PENDAL

Factsheet

Pendal Australian Share Fund

Equity Strategies

ARSN: 089 935 964

December 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 31 Dec 2019)	$980 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	-1.87	-1.80	-2.02
3 months	2.51	2.71	0.71
FYTD	4.44	4.86	3.28
6 months	4.44	4.86	3.28
1 year (pa)	23.80	24.80	23.77
2 years (pa)	8.67	9.54	9.54
3 years (pa)	10.75	11.64	10.33
5 years (pa)	8.80	9.66	9.07

Sector Allocation (as at 31 December 2019)

Energy	8.1%
Materials	19.6%
Industrials	11.5%
Consumer Discretionary	5.8%
Consumer Staples	2.4%
Health Care	11.7%
Information Technology	2.3%
Telecommunication Services	7.1%
Financials ex Property Trusts	24.5%
Property Trusts	4.2%
Cash & other	2.8%

Top 10 Holdings (as at 31 December 2019)

CSL Limited	8.5%
Commonwealth Bank of Australia Ltd	6.6%
BHP Billiton Limited	6.5%
Telstra Corporation Limited	5.0%
ANZ Banking Group Limited	4.6%
Qantas Airways Limited	4.0%
Westpac Banking Corporation	3.8%
Santos Limited	3.3%
Macquarie Group Limited	3.2%
Transurban Group	3.1%

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 Australian equity market had a choppy quarter. The market made a strong recovery after a sharp initial fall, but then a softer end to the year meant that the S&P/ASX 300 Accumulation index rose 0.71% for the quarter.

Overall, the Australian equity market delivered a strong returns in 2019, with the S&P/ASX 300 Accumulation index gaining +23.8%. Aggregate index earnings declined over the year, despite an expansion in the resource sector. As such, the year's gains were driven by a valuation re-rating, helped in turn by lower interest rates and bond yields.

A majority of sectors made gains over the quarter, however a -6.7% decline in the heavyweight Financial sector dragged on the market. This, in turn, was driven largely by the banks, which delivered an uninspiring set of updates and results. Revenue growth remains muted, while cost pressure remains. At the same time lower rates are likely to start eating into margins.

Commonwealth Bank (CBA, -1.2%) held up best, while ANZ (ANZ, -10.9%), National Australia Bank (NAB, -14.6%) and Westpac (WBC, -15.8%) also saw reasonable declines. The latter also had to contend with the announcement of civil proceedings brought by AUSTRAC in response to failings in anti-money laundering systems and procedures, which ultimately saw material changes in management.

Consumer staples (-2.2%) were also weaker, with both Woolworths (WOW, -3.0%) and Coles (COL, -3.6%) retreating late in the year.

Health care (+14.8%) was the best performing index. The sector was led by CSL (CSL, +18.0%) which continues to benefit from a shortage of immunoglobulin product in the US. This has underpinned demand for CSL, which has also benefited from a mix shift as it has been able to sell more product into the higher margin US market. The rest of the large cap health care stocks also made decent gains. It was interesting to note that this cohort of stocks was able to shrug off the rotation away from growth to value that occurred in other equity markets around the world.

Energy (+6.6%) also did well, helped by stronger oil prices. Late in the year OPEC and its major oil producing partners met and agreed to extend existing production cuts in 2020.Woodside (WPL, +6.2%), Origin Energy (ORG, +6.0%) and Santos (STO+5.8%) all did well. Caltex Australia (CTX, +29.0%) surged as it caught a bid from global giant Alimentation Couche-Tard.

The US and China announced that they had agreed to the first phase of a new trade deal. While the agreement is thus far short on detail – and only partially rolls back the most recent set of tariffs, it served to deescalate tension and uncertainty. Iron ore gained +4.5% in December in response. Materials (+4.8%) had a decent quarter as a result. BHP (BHP) gained 6.0%, Rio Tinto (RIO) +8.3%) while Fortescue Metals was up +21.5%.

Fund performance

The Fund outperformed its benchmark over the December quarter.

Contributors

Overweight Qantas

Qantas (QAN, +13.0%) announced new long-term margin targets at its investor day in November, with a strategy to lift the Qantas domestic margin from 12% to 18% and Jetstar's domestic margin from 14% to 22% in 2024. This would be considered a stretch by many people. However these targets are also in line with margins in other domestic markets with a stable industry structure. Even if these targets are not achieved, there is a sense that efforts to do so will still lead to material margin improvement. The national airliner remains one of our highest conviction positions.

Overweight CSL

Our preferred growth company, CSL (+18.0%) performed strongly, amid some selective selloffs amongst the growth cohort. Many of the stocks within this cohort are on challenging valuations, however we believe CSL to be among the few where genuine underlying growth can justify a higher valuation rating. Its most recent result demonstrated strength in its core IG business, where it continues to win share from competitors and benefit from an improving product mix. Its Speciality businesses also continues to do well.

Detractors

Overweight Metcash

MTS delivered a decent full year result. Crucially, it delivered underlying food sales growth for the first time in 2012. This indicates that the recent work management have done to improve and focus the offering and service has started to bear fruit. The markets' response suggests that it remains wary of the outlook for independent supermarkets despite the improving trend, while the contract loss with 7-Eleven also seems to weigh on investor's minds. We retain confidence in the company's outlook.

Overweight ANZ

ANZ (-10.9%) reported full year results in October. While the issues facing banks on revenue, earnings and capital are well known, ANZ's result still came as a slightly negative surprise. Some of this is due to ANZ's relatively large exposure to institutional loans, part of which is Asian-based and has the additional pressure from falling global rates. ANZ has also been the only bank attempting to reduce costs in an absolute sense in recent years. It has been successful in reducing costs from over $9bn to $8.6bn currently – towards a stated target of $8bn. However management flagged that while the long-term target remained, costs were likely to rise over the next year. Capital provided one of the few bright spots. Changes to the Reserve Bank of New Zealand's treatment of capital are likely to eat into the previously large surplus ANZ enjoyed, but there are solid indications they will be able to manage the position while maintaining dividends for the moment. ANZ's result painted a clear picture of the tough environment for banks, in which we remain underweight.

Strategy and outlook

The portfolio held up better than the index in December, topping a decent quarter in terms of relative performance. It outperformed the index over 2019, delivering strong absolute gains.

The portfolio's growth exposure helped relative performance over the fourth quarter of 2019. Although both Xero (XRO, -1.57%) and CSL (CSL, -2.7%) declined in December, this growth exposure has helped relative performance over the fourth quarter, with XRO up +28.4% and CSL +18.0%. It has been interesting to note that the rotation from growth to value has not been as marked in the Australian market as it has at a global level. While some of the Australian growth cohort have underperformed over the quarter - such as Afterpay Touch (APT, -18.4%) and Wisetech (WTC, -32.7%) – others such as CSL and XRO have maintained their momentum.

While bond yields have risen from a mid-year nadir, they are still low by historical standards in absolute terms. This, in turn, can continue to support higher-than-average valuations for the growth and defensive bond sensitives. As a result we maintain exposure in growth stocks, but remain selective, looking for opportunities where valuations enjoy some fundamental support at the company level – not just from the bond yield thematic. In CSL's case, this comes from a shortage in immunoglobulin product in the US, which is helping the company's volumes and margins. XRO, meanwhile, continues to make inroads into the UK market on the back of a compulsory shift to online tax returns for small businesses.

Elsewhere, Qantas (QAN) returned -2.6% in December but was among the best performers over the quarter, up +13.0% as some of the market's near-term fears over demand receded.

The strategy aims to drive performance via multiple ideas and different types of stocks, rather than via a large bet on a particular thematic. The year's performance was pleasing in this regard as the largest contributors to performance included LNG producer Santos (STO), tech company Xero, building products maker James Hardie (JHX) and health care company CSL. There was a mix of growth companies and cyclicals – as well as large, mid and small-cap companies among the best performers.

At the outset of 2020, some of the risk to global growth from US-China trade seems to have receded. We are mindful that the strategic arm wrestle between the two countries is likely to be a structural feature of markets and a source of periodic volatility, however for the moment the outlook here is less uncertain.

The domestic economic outlook remains muted. Tax and interest rate cuts seem to have helped stem a further decline, however many companies are still feeling the pressure from a lack of growth in demand. The lack of a strong cyclical tailwind emphasises the importance of management quality and business strategy – and the ability to allocate accordingly.

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

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