.42
6 months	18.53	19.01	19.84
1 year (pa)	7.87	8.74	11.42
2 years (pa)	11.30	12.20	12.33
3 years (pa)	12.77	13.67	12.82
5 years (pa)	8.77	9.63	8.88

Sector Allocation (as at 30 June 2019)

Energy	8.5%
Materials	21.7%
Industrials	11.0%
Consumer Discretionary	6.1%
Consumer Staples	2.3%
Health Care	11.7%
Information Technology	1.5%
Telecommunication Services	6.6%
Financials ex Property Trusts	25.4%
Property Trusts	2.4%
Cash & other	2.8%

Top 10 Holdings (as at 30 June 2019)

CSL Limited	8.3%
BHP Billiton Limited	8.0%
Commonwealth Bank of Australia Ltd	7.9%
ANZ Banking Group Limited	5.9%
Telstra Corporation Limited	4.7%
Westpac Banking Corporation	4.4%
Qantas Airways Limited	4.0%
Transurban Group	3.6%
Santos Limited	3.4%
Amcor Limited	2.9%

Risks

An investment in the Fund involves risk, including:

- **Market risk**: The risk that factors affecting one or more countries that can influence the direction and volatility of an overall market, as opposed to security-specific risks.
- **Security specific risk**: The risks associated with an individual security.

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

Market review

The S&P/ASX 300 Accumulation index had a strong second quarter, adding 8.1% to what was already a solid recovery in the previous quarter (+10.9%) following the market's decline in late 2018. Overall, the market returned +11.4% for FY19, with Resources (+15.0%) outperforming and Industrials (+10.5%) the laggard.

Domestically, sentiment improved somewhat following the Coalition's surprise win in the Federal election. Nevertheless, the 10-year bond yield is now at record lows, down by 45bps over the June quarter, and by 132bps over the year. The subdued outlook for the economy, and the dovish stance global central banks, including the RBA, which cut the cash rate to a record low of 1.25% in June have been driving down long-term bond yields globally. In that vein, gold is also fetching multi-year high prices, as investors make the rotation into the safe haven asset. Outside Australia, the reprieve achieved in the US-Sino trade is expected to somewhat allay concerns around the outlook for global economic growth, although this may prove temporary.

Over the quarter, Energy (-0.2%) was the worst performing GICS sector, and the only one posting a loss. The oil price, which had been volatile over the period is starting to stabilise somewhat, finishing the quarter at US$65/bbl; down from US$68/bbl at March end - it was fetching $75/bbl and $60/bbt at the highs/lows during the period. Global supply could become tight again given the OPEC+ has decided to extend existing production curtailment. Within the sector, Oil Search (OSH, -9.9%), Viva Energy (VEA, -13.9%) and Caltex (CTX, -5.6%) were the largest performance detractors. For OSH, the political unrest in PNG, which saw the country's Prime Minister resign in May has led to some concerns that it could result in a re-negotiation of OSH's gas agreements with the local government. For VEA and CTX, the combination of weak refiner margins and subdued retail fuel margins was a key drag on investor sentiment.

On the other side of the tally board, Communication Services (+12.2%) gained the most over the quarter with the help of some retail cyclicals following the Federal election. No change in government and therefore no significant policy shifts is expected to improve sentiment for older consumers and help business confidence. The subsequent cut to the cash rate by the RBA, together with news APRA may reduce its mortgage serviceability assessment rate from 7.25% provided investors with some assurance policy makers are actively trying to avoid a housing confidence-led downturn. REA (+28.6%), Nine Entertainment (NEC, +9.7%) and Domain Holdings (DHG, +24.7%) all advanced in that regard. The largest contributor from the sector was however Telstra (TLS, +16.0%), which has recently come out of the nadir of sentiment. In that vein, the Australian Competition and Consumer Commission (ACCC) ruled against the tie-up between telecom operators TPG Telecom (TPM, -7.1%) and Vodafone. The outcome will be a legal tussle which is likely to be resolved towards the end of CY19 – at best – but could drag on into mid-next year. It is a positive for Telstra in the near term as it further delays a roll-out of a competitive 5G network.

Lastly, index heavyweight Banks (+13.4%) outperformed through the quarter. The retention of negative gearing, lower rates and an easier serviceability hurdle in conjunction is expected to stabilise the housing market and, in turn, reduce pressure on the banks. The 'big four' banks all recorded strong returns for the quarter as a result, ranging from 9.4% (NAB) to 17.2% (CBA).

The other key cohort of the market, the miners had mixed performance over the quarter: Gold miners (+19.7%) outperformed strongly; whereas the iron ore miners such as BHP (+6.9%) and Rio Tinto (RIO, +6.0%) were the laggard. That said, Australian iron ore miners continue to operate in their sweet spot, with the commodity now trading ~US$110/mt and the Australian dollar hovering around 70cents USD.

Fund performance

The Fund underperformed its benchmark over the June quarter end.

Contributors

Overweight Aristocrat

Aristocrat (ALL, +26.3%) delivered a good set of 1H19 results where the Normalised profit after tax and before amortisation of acquired intangibles (NPATA) came in strongly at $422.3m. It represented a 17% increase compared to that of 1H18, beating market expectation. Investors were also pleased to see Management reiterate the "continued growth" outlook for FY19, suggesting some earnings skew towards the second half of FY19.

Overweight Fortescue Metals

The Australian iron ore miners as a cohort is operating in a sweet spot, given the confluence of a number of macro and stock-specific factors. Reasonable Chinese demand and a reduction in Brazilian production is supporting prices at a far higher level than the market expected. The return of Fortescue (FMG, +35.9%) was boosted by the announcement of a 60c-a-share special dividend - the company's total yield, including special dividends and buy-backs, is now running at about 20%, providing plenty of stock support. While we do not anticipate global iron ore prices to stay elevated at the US$110-120/mt level, it is also hard to see the commodity trade on the downside of $80/mt due to the supply constraints globally. The demand side of the equation is somewhat bifurcated: weak demand from Auto is offset by strong demand from infrastructure. Overall, the commodity still looks strong and as such, we continue to hold convictions in Fortescue Metals (FMG, +12.0%).

Detractors

Overweight Viva Energy

Viva Energy (VEA, -13.9%), which supplies more than 50% of all fuel used in Victoria, and the sole distributor of Shell-branded fuel in Australia pulled back over the quarter. The refiner margin, which has always been volatile, has been at the downside lately. In addition, VEA's Retail business update in April revealed that lower retail fuel margins on the back of the rising oil prices, and the lag in passing these on to end customers is also going to hit the earnings harder than expected. We remain mindful that there have been unmistakeable signs of economic deceleration in recent months. However the Coalition's surprise victory in the Federal Election, coupled with a rate cut from the RBA, should help to underpin consumer sentiment. Economic growth remains muted, but government and regulator efforts to combat a housing-induced economic slowdown does remove a material portion of downside risk for the economy. In addition to these cyclical factors, the recent favourable restructuring of VEA's fuel supply agreement with Coles should add substantial value and see benefits in both fuel and non-fuel revenues. VEA paid a low price for access to the retail fuel margin and there is the potential for the retail network to return to growth on the back of a better approach to pricing. It also possesses attractive infrastructure assets – one of only four refineries in Australia as well as pipelines and terminals and other pieces of key infrastructure which underpin strong positions in mining, marine, airports etc. We continue to hold convictions in the company.

Overweight Qantas

A stronger oil price and softer domestic environment has weighed on Qantas (QAN, -2.7%) in recent months. We believe that improved demand in the international sector should help offset a slowdown in domestic corporate travel. QAN has also been able to grow revenues off the back of less fare discounting, which should enable it to offset higher fuel costs for FY19.

Strategy and outlook

Solid gains in June capped a strong first half to 2019, in which Australian equities have staged rapid rebound from the sell-off in late 2018. The S&P/ASX 300 is up +3.6% for the month, +8.1% for the quarter and +19.8% for the first half.

At an economic level, we remain in an environment of muted growth. While the effect of interest rate cuts on broader economic activity is questionable, it does demonstrate that policy makers are actively working to avoid a housing-led economic downturn. The reduction in this threat has improved sentiment, however we believe that it is a case of removing downside risk, rather than expecting a meaningful pick-up in near-term economic growth. This is a view echoed in our meetings with domestic cyclical companies, who have noted that the environment remains challenging.

Corporate earnings look set to grow in the mid-single-digit range over the near term. There is considerable dispersion underneath this headline figure. Resource stocks – and in particular iron ore miners – remain in a sweet spot, as do the contracting companies which service them. The bank sector has seen some sentimental improvement alongside the housing sector, however the already stiff headwinds for earnings are only exacerbated by rate cuts. Elsewhere growth, while present, is patchy.

This underpins the benefits of being able to distinguish between those companies which can adapt to the current environment – and those which are more challenged – and allocate capital accordingly.

While elevated macro risk – primarily related to trade – dominates headlines, there are several positive factors for Australian equities including high commodity prices, a depreciated currency, and falling interest rates. As a result we believe that despite the market's strong run over the year to date, the outlook for equities remains reasonable.

The portfolio made decent absolute gains in June, with strong performance from the iron ore stocks. The bond-sensitives exposures via infrastructure stocks such as Transurban and Atlas Arteria also performed well. However it underperformed the index given a weak month for Qantas, one of the Fund's largest positions, as well as a drag from Metcash, Nine Entertainment and Caltex.

Qantas also dragged over the quarter, largely on the back of a higher oil price. We retain the view that Qantas can offset a higher fuel bill via revenue growth. The oil price has also seen weaker volumes for fuel companies Viva Energy and Caltex Australia, which are also among detractors for the quarter. Both are facing headwinds – however they are largely cyclical rather than structural – and we believe the market is under appreciating the value in both companies.

On the positive side, the iron ore exposure has worked well in Q2 2019. Iron ore miners are in a sweet spot given a high US dollar price combined with a weaker dollar and a far lower cost base than has been the case in previous years. The infrastructure exposure has also worked well, as has the position in Telstra which has rebounded following the ACCC's decision to try and block the tie up between TPG Telecom and Vodafone.

Growth exposure has been one of the more challenging areas over the last twelve months, given the relative scarcity of genuine growth opportunities in the Australian market and the heady valuation that many of the stocks are subsequently pushed to. Nevertheless our preferred growth stocks such as Xero and Aristocrat Leisure also performed well.