PENDAL

Factsheet

Pendal Australian Share Fund

Equity Strategies

ARSN: 089 935 964

September 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 Sep 2019)	$975 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	1.99	2.06	1.91
3 months	1.89	2.09	2.55
FYTD	1.89	2.09	2.55
6 months	8.81	9.25	10.80
1 year (pa)	8.20	9.07	12.57
2 years (pa)	11.35	12.25	13.30
3 years (pa)	11.85	12.75	11.85
5 years (pa)	9.16	10.03	9.55

Sector Allocation (as at 30 September 2019)

Energy	8.1%
Materials	19.1%
Industrials	11.5%
Consumer Discretionary	6.6%
Consumer Staples	2.8%
Health Care	11.6%
Information Technology	1.8%
Telecommunication Services	7.0%
Financials ex Property Trusts	25.9%
Property Trusts	3.9%
Cash & other	1.7%

Top 10 Holdings (as at 30 September 2019)

CSL Limited	8.5%
Commonwealth Bank of Australia Ltd	7.2%
BHP Billiton Limited	6.5%
ANZ Banking Group Limited	5.9%
Telstra Corporation Limited	5.0%
Qantas Airways Limited	4.4%
Westpac Banking Corporation	4.2%
Transurban Group	3.6%
Santos Limited	3.3%
Macquarie Group Limited	2.7%

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

Australian stocks (S&P/ASX 300 Accumulation Index) gained 2.6% in the most recent quarter. Despite the mixed reporting season, nine out of the eleven GICS sector finished in the green with Consumer Staples (+11.6%) leading the cohort. Within the sector, supermarket chains, Coles (COL, +18.4%) and Woolworths (WOW, +13.9%) gained after both beating market expectations in net income – by 22.3% and 3.4% respectively. Woolworth's management had noted that there was lower discounting in long-life goods – a potential sign of grocery deflation bottoming that would pose as positive tailwinds for the sector. Treasury Wine Estates (TWE, +25.8%) also gained after reporting strong organic sales growth and an earnings to cash conversion rate that was in line with market expectations. On the flipside, A2 Milk (A2M, -12.2%) disappointed after revealing some underwhelming results. Management reported an FY19 EBITDA margin of 28.2%, which was 12% below market consensus.

Elsewhere, defensive sector Healthcare (+7.2%) outperformed. Resmed (RMD, +15.8%) led the sector after reporting a 13% YoY revenue growth and strong revenue generation from its software and services division (111% revenue growth YoY). Management was optimistic on the continued momentum in the SaaS program, expecting it to grow from 100 million user base to 250 million within the next 6 years. CSL Limited (CSL, +9.4%) also experienced strong growth in FY19 - driven by high product volume. Despite some initial approval issues in China, CSL managed to substantially improve the country's albumin sales in the second half of FY19. On the flipside, Ramsay Health Care disappointed markets (RHC, -8.9%) when its EPS growth fell short of market expectations.

Financials (+3.3%) also gained over the quarter despite being the August laggards. The 'Big 4' banks all tracked positive returns ranging between NAB's 11.2% gain to Commonwealth's (CBA) 0.6% gain. CBA, the only bank that has reported FY19 financials so far, lagged after announcing softer earnings and overall profits, with a 12% YoY decrease in retail banking profitability. Management has stated that rate cuts have put pressure on their profit margins, as they cannot pass on the decrease in rates onto their deposit accounts (worth $160 billion). On other side of the tally board, AMP (-13.9%) decreased in share price with its complicated turn-around story to restructure its wealth management arm. The share price dropped to new lows in July after its failed attempt to sell off its $3.3 billion life insurance arm and suffered more in August, after issuing a heavily discounted capital raising of $650 million to fund the wealth management restructure. Similarly, CYBG (CYB, -39.2%) dragged within the sector, following the announcement of an additional provision of GBP 350 – 400 million against mis-selling claims for its payment protection insurance. The net effect of CYB's provision equates to 10% of the company's capital base. Although payment amounts have been running in the low teens as a percentage of claims made, the administration costs in processing the claims renders the final amount required to be highly uncertain.

On the other side of the tally board, Materials (-3.5%) lagged after many Metals & Mining stocks fell on the back of the pull back in commodity prices. As a result, despite reporting some strong results in the first half of FY19, with a 24% revenue growth and a higher than expected dividend growth, the share price of Rio Tinto (RIO, -7.6%) still dropped over the quarter. A large boost to RIO's earnings was due to the high commodity prices, and with the recent price decreases the main concern is whether the miner can sustain its revenue growth from here. For similar reasons, BHP (-8.0%) retreated. Offsetting some of the losses, gold miners such as Newcrest (NCM, +9.4%) and Evolution Mining (EVN, +5.1%) fared better this quarter. The rising gold price on the back of heightened geopolitical uncertainties and a low-interest-rate environment supported the cohort.

Fund performance

The Fund underperformed its benchmark over the September quarter.

Contributors

Overweight Qantas

Qantas (QAN, +19.0%) delivered a decent result in August, despite the headwind of higher fuel costs and softer demand in the domestic market. The company also dialled-up its capital return by $100m to $600m per half year, which was well received by the market. There was also a positive read on the implications of Virgin Australia's (VAH) poor earnings result. VAH's announcement that it is looking to cut unprofitable routes, plus the increased gearing that comes with its US$-denominated debt, had some investors questioning its ability to survive. We believe that it does; however, VAH is in no position to start aggressively discounting fares, while fewer routes means less capacity in the domestic Australian market. Both situations are good for QAN.

Overweight James Hardie

James Hardie (JHX, +33.0%) in August posted a double-digit gain in August on the back of a surprisingly good result. While US housing remains soft, JHX's share of fibre cement is showing signs of growing and the fibre cement category itself is growing in usage, so two out of the three tenets of their story are now better placed. Pulp prices are also falling which is also supportive for JHX. The company also updated investors in September on its North American strategy, where a reorganisation of its account management is showing signs of traction in regaining lost market share in building products.

Detractors

Overweight CYBG

CYBG (CYB, -39.2%) dragged over the quarter, following the announcement of an additional provision of GBP 350 – 400 million against mis-selling claims for its payment protection insurance. The net effect of CYB's provision equates to 10% of the company's capital base. Although payment amounts have been running in the low teens as a percentage of claims made, the administration costs in processing the claims renders the final amount required to be highly uncertain. The company's share price also remains highly responsive to any Brexit news.

Overweight Telstra

Telstra (TLS) fell -6.8% over the quarter, which looks to have been driven largely by offshore selling. Investors were disappointed with the earnings result revelation that the headwind from NBN would be $400m more than expected. That said, in our view this issue is unlikely to deteriorate, while we believe the market is underestimating the effect of slightly better pricing in mobile telephony. TLS is not at a demanding valuation and therefore lacks the risk of de-rating seen in other parts of the market. It is also offering a 4.6% dividend yield, pre-franking, in an environment where interest rates and bond yields remain low. We believe it could do well in this environment.

Strategy and outlook

The equity market continues to trade around shifts in sentiment on US-China trade, with a more optimistic bent in September driving a recovery from the reversal in August. The situation is unpredictable, to say the least, although signs that a deterioration in corporate confidence is starting to affect growth have raised the importance of getting some sort of deal done. December 15th looms as a key date; this is the deadline for the next round of potential tariffs, which will have a greater proportional effect on consumer goods and therefore on the hip pockets of middle America.

The trade war is one key touchpoint for sentiment in Australian equities. We see liquidity, the broader Chinese economy, and the state of the domestic economy as three others.

Coordinated monetary easing has reignited the search for yield beyond the traditionally defensive asset classes of term deposits and bonds. The dividend yield premium of the S&P/ASX 200 over ten year Australian government bonds is a touch over 3%. The last time it was anywhere near these levels – apart from the GFC – was back in 1942. And for much of the intervening period the equity market has yielded less than ten year sovereigns.

We see this as supportive of the overall equity market, particularly given the relatively unpredictable macro-economic and geopolitical environment. It is also driving liquidity into the higher yielding parts of the market, such as REITs and infrastructure. It has also continued to drive growth stocks. We are less convinced that some of the stocks in these parts of the market can sustain their high valuation ratings – and there have been recent signs of a rotation away from these parts of the market.

This liquidity injection is perhaps the most important thematic element at play in today's market. However Chinese economy growth remains an important indicator. Here, there have been signs of stress from the ongoing trade war, however this far the authorities have been able to offset this via stimulus measures. As a result, the demand side of the equation remains largely intact for key commodities such as iron ore – for the moment. We think that increased supply will slowly erode iron ore prices, but that reasonable demand should help mitigate the risk of a calamitous drop. This is important for both the Australian mining sector – and also for the royalty revenues for the Federal government, which can be potentially used to fund stimulus measures.

Balancing factors are also at play in the domestic economy. Tighter lending standards and construction weakness are weighing on growth, while low wage growth is a limiting factor on consumption. Interest rate and tax cuts, plus lower utility bills, have thus far managed to prevent further slippage in growth, however we believe that it will take more fiscal stimulus to help drive any signs of recovery, particularly as the RBA nears the bottom of its tool bag in terms of rate cuts.

As always, the portfolio is built to be driven primarily by company specific opportunities, rather than thematic drivers. We think this is especially important in the current environment given heightened thematic uncertainty. We have exposure to growth via some of the more reasonably valued names such as CSL and Xero. Our preferred defensive yield plays include Transurban and Atlas Arteria, which have dominant toll road positions in Australia and France, respectively. We also continue to find companies – such as Qantas - with strong free cash flow and capital return to investors outside of the more traditional sectors. We do have some more cyclical exposures – such as James Hardie and JB Hi-Fi – while remaining very selective given signs of slowing growth.

For more information please call **1800 813 886**,
contact your key account manager or visit **pendalgroup.com**

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