PENDAL

Factsheet

Equity Strategies

December 2020

Pendal Ethical Share Fund

ARSN: 096 328 219

The future is worth investing in

About the Fund

The Pendal Ethical Share Fund (**Fund**) is an actively managed, high-conviction, values-orientated, concentrated portfolio of Australian shares. It seeks to invest in companies that enable, lead and participate in the transition to a more sustainable Australian economy, while avoiding those which cause significant harm, undermine a more sustainable economy, or that do not meet our minimum environmental, social and governance (ESG) performance standards. The investment process combines the potential to achieve strong performance over the long term through a diversified set of investment opportunities while also investing in companies whose practices and impacts are in our view 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 rolling 5 year periods. The suggested investment timeframe is five years or more.

Investment Approach

We adopt a principles-based approach in defining our investment opportunity set. We have a set of exclusionary screens (see PDS for full details) and a framework to identify companies which are aligned with our Fund priorities of supporting a more sustainable, future-ready Australian economy.

We seek companies involved in…

- ✓ Innovation & technological advances (including climate solutions)
- ✓ More sustainable resource consumption
- ✓ Sustainable & resilient infrastructure
- ✓ Quality education
- ✓ Meeting basic needs
- ✓ Health & wellbeing
- ✓ Social inclusion & diversity
- ✓ Low carbon transportation

We avoid companies involved in…

- x Fossil Fuels
- x Tobacco
- x Weapons
- x Alcohol
- x Gambling
- x Animal testing
- x Pornography
- x Predatory lending
- x Logging
- x Uranium

Investment Process

The Fund uses the same investment process as Pendal's flagship Australian equities funds with the additional application of exclusionary screens and a sustainability-focused framework.

1. The negative screening process effectively determines the investment universe of the Pendal Ethical Share Fund.
2. Investment ideas are generated through our proprietary framework, identifying companies which contribute to a more sustainable economy.
3. We construct a portfolio with stocks which we believe will generate alpha and at a minimum 'do-no-harm'.

We also actively undertake targeted engagement with companies to support a more sustainable economy and to ensure ESG risks are being appropriately managed.

Investment Team

Pendal's nineteen member Australian Equities team is one of the largest in the industry. The portfolio manager is Head of Equities, Crispin Murray, assisted by Elise McKay, Oliver Renton and Patrick Teodorowski on the application of the Fund's investment framework.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.50	0.58	1.32
3 months	13.14	13.41	13.79
FYTD	13.03	13.57	13.73
6 months	13.03	13.57	13.73
1 year (pa)	2.26	3.24	1.73
2 years (pa)	12.55	13.62	12.21
3 years (pa)	6.12	7.14	6.87
5 years (pa)	7.80	8.83	8.84

Investment Guidelines

Ex-ante (forward looking) tracking error	3.0% - 8.0%
Min/max stock position	+/-10%
Min/max sector position	+/-10%

Management Costs[1]

Issuer fee[2]	0.95% pa

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

[2] 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.

Other Information

Fund size (as at 31 Dec 2020)	$214 million
Date of inception	May 2001
Minimum investment	$25,000
Buy-sell spread[3]	0.50 (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	RFA0025AU

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

Signatory of:

PRI Principles for Responsible Investment

CERTIFIED RESPONSIBLE INVESTMENT ®

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 for details.

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.

Sector Allocation (as at 31 December 2020)

Materials	16.9%
Industrials	9.3%
Consumer Discretionary	2.7%
Consumer Staples	1.1%
Health Care	14.9%
Information Technology	5.6%
Telecommunication Services	10.0%
Utilities	0.0%
Financials ex Property Trusts	26.7%
Property Trusts	6.4%
Cash & other	6.4%

Top 10 Holdings (as at 31 December 2020)

CSL Limited	9.7%
Commonwealth Bank of Australia Ltd	7.0%
ANZ Banking Group Limited	6.4%
Fortescue Metals Group Limited	6.3%
Telstra Corporation Limited	5.4%
Macquarie Group Limited	4.5%
Xero Limited	4.3%
Qantas Airways Limited	3.9%
National Australia Bank Limited	3.8%
James Hardie Industries Plc	3.4%

Market review

The S&P/ASX 300 Accumulation index rebounded strongly over the December quarter (+13.8%), capping the year's return at +1.7%. Stronger commodity prices, the iron ore in particular, which gained ~70% over the year propelled returns for Resources (+18.6%/+9.2% Q4/CY20); whereas Industrials (+12.6%/-0.1%) were the laggard.

Covid cases in the US continue to rise and Europe has started to deteriorate again. In the UK concern centres on the rise of cases in London, and the focus has been on a potentially new strain/variant of Covid-19. While it has proven more infectious, there is no evidence to suggest this new strain will make people sicker or is more resistant to vaccines. The latter is critical to market sentiment.

Despite worsening health news and greater restrictions, the economy is holding up better than expected. This is despite softer consumer confidence and shoppers holding back from physical retailers and restaurants. November retail sales, released in December were softer, but real times measures suggest this may have picked up again. Surveys for holiday sales continue to look ok, with a substantial shift to online.

Turning to sector performance, Healthcare (-1.0%) and Utilities (-5.4%) were the only GICS sectors that recorded a loss over the quarter. In contrast, Financials (+22.8%), Information Technology (+22.8%), Energy (+26.1%), Materials (+15.9%), Real Estate (+13.7%), Communication Services (+12.7%) and Consumer Discretionary (+11.1%) all posted double-digit gains.

The "big four" banks all recoded strong gains over the quarter, ranging from +16.9% (WBC) to 34.2% (ANZ). For ANZ, its latest results revealed some trends that are prevalent within the sector. The good news was the bad and doubtful debts (BDD) provisions were lower, which helped drive a better capital position. However margins were softer and the cost outlook was a bit higher due to the need for investment in technology. Pre-provision profit forecasts were cut by 3-4%. There is a silver lining in that the company acknowledges the outlook for BDDs looks better than feared. This could lead to EPS and DPS upgrade in future years.

Elsewhere, iron ore miners, including BHP (+19.9%), Fortescue Metals (FMG, +43.7%) and Rio Tinto (RIO, +20.7%) continued to rise on the back of the strong iron ore price – seaborne iron ore surpassed US$160/mt over the month, a price level that was last seen in 2011. End-of-year restocking, as well as concerns that recommendations on the government inquest into the Juukan Gorge incident may have some impact on supply.

Lastly, Afterpay (APT, +47.5%) and Xero (XRO, +45.7%) were the largest two return contributors within the IT sector. APT provided a trading update for November at the beginning of December, which saw its global underlying sales grow by +112% from last year to A$ 2.1b. The US region recorded sales of 1.0b, exceeding ANZ's 0.9bn for the first time. Referrals to global retailers also continued to grow strongly with over 35m leads generated during the month of November, which was 147% up on November 2019. In the same vein, XRO delivered a good result in November. New subscriber growth softened in the US and UK, in line with expectations given the challenges in attracting new customers during the Covid period. However, there was stronger than expected subscriber growth in Australia – and particularly in New Zealand – which was surprising given that these are already heavily penetrated markets. This may suggest a further post-Covid shift in mentality towards the importance of online cloud-based accounting. There were also constructive signals around the development of the broader platform and ancillary services.

Fund performance

The Fund underperformed the benchmark over the December quarter.

Contributors

Overweight Fortescue Metals Group

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Overweight Xero Limited

Xero (XRO, +45.7%) delivered a good result in November. New subscriber growth softened in the US and UK, in line with expectations given the challenges in attracting new customers during the Covid period. However the key metrics we are watching in those markets continue to track well. There was stronger than expected subscriber growth in Australia – and particularly in New Zealand – which was surprising given that these are already heavily penetrated markets. This may suggest a further post-Covid shift in mentality towards the importance of online cloud-based accounting. There were also constructive signals around the development of the broader platform and ancillary services. XRO remains among our preferred tech growth exposures.

Detractors

Overweight Evolution Mining

Gold continues to sell-off amid the rise of the long-term bond yields, as investor's need for safe haven reduces for now. This saw gold miners, including Evolution Mining (EVN, -13.2%) pull back during the quarter.

Overweight CSL

As the market turned risk-on over the quarter, the Health Care sector pulled back in general among other defensive names. The cancellation of the UQ/CSL Covid-19 vaccine also dampened investor sentiment for the company, as it has removed one potential earnings boost to CSL; although the consensus numbers had not made much allowance for it.

Market outlook

The rate of Covid infection continues to deteriorate in the northern hemisphere, leading to lockdowns. Jobs have stalled well below pre Covid-levels in the US as the restrictions hit sectors such as leisure and hospitality. Health care systems are under pressure in several countries and regions. Meanwhile, a Covid outbreak in NSW has led to localised restrictions and state border closures.

Nevertheless, the market remains relatively positive, driven by the twin beacons of vaccines and policy support.

Vaccination programmes are ramping up – at differing rates – across many countries. This is giving hope of rolled back restrictions and demand growth. This remains a key risk to watch – any disappointment here could hit markets and the recovery sectors which have recently run hard.

Policy remains a key bulwark of market support. The Democrat victory in the Georgia run-off hands them control of the Senate – and Congress. This means more fiscal stimulus, against the backdrop of already extremely accommodative monetary policy.

The current policy settings are extraordinary. In short, we could see stimulus worth near 9% of US annual GDP channelled into the first quarters of 2021. Even if only a fraction gets spent in that period, it means both growth and earnings are likely to be a lot higher than current consensus expectations.

At the same time, we don't believe that the Georgia win leads to legislation of some of the more radical Democrat policies, given that their majority remains thin in both Houses. The markets concerns are centred on the potential for tax increases. Corporate tax rates are likely to increase, but from 21% to something in the vicinity of 23-25%, rather than the 28% pledged by Biden on the campaign trail.

It is also important to remember the importance of the Fed's conceptual shift from expected to actual inflation targeting and its stated desire to see inflation run above 2% for a sustained period. This is likely to require unemployment to drop below 3%, which is going to take some time. To give some context to this shift the Fed indicated that under the current policy framework the rise in rates post-GFC would have been delayed around 2 ¾ years.

The combination of this fiscal stimulus and Fed accommodation means the US economy could grow above 6% through 2021, driving earnings upgrades and supporting valuation.

Markets have run hard – and a period of consolidation may be in order. The roll out of vaccinations also presents a potential risk of disappointment and must be watched. Nevertheless, we continue to see considerable support on the policy side. We maintain the portfolio's balanced construction, positioned for performance in a range of scenarios, however in recent times we have been adding to some of the more cyclical exposures as the scale of policy support has looked likely to increase.

Carbon Footprint

The estimated weighted average carbon intensity (WACI) of the portfolio, using greenhouse gas emissions (scope 1 and 2[1]) data supplied by MSCI and weighted by the size of our holding in each company, is shown in the table below. In other words, this provides an indication of a portfolio's exposure to carbon intensive companies. We also compare this to the weighted average emissions for the companies in the aggregated ASX300 index.

We caution that there are limitations of using carbon footprinting measures as an indicator of a portfolio's overall exposure to climate-related risks. For example, not all companies report their emissions data and hence some of the below analysis includes estimates. Also, it does not include scope 3 emissions. Further, portfolio carbon analysis does not capture exposure to physical climate-related risks, or the unique transition risks some companies within the portfolio face. Nevertheless, the WACI metric is recommended by the Task Force on Climate-related Financial Disclosures (TCFD)[2], noting it supports greater comparability of investor reporting.

Carbon Intensity (tonnes CO2e / $M sales)

Pendal Ethical Share Fund	ASX 300	Relative to ASX300
113.9	207.1	-93.2

Source: Pendal, MSCI as at 31 December 2020

[1] Scope 1 emissions result from sources directly owned or controlled by the company. Scope 2 accounts for GHG emissions from the generation of purchased electricity consumed by the company. Scope 3 emissions result from activities not directly owned or controlled by the company but are associated with its operation such as business travel, waste management, commuting, and the use of sold products and services. https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

[2] *Recommendations of the Task Force on Climate-Related Financial Disclosures, June 2017* https://www.fsb-tcfd.org/recommendations/

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.
- **Concentration risk:** The Fund's investment strategy of seeking to generate high returns by investing in a concentrated portfolio of Australian shares makes the Fund more volatile than a diversified Australian share fund.

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

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

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