

Pendal MidCap Fund

ARSN: 130 466 581

Factsheet

Equity Strategies

December 2020

About the Fund

The Pendal MidCap Fund (**Fund**) is an actively managed portfolio of Australian mid cap shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Pendal MidCap Custom 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 from a portfolio of primarily 40-60 Australian mid cap shares and are prepared to accept higher variability of returns. Pendal defines the mid cap universe to include companies ranked between 51 and 150 of the S&P/ASX 200 Index. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange, 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).

The Fund may have assets denominated in foreign currencies. This means that changes in the value of the Australian dollar relative to foreign currencies may affect the value of the assets of the Fund. The Fund's foreign currency exposure may be hedged from time to time, in whole or part.

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

Investment Team

Pendal's Equity team is headed up by Crispin Murray who has extensive experience and a strong record in equities research. Andrew Waddington is the portfolio manager for the Fund.

A combination of the Australian equities large cap and small cap teams' research is used to construct the Pendal MidCap Fund.

Investment Guidelines

Investable universe	ASX and NZX listed and soon to be listed companies, generally with a market capitalisation of A\$0.5 billion to A\$5 billion; derivatives; cash
Investment ranges	Australian shares 80 - 100% New Zealand shares 0 - 10% Cash 0 - 20%
Ex-ante tracking error	3 – 8%
Number of stocks	Typically 40 – 60
Absolute stock position	15%
Maximum active stock position	+/- 5% ¹
Maximum active sector position relative to index	+/- 10% ¹

¹ compared to benchmark.

Performance

(%)	Total Returns		Benchmark Return
	(post-fee)	(pre-fee)	
1 month	4.39	4.47	3.02
3 months	16.66	16.92	15.83
6 months	20.10	20.65	20.98
1 year (pa)	17.18	18.26	14.89
3 years (pa)	8.48	9.68	8.66
5 years (pa)	12.29	13.40	12.82
7 years (pa)	12.52	13.82	12.01
10 years (pa)	11.05	12.68	8.91
Since Inception (pa)	10.46	12.46	6.79

Sector Allocation (as at 31 December 2020)

Energy	1.5%
Materials	19.4%
Industrials	18.6%
Consumer Discretionary	8.5%
Consumer Staples	7.7%
Health Care	6.8%
Information Technology	4.7%
Telecommunication Services	7.1%
Financials ex Property Trusts	4.1%
Property Trusts	5.8%
Cash & other	15.8%

Top 10 Holdings (as at 31 December 2020)

Metcash Trading Limited	5.2%
Nine Entertainment Co Ltd	4.9%
Seven Group Holdings Ltd	4.7%
Atlas Arteria	3.7%
Resmed Inc	3.7%
Bluescope Steel Limited	3.7%
Monadelphous Group Limited	3.5%
JB Hi-Fi Limited	3.3%
Evolution Mining Limited	2.8%
Healius Limited	2.8%

Other Information

Fund size (as at 31 Dec 2020)	\$533 million
Date of inception	June 2008
Minimum investment	\$25,000
Buy-sell spread ²	
For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
Distribution frequency	Quarterly
APIR code	BTA0313AU

²The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Management Costs³

Issuer fee ⁴	0.90% p.a.
Performance fee ⁵	20% x the Fund's performance (before fees) in excess of the performance hurdle

³ You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

⁴ 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.

⁵ The Fund's performance fee is 20% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (Pental MidCap Custom Index) plus the issuer fee of 0.90% pa. If a performance fee is payable, it is charged in addition to the issuer fee. The fee is calculated each Business Day based on the investment performance and value of the Fund on that day. If we are entitled to a performance fee, it is paid to us as at 30 June each year.

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 51-150 Accumulation index made some further gains (+3.0%) in December, capping the year's return at +14.9%. This saw the small cap index outperform its broader cap counterpart, the ASX 300 index by +1.7% over the month; and +13.2% over the year. Resources (+5.7%) led the gains in December; whereas Industrials (+2.3%) 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 time 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, some performance divergence was evident. Information Technology (+7.4%), Materials (+5.7%), Consumer Staples (+5.5%) and Real Estate (+4.2%) outperformed the headline index; whereas Healthcare (-6.5%), Energy (-0.5%) and Financials (-0.3%) recorded some losses. Afterpay (APT, +24.2%) was the largest return contributor within IT, followed by Xero (XRO, +10.8%) and Nextdc (NXT, +8.7%). The former two have both made into the S&P/ASX 50 index recently (and the S&P/ASX 20 index in APT's case). APT provided a trading update for November at the beginning of the month, 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. Offsetting some of these gains, Appen (APX, -21.7%) was sold off after management downgraded CY20 guidance to A\$108-111m, from A\$125-130m (EBITDA). Whilst it was expected somewhat due to the Covid-19 impact, it dampened investor sentiment.

Elsewhere, nickel and gold miner, IGO (+37.4%) appears determined to expand its exposure to the electric vehicle thematic. The company purchased from Tianqi a 24.99% stake in the Greenbushes lithium mine and a 49% interest in the downstream Kwinana Lithium Hydroxide plant for US\$1.4bn. Given the quality of the asset, which is both low cost in its current capacity and expandable, and the price paid, the transaction was well received by the market. In a similar vein, Oz Minerals (OZL, +15.7%) provided an updated pre-feasibility study for the West Musgrave development. Whilst there has been an 11% increase in the capex, it will be more than offset by a 13-14% upgrade to the reserve and a 20% increase in process plant capacity. Overall, there is a 25% increase in the project's NPV, to ~A\$1bn.

On the other side of the tally board, Mesoblast (MSB, -45.9%) was amongst the worst performers of the month. Management announced the trial results from its drug remestemcel-L, which was tested on COVID-19 infected patients but was not likely to meet the 30-day mortality reduction endpoint at the planned 300 patient enrolment. It was the largest performance detractor from the Healthcare sector.

Fund performance

The Fund outperformed the benchmark over the month of December.

Contributors

Overweight Metcash Trading Limited

Metcash (MTS, +17.2%) delivered a well-received half yearly result. The supermarket side continues to do well, with stronger sales its larger competitors. Work from home accelerated sales in neighbourhood-style shopping, helping IGA, however the benefits seem to have persisted even as restrictions have eased. However the larger surprise was on the hardware side, where recent acquisitions are doing much better than expected. The larger exposure to trade – as opposed to retail – means they are well positioned to capture the surge in renovations accompanying the trend to more working from home. MTS also saw strong cash flow, as franchisees have paid back some of the emergency funding from earlier this year faster than expected. At just 14x NTM P/E – versus over 28x for Woolworths – we continue to see upside here.

Overweight Xero Limited

Our preferred tech name, Xero (XRO, +10.8%) continued to rise on the back of a good set of results released in November. While new subscriber growth softened in the US and UK, in line with expectations given the challenges in attracting new customers during the Covid period, there was stronger than expected subscriber growth in Australia and New Zealand. Given these are highly penetrated markets, this may suggest a further post-Covid shift in mentality towards the importance of online cloud-based accounting. Overall, we believe XRO's growth is a function of several macro and secular drivers combined with solid execution.

Detractors

Does not hold Afterpay

Afterpay (APT, +24.2%) provided a trading update for November at the beginning of the month, 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. We do not hold Afterpay, and Xero (XRO, +10.8%) is our preferred exposure in the tech space.

Does not hold OZ Minerals

Oz Minerals (OZL, +15.7%) provided an updated pre-feasibility study for the West Musgrave development. Whilst there has been an 11% increase in the capex, it will be more than offset by a 13-14% upgrade to the reserve and a 20% increase in process plant capacity. Overall, there is a 25% increase in the project's NPV, to ~A\$1bn. We do not hold OZL in the fund, and it weighed on relative performance.

Strategy and outlook

The positive vaccine trial results from multiple global pharma companies in Q4 has opened the door to the prospect of some normalisation in economic activity.

The portfolio has had exposure to companies which are aligned with the “recovery/re-opening” theme. These include Tabcorp (TAH), Corwn (CWN) and ALS (ALQ).

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 ¼ 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, among the stocks which are aligned with economic recovery we have some which are leveraged the overseas demand and others which are more domestically focused. This reflects that the fact that geography, politics, and the structure of a vaccination programme may see an uneven pace of recovery across different countries. We also continue to hold defensive companies such as Metcash (MTS) and Saracen (SAR) as protection in the case of a material downturn in market sentiment.

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

PENDAL

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