

## Pendal Ethical Share Fund

ARSN: 096 328 219

## Factsheet

Equity Strategies

September 2020

### About the Fund

The Pendal Ethical Share Fund (**Fund**) is an actively managed portfolio of Australian shares which seeks to ensure that funds are invested in an ethical and socially responsible manner. The investment process combines the potential to achieve strong performance over the long term while also investing in companies whose practices and impacts are aligned with an investor's own social, environmental and ethical preferences.

### 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.

### Investment Approach

The Fund will not invest in companies which:

- produce alcohol or tobacco
- manufacture or provide gaming facilities
- directly mine uranium for the purpose of weapons manufacture
- manufacture weapons and armaments
- derive more than 10% of revenue from the manufacture or distribution of pornography.

In addition to the above ethical exclusions, the Fund also applies an exclusion screen based on companies who have been subject to environmental, workplace healthy and safety, anti-discrimination, equal opportunity, trade practices, or industrial relations prosecutions.

### Investment Process

The Fund uses the same investment process as Pendal's flagship Australian equities products with the addition of ethical and social responsibility screens.

1. The negative screening process effectively determines the investment universe of the Pendal Ethical Share Fund
2. The Fund then applies a positive screen that seeks exposure to companies assessed as demonstrating and/or offering leading practices, products and services that provide a direct benefit to social or environmental outcomes (such as environmental management, energy efficiency, improved health & community well-being, business ethics and conduct or occupational health and safety).

### Investment Team

Pendal's nineteen member Equity team is one of the largest in the industry. The portfolio manager for the Fund is Crispin Murray assisted by Rajinder Singh, who have a combined 46 year's 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%

### Management Costs<sup>1</sup>

Issuer fee <sup>2</sup>	0.95% pa
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CERTIFIED BY RIAA

The Pendal Ethical Share Fund has been certified by RIAA according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See [www.responsibleinvestment.org](http://www.responsibleinvestment.org) for details<sup>5</sup>.

### Performance

(%)	Total Returns		Benchmark Return
	(post-fee)	(pre-fee)	
1 month	-3.17	-3.10	-3.59
3 months	-0.10	0.14	-0.06
FYTD	-0.10	0.14	-0.06
6 months	16.03	16.58	16.73
1 year (pa)	-7.55	-6.66	-9.96
2 years (pa)	-0.15	0.81	0.67
3 years (pa)	4.41	5.40	4.94
5 years (pa)	6.73	7.75	7.42

### Sector Allocation (as at 30 September 2020)

Energy	5.1%
Materials	25.1%
Industrials	10.9%
Consumer Discretionary	1.6%
Consumer Staples	3.9%
Health Care	11.9%
Information Technology	3.9%
Telecommunication Services	7.0%
Financials ex Property Trusts	21.0%
Property Trusts	3.1%
Cash & other	6.5%

### Top 10 Holdings (as at 30 September 2020)

CSL Limited	9.5%
BHP Billiton Limited	8.9%
Commonwealth Bank of Australia Ltd	5.7%
ANZ Banking Group Limited	4.9%
Xero Limited	3.9%
Telstra Corporation Limited	3.8%
Qantas Airways Limited	3.5%
Metcash Trading Limited	3.4%
National Australia Bank Limited	3.2%
Atlas Arteria	3.2%

### Other Information

Fund size (as at 30 Sep 2020)	\$176 million
Date of inception	May 2001
Minimum investment	\$25,000
Buy-sell spread <sup>3</sup>	
For the Fund's current buy-sell spread information, visit <a href="http://www.pendalgroup.com">www.pendalgroup.com</a>	
Distribution frequency	Quarterly
APIR code	RFA0025AU

<sup>3</sup> The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

<sup>1</sup> You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged. <sup>2</sup> 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. <sup>4</sup> The Responsible Investment Certification Program does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Appropriate professional advice should be sought prior to making an investment decision. RIAA does not hold an Australian Financial Services Licence.

## 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 equities market lost momentum during the last month of the quarter. The S&P/ASX 300 Accumulation index dropped by -3.6% in September; making its performance over the quarter flat (-0.1%). There was no meaningful divergence between Resources (-0.1%) and Industrials (+0.1%) over the period.

While the Covid situation in Australia continues to improve, deteriorating case numbers and softer macro data overseas weighed on the local market more recently. The US equity market also reflected growing concerns on a number of fronts; including the lost momentum in further stimulus, and uncertainties around the upcoming US election.

Turning to sector performance, Energy (-13.5%) was the worst performing sector amongst all, on the back of a declining oil price as markets tempered expectations of the rebound in demand. The impact of aircraft fuel is playing a role in this, however diesel demand has also been weaker than many would have expected by this point. Utilities (-8.2%), Financials (-5.8%) and Consumer Staples (-3.9%) also finished the quarter in the red. Offsetting most of these losses, Real Estate (+6.1%) and Materials (+4.1%) were the best performing sectors; whereas Industrials (+0.3%) and Healthcare (+0.8%) also finished the period in the positive territory.

Reporting season saw a number of key company updates from management. On the positive side:

- Fortescue Metals (FMG, +24.5). Continued to do well off the back of strengthening iron ore prices, where much stronger than expected Chinese demand has combined with disrupted supply from Brazil. Management announced that it had exceeded the upper end of production guidance for FY20.

- Goodman Group (GMG, +20.8%). The stronger than expected order book of new developments demonstrates the current bifurcation in the REITs sector. While malls face challenges from foot traffic, soaring online sales is a stiff tailwind for GMG.

- Afterpay (APT, +33.4%). Result itself was mixed; gross margin was good but there were some signs of momentum slowing in US - this could be a significant issue in next 3 months. However the stock continued its relentless re-rating, most recently driven by the acquisition of small European and Asian businesses which are being factored into a material uplift in "total addressable market (TAM)".

On the other side of the ledger:

- A2 Milk (A2M, -24.7%). There was a downgrade from management in September. The key issue is an inventory overhang in key channels, which is dragging on sales in Q1 FY21 and expected to continue into Q2. Earnings expectations were downgraded 15%, however management are pointing to near term factors such as the Victorian shut down and expect a rebound in the second half.

- Telstra (TLS, -8.8%). Hit its FY20 numbers, but gave a disappointing outlook. There are two issues; first, the losses associated with the rump of its fixed line business, which the market expected to hit in FY22, are now likely to come through earlier, leading to a downgrade in FY21. Second, and more importantly, management have cut the return on capital target for FY23 from 10% to 7%. While consensus had not factored in a 10% return, this shift is seen as a signal that the environment is going to be tougher than management has previously indicated.

- AGL Energy (AGL, -17.4%). Management downgraded earnings based on weaker forward pricing trends for electricity. This is likely to be an ongoing issue.

## Fund performance

The Fund outperformed its benchmark (pre-fee) over the September quarter.

## Contributors

### Overweight Nine Entertainment (NEC, +28.0%)

The market's initial reaction to NEC's (+28.0%) results was negative given a worse than expected update for TV ad numbers in July. However signs of improvement are coming through, while the result delivered good cash flow. Potential structural improvements in revenue - from Stan subscriptions and social media payments - coupled with cost out, place NEC in a good spot when the cycle improves, which is where the market expectation is at currently

### Overweight James Hardie Industries (JHX, 20.4%)

Lower input costs and improvements in the US housing market have been providing cyclical tailwinds for the sector, which saw the likes of James Hardie (JHX, +20.4%) continue to outperform. In addition, investor sentiment has also been supported by the expectation that any housing-related stimulus in response to current economic conditions will also directly benefit the sector.

## Detractors

### Overweight Insurance Group Australia (IAG, -24.1%)

IAG (-24.1%) preannounced its FY20 result in July, stating that net profit after tax (NPAT) was likely to be less than half that of FY19. While management are confident that they won't face a flood of business interruption claims from Covid, they did increase provisions against the knock-on effects. Given this, they will also not pay a final dividend for FY20.

### Does not hold Afterpay (APT, +31.2%)

Afterpay (APT, +31.2%) continued its relentless re-rating, driven most recently by the acquisition of small European and Asian businesses which are being factored into a material uplift in "total addressable market (TAM)". The result itself was mixed; gross margin was good but there were some signs of momentum slowing in US - this could be a significant issue in next 3 months. The company also pulled back somewhat in September following the news that PayPal is releasing a buy now pay later (BNPL) option as part of its existing service to customers. We continue to prefer Xero as our growth exposure.

## Strategy and outlook

The Australian Federal budget was stimulatory, as expected. On balance, the size of the total package was probably a touch larger than consensus was looking for. The scale of measures, which will drive the budget deficit close to 12%, demonstrates the willingness of policy makers to underpin the economy.

This is a material shift in mindset away from the fiscal prudence and balanced budgets that Western governments have generally adopted over the last three to four decades. It is an important factor at play in the determining the ultimate economic impact of Covid 19 and the speed of the recovery.

Both government and central bank rhetoric - in Australia and in many countries overseas - is emphasizing the determination to limit the structural economic and social damage from the virus and shutdowns. The outcome is likely to be loose monetary policy for some time - alongside large scale stimulus from the government.

At this point the constraint on fiscal stimulus is either rampant inflation or loss of confidence in government credit. Neither issue is in play at the moment. Over time, we think there is a chance of a period of negative real interest rates, as inflation expectations rise while nominal rates are kept low. This is one factor in the portfolio's exposure to gold miners - as real assets such as gold, commodities and property tend to do well in period of negative real rates.

We remain mindful of the resurgence of Covid cases in the US and, more recently, in Europe. The second wave in the US has thus far not stalled the economic recovery and the hospitalization and mortality rates remain far below the levels of the first wave.

Likewise, in Europe, there has not been any material impact on economic activity so far.

In the US, the rate of the rebound is slowing as household income falls. However at this point it seems that accrued savings from the previous months – when the savings rate spiked – is helping offset the effect of previous support rolling off.

The impasse over the next stimulus package remains and it appears increasingly unlikely that an agreement will be reached prior to the Presidential election, with Senate Republicans focused instead on nomination of a new Supreme Court Justice. At this point the notion of a Democrat sweep of the White House and Senate – supported by current bookmaker odds – and therefore a larger package post-election is doing enough to calm market fears on this front.

We maintain the portfolio's balanced construction. While policy support is rendering the possibility of a double dip recession less likely, there is still the risk of a market downturn and hence we retain the portfolio's protection in the form of companies with defensive earnings and the exposure to gold. At the same time, there is a sense that perhaps the worst has passed for some domestic cyclicals – we have seen the portfolio's positions in Qantas and Nine Entertainment start performing over the last two months. There are still stocks that are trading well below pre-Covid highs and are in decent shape and aligned with the recovery. We have been adding here selectively in recent weeks.

For more information please call **1800 813 886**,  
contact your key account manager or visit [pendalgroup.com](http://pendalgroup.com)

**PENDAL**

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