PENDAL

Factsheet

Equity Strategies

December 2020

Pendal Focus Australian Share Fund

ARSN: 113 232 812

About the Fund

The Pendal Focus Australian Share Fund (**Fund**) is an actively managed concentrated portfolio of Australian shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes), that significantly exceeds the S&P/ASX300 (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 from a concentrated portfolio of primarily 15-30 Australian shares 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. Derivatives can also be used to gain exposure to assets and markets.

Fund Positioning

The Fund is designed to complement a conventional, core share portfolio by providing satellite exposure to selected Australian equities with the potential for performance enhancement.

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.

Other Information

Fund size (as at 31 Dec 2020)	$1,072 million
Date of inception	April 2005
Minimum investment	$25,000
Buy-sell spread[1] For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
Distribution frequency	Half-yearly
APIR code	RFA0059AU

Investment Guidelines

Ex-ante tracking error	4.5% - 8.0%
Max absolute stock position	15%
Min/max sector position relative to index	+/- 15%
Min/Max BARRA style factors	+/- 0.5 SD
SIRA style factors	Within 1 SD
Maximum cash level	30%
Shorting	No
Borrowing	No

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	1.58	1.62	1.32
3 months	15.43	15.97	13.79
FYTD	15.66	16.43	13.73
6 months	15.66	16.43	13.73
1 year (pa)	4.94	6.22	1.73
2 years (pa)	15.51	16.69	12.21
3 years (pa)	8.48	9.58	6.87
5 years (pa)	9.91	10.95	8.84

Sector Allocation (as at 31 December 2020)

Energy	4.7%
Materials	24.3%
Industrials	13.1%
Consumer Discretionary	5.8%
Consumer Staples	4.3%
Health Care	8.2%
Information Technology	5.9%
Telecommunication Services	8.2%
Financials ex Property Trusts	20.3%
Property Trusts	2.9%
Cash & other	2.3%

Top 10 Holdings (as at 31 December 2020)

BHP Billiton Limited	11.5%
CSL Limited	8.2%
Commonwealth Bank of Australia Ltd	5.7%
ANZ Banking Group Limited	5.4%
Telstra Corporation Limited	5.1%
Westpac Banking Corporation	4.9%
Qantas Airways Limited	4.4%
Metcash Trading Limited	4.3%
Xero Limited	4.1%
James Hardie Industries Plc	3.9%

Management Costs[2]

Issuer fee[3]	0.75% pa
Performance fee[4]	15% x the Fund's performance (before fees) in excess of the performance hurdle.

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

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.

4 The Fund's performance fee is 15% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (S&P/ASX 300 (TR) Index) plus the issuer fee of 0.75% 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.
- **Concentrated portfolio 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.

Market review

The S&P/ASX 300 Accumulation index made some further gains (+1.3%) in December, 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 (+8.4%/+9.2% Dec/CY20); whereas Industrials (-0.4%/-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, some dispersion was evident. Materials (+8.8%) and Information Technology (+8.6%) were the best performing sectors, whereas Health Care (-4.7%), Industrials (-2.2%) and Utilities (-5.4%) recorded the largest losses. Iron ore miners, including BHP (+11.5%), Fortescue Metals (FMG, +28.5%) and Rio Tinto (RIO, +12.3%) 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.

Within Information Technology, Afterpay (APT, +24.2%) was the largest return contributor, followed by Xero (XRO, +10.8%) and Nextdc (NXT, +8.7%). 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.

On the other side of the spectrum, A2 Milk (A2M, -17.1%) posted a huge downgrade, which offset gains from Woolworths (WOW, +6.3%), Treasury Wine (TWE, +9.4%) and Metcash (MTS, +17.2%) inside Consumer Staples (+2.2%). Revenues were 20% lower than expectation while margins fell to 27% from 30. The two factors equated to a downgrade of more than 30%. The company explained the downgrade as a function of weak Daigou demand, which also impacts on the cross-border e-commerce channel.

Similarly, within Financials (-0.5%) QBE (-14.7%) had a disappointing downgrade as the interim CEO flagged more prior-year reserving, while indicating higher catastrophic costs/reinsurance. The scale of the reserving, while for different reasons to IAG (-8.7%) leaves the same issue — either indicating a business that has managed risks poorly or is being conservative under new management. The downgrades are 5-6% and the stock currently trades on 11-12x.

Fund performance

The Fund outperformed the benchmark over the month of December.

Contributors

Overweight Metcash

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 BHP

Iron ore miners, including BHP (+11.5%) 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.

Detractors

Overweight Qantas

Qantas (QAN, -9.9%) gave up some recent gains in December. It provided an update which was encouraging, with domestic capacity set to ramp up to 80% of pre-Covid levels. Debt was a little higher than expected. However there was a lot of focus on the enterprise value (EV), which is returning to pre-Covid levels, potentially prompting some profit-taking from investors who bought it as a recovery play. In our view, this misses the impact of a large return of working capital, which is likely to drive the EV higher. We see more upside from current levels.

Overweight QBE

QBE (-14.7%) had a disappointing downgrade as the interim CEO flagged more prior-year reserving, while indicating higher catastrophic costs/reinsurance. The scale of the reserving, while for different reasons to IAG (-8.7%) leaves the same issue — either indicating a business that has managed risks poorly or is being conservative under new management. The downgrades are 5-6%. Nevertheless, we continue to own the insurer as it has been benefitting from a continued rise in premium rates increases, which are now running at close to 10%.

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.

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

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