Pendal Monthly Commentary

Pendal Australian Tax Effective Income Portfolio

September 2023

Market commentary

Continued resilience in the US economy has pushed out the timeline for expected rate cuts and saw expectations around the ultimate terminal rate creep up.

In combination with larger US bond supply, this pushed US ten-year bond yields up materially, weighing on equity markets in the US and around the world.

The dominant narrative of resilient global economic momentum and higher-for-longer rates continues.

The S&P 500 fell -4.9% for the month. The S&P/ASX 300 proved more resilient, helped by index composition with a greater exposure to financials and commodities, which held up relatively well. It ended down -2.89% for September.

The Energy sector (+2.23%) was the only one to rise. Higher oil prices helped Woodside Energy (WDS, -1.43%) and Santos (STO, +3.00%) outperform, while Whitehaven (WHC, +16.75%) and New Hope (NHC, +12.79%) benefited from increased coal prices.

Financials (-1.61%) generally benefit from higher rates and held up better than the broader market. National Australia Bank (NAB, +0.38%) and ANZ (ANZ, +1.30%) were the best of the large banks, while insurer QBE (QBE, +4.89%) also did well.

Real Estate (-8.54%) underperformed on broad-based weakness. The recent reporting season demonstrated the effect that higher rates was having on interest expense and earnings. Goodman Group (GMG) fell -8.18% and Scentre Group (SCG) -10.55%.

The prospect of higher-for-longer rates also weighed on Information Technology (-7.74%). Again, weakness was broad-based with the sector's largest stocks Xero (XRO, -10.13%), Wisetech (WTC, -6.29%) and NextDC (NXT, -8.49%) all down.

Portfolio overview

Australian Tax Effective Portfolio	
Investment strategy	Pendal employs a bottom up, fundamental approach to build a diversified portfolio of Australian shares where the majority of active risk and outperformance is driven by stock selection. The portfolio focuses on both capital growth and delivering higher than market yield with a particular consideration for CGT.
Investment objective	To deliver outperformance relative to the benchmark after fees on a rolling three year period while delivering a higher gross yield than the market.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15 - 35 (29 as at 30 September 2023)
Sector limits	Australian Shares 60 - 98%, Australian Property 0 - 30%, Cash 2 - 10%
Dividend Yield	4.16%#

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	12.37%
CSL	CSL Limited	7.95%
CBA	Commonwealth Bank of Australia	7.28%
TLS	Telstra Group Limited	6.23%
NAB	National Australia Bank Limited	5.97%
WBC	Westpac Banking Corporation	4.61%
STO	Santos Limited	4.32%
QBE	QBE Insurance Group Limited	4.11%
MTS	Metcash Limited	4.10%
QAN	Qantas Airways Limited	3.42%

Source: Pendal as at 30 September 2023

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
TLS	Telstra Group Limited	4.16%
MTS	Metcash Limited	3.93%
STO	Santos Limited	3.13%
QBE	QBE Insurance Group Limited	3.02%
QAN	Qantas Airways Limited	3.01%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
WES	Wesfarmers Limited (not held)	-2.79%
WOW	Woolworths Group Ltd (not held)	-2.11%
RIO	Rio Tinto Limited (not held)	-1.96%
TCL	Transurban Group Ltd. (not held)	-1.82%
ANZ	ANZ Group Holdings Limited	-1.67%

Source: Pendal as at 30 September 2023

#The Portfolio's dividend yield represents the weighted average 12-month forward-looking dividend yield of the portfolio holdings (excluding cash), as at the date of the Factsheet. Each individual security's dividend yield is calculated using market consensus Dividend Per Share (DPS) before tax and franking credits, collated by Pendal and divided by the closing market price of the security as at the date of the Factsheet. The portfolio dividend yield therefore is only an estimate, and does not reflect the actual returns of the Fund, which will be affected by market movements in the price of individual securities, the returns on other assets such as cash holdings and variances of individual security's actual dividends from the forecasted DPS.

Performance

	1 month	3 month	6 month	1 year	3 year (p.a.)	5 year (p.a.)	Since inception (p.a.)*
Pendal Australian Tax Effective Income Portfolio	-2.79%	-0.93%	-0.27%	11.52%	12.20%	7.18%	8.67%
S&P/ASX 300 (TR) Index	-2.89%	-0.84%	0.14%	12.92%	10.78%	6.62%	8.50%
Active return	**0.10%**	**-0.09%**	**-0.41%**	**-1.40%**	**1.42%**	**0.55%**	**0.18%**

Source: Pendal as at 30 September 2023

*Since Inception - 14 September 2015

Performance returns are pre-fee. Investors should contact their platform provider for applicable fee rates.

Past performance is not a reliable indicator of future performance.

Top 5 contributors - monthly

Code	Name	Value Added
QBE	QBE Insurance Group Limited	0.22%
STO	Santos Limited	0.17%
NEC	Nine Entertainment Co. Holdings Limited	0.16%
MTS	Metcash Limited	0.16%
BHP	BHP Group Ltd	0.08%

Top 5 detractors - monthly

Code	Name	Value Added
QAN	Qantas Airways Limited	-0.30%
ORA	Orora Ltd.	-0.24%
XRO	Xero Limited	-0.16%
JHX	James Hardie Industries PLC	-0.14%
CSL	CSL Limited	-0.12%

Top 5 contributors - 1 year

Code	Name	Value Added
QBE	QBE Insurance Group Limited	0.68%
NXT	Nextdc Limited	0.32%
XRO	Xero Limited	0.30%
RMD	*Resmed Inc (not held)*	*0.29%*
SUN	Suncorp Group Limited	0.23%

Top 5 detractors - 1 year

Code	Name	Value Added
CSL	CSL Limited	-0.59%
DOW	Downer EDI Limited	-0.46%
MTS	Metcash Limited	-0.41%
TLS	Telstra Group Limited	-0.39%
WES	*Wesfarmers Limited (not held)*	*-0.38%*

Source: Pendal as at 30 September 2023

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight QBE Insurance (QBE, +4.87%)

There was little material stock-specific news for QBE Insurance, however it is likely to have benefited from a strengthened higher-rates-for-longer thematic in the market. We continue to like QBE due to a supportive pricing cycle, in which premium growth is more than offsetting claims inflation. At the same time the company continues to execute on a turnaround, divesting and running-off troubled businesses.

Overweight Santos (STO, +3.00%)

A higher oil price, underpinned by OPEC supply discipline, helped support Santos. In addition, it agreed to sell 2.6% of its stake in its PNG LNG Project to Kumul Petroleum for $576M. The valuation is in-line with the original agreed price, and broadly regarded as fair value. Although the amount is reduced from the original 5% sell-down, the price is a positive as are the implications for the balance sheet and capital returns.

Overweight Nine Entertainment (NEC, +2.01%)

Nine Entertainment remains among our preferred quality cyclical exposures and held up well relative to the market in September. We see material valuation upside in NEC as a result of what we believe to be the market mis-pricing the impact of a slowing cycle. At the same time, management is being disciplined around capital. It is on a dividend yield of ~5.0% and is buying back stock.

Three largest detractors

Overweight Qantas (QAN, -12.35%)

QAN endured a month of negative headlines and CEO Alan Joyce brought forward his retirement by two months. The company has committed to restoring its damaged brand, announcing a further $80m investment to support customer experience in FY24, on top of the $150m already budgeted for this area at the FY23 result. The board have also made changes to management remuneration with an increased weighting to customer metrics and greater scope for discretion around long-term incentives. While there is a lot of work for QAN to do to restore their reputation, the key issue is whether profits will be structurally impacted via flight slots being reallocated, demand affected or costs rising. The stock is trading at 25-30% below pre-pandemic value, with profits 60% higher. In our view, we see this as a large buffer of value.

Overweight Orora (ORA, -14.51%)

Orora announced an equity capital raising to fund the acquisition of global luxury/premium bottling business Saverglass. The market expressed concern that this fell outside ORA's core area of expertise. However while there are risks, we see merit in the deal and valuation upside for the combined entity.

Overweight Xero (XRO, -10.13%)

The prospect of higher-for-longer rates weighed on many long-duration growth stocks, where higher rates tend to drag on valuation ratings. This was the case for Xero. We maintain conviction in Xero as one of our preferred growth exposures. The fundamental opportunity is compelling as it combines a large revenue growth opportunity with a more recent focus on profitability and operational efficiency which can support further earnings upgrades.

Performance and outlook

Equity markets sit at an interesting juncture after falling over the last month.

The bullish perspective is this is a period of consolidation at a seasonally weak time of year. From here, this could see US inflation and wage growth continue to slow while the economy holds up, which may mean no recession. In this case, interest rates may have peaked despite Fed rhetoric, implying that earnings are set to grow and valuation ratings rise, lifting markets higher.

The alternative, bearish case is that bond yields, the US dollar and the oil price have all been moving higher, which have historically been warning signals for the market. Higher oil prices means that inflation in the US, while softening, may not fall as fast as the market wants. There is also risk that the delayed effects of monetary tightening will lead to the economy slowing more materially than expected, putting pressure on earnings.

Australian GDP grew 0.4% in the June quarter and 2.1% year-on-year. While in line with expectations, it highlighted some challenges for the economy.

GDP per capita fell 0.3% for the quarter given strong population growth. When it comes to company earnings aggregate spending is what counts.

Breaking down the data, quarterly growth in household consumption was weak at 0.1% quarter-on-quarter. Savings rates have fallen to 3.1% which is a cycle low.

There is growth coming from business investment, which is up 5.6% year-on-year in mining and 9.1% in non-mining sectors. Government spending remains strong at 1.8% growth quarter-on-quarter and exports grew 4.3%, helped by mining.

Employee compensation growth is strong at 1.6% quarter-on-quarter and 9.6% year-on-year. Households continue to find ways to supplement income.

Nevertheless Australia is an economy with slowing growth, reliant on government spending, business investment and commodity exports. All of which are either unsustainable or volatile and potentially leaves us vulnerable to an inflation surprise and/or a growth problem if the current environment shifts.

At the same time productivity is very weak, which may lead to profits coming under pressure, higher unemployment or more price inflation as companies pass costs on.

There have been some positive signs on China. While we have not seen a large-scale stimulus packages, there have been a slew of more targeted measures to help underpin the economy. The latest PMI activity indices may suggest the worst of activity data could now be behind us. Nevertheless the property market remains weak, although the iron ore price has remained surprisingly resilient.

In this environment we see stock selection as critical. The range of macro pathways and outcomes remains wide, in our view this means it is important to try and balance thematic risks in the portfolio. Instead we are looking for companies which offer different types of macro exposures, in combination with a company-specific opportunity for earnings growth or valuation re-rating.

In this vein, rolling twelve-month sector dispersion has fallen materially versus stock dispersion for the S&P/ASX 300 over the course of 2023, after rising for most of the previous year. This suggests an improved environment for stock picking, which we believe plays to the strengths of our team.

New stocks added and/or stocks sold to zero during the month

No new stocks added or sold to zero during the month.

For more information contact your
key account manager or visit **pendalgroup.com**