Pendal Monthly Commentary
Pendal Australian Shares Portfolio

October 2023

Market commentary

Higher long-term bond yields in both the US and Australia weighed on equity markets in October.

Inflation continued to trend in the right direction in the US. However resilience in the economy, underpinned by several stronger-than-expected economic data points, saw the market shift to a "higher for longer" narrative in its outlook for interest rates.

Instability in the Middle East added to the mix, and saw sharp rallies in both gold and oil, although Brent crude finished off -8.3% for the month.

In Australia, the RBA held rates steady at 4.10%, However the headline monthly consumer price index (CPI) rose 5.6% for September, which was stronger than August's 5.2% gain and is still well ahead of the RBA's target. This underpinned the view that the RBA has to shift rates higher to bring inflation under control.

The S&P 500 fell -2.2% while the S&P/ASX 300 shed -3.8%.

Weakness was broad-based across the Australian market with every sector except Utilities (+1.68%) going backwards. The gains in this sector came as a result of the ACCC granting conditional authorisation for the Brookfield consortium's proposed takeover of Origin Energy (ORG, +3.99%), although the deal still remains in doubt.

Materials (-1.19%) held up relatively well on the back of the large cap miners with BHP (BHP) up 0.56%, Rio Tinto (RIO) +3.55% and Fortescue Metals (FMG) +6.6%. The iron ore price rose a further 2.1%, defying ongoing weakness in the Chinese property sector. There is continued hope and speculation that Beijing will stimulate further to put a floor under economic growth.

It was the long-duration growth stocks and sectors which bore the brunt of higher bond yields.

Information technology (-7.36%) fell furthest as higher yields weighed on valuations. Xero (XRO, -5.11%), Wisetech (WTC, -10.59%), NextDC (NXT, -5.17%) and Altium (ALU, -8.63%) all finished the month down.

Higher yields also dragged on the growth names in Health care (-7.11%). This sector has seen additional volatility in recent months as the market grapples with the potential impact of anti-obesity GLP-1 drugs on the addressable market for various companies. Of the three largest stocks in the index, CSL (CSL) was off -7.36%, Cochlear (COH) -5.67% and Sonic Health Care (SHL) -3.52%.

Portfolio overview

Australian Shares 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 will focus primarily on capital growth.
Investment objective	To deliver outperformance relative to the benchmark after fees over a rolling three year period.
Benchmark	S&P/ASX 300 (TR) Index
Number of stocks	15 - 35 (29 as at 31 October 2023)
Sector limits	Australian Shares 60 - 98% Australian Property 0 - 30% Cash 2 - 10%
Dividend Yield	3.88%#
Income target	No target

Top 10 holdings

Code	Name	Weight
BHP	BHP Group Ltd	12.77%
CSL	CSL Limited	8.24%
STO	Santos Limited	7.63%
NAB	National Australia Bank Limited	6.22%
CBA	Commonwealth Bank of Australia	6.09%
TLS	Telstra Group Limited	5.94%
WBC	Westpac Banking Corporation	4.76%
XRO	Xero Limited	4.37%
QAN	Qantas Airways Limited	4.17%
QBE	QBE Insurance Group Limited	3.95%

Source: Pendal as at 31 October 2023

Top 5 overweights versus S&P/ASX 300

Code	Name	Weight
STO	Santos Limited	6.42%
TLS	Telstra Group Limited	3.81%
QAN	Qantas Airways Limited	3.76%
XRO	Xero Limited	3.64%
QBE	QBE Insurance Group Limited	2.83%

Top 5 underweights versus S&P/ASX 300

Code	Name	Weight
ANZ	ANZ Group Holdings Limited (not held)	-3.59%
WDS	Woodside Energy Group Ltd (not held)	-3.14%
WES	Wesfarmers Limited (not held)	-2.77%
RIO	Rio Tinto Limited (not held)	-2.11%
WOW	Woolworths Group Ltd (not held)	-2.07%

Source: Pendal as at 31 October 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 Shares Portfolio	-3.64%	-7.54%	-5.04%	2.38%	9.63%	7.86%	8.10%
S&P/ASX 300 (TR) Index	-3.80%	-7.29%	-5.41%	2.51%	8.68%	7.15%	6.72%
Active return	0.16%	-0.25%	0.37%	-0.14%	0.95%	0.71%	1.38%

Source: Pendal as at 31 October 2023

*Since Inception – 15 June 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
NST	Northern Star Resources Ltd	0.15%
LTR	*Liontown Resources Limited (not held)*	*0.11%*
TLS	Telstra Group Limited	0.10%
QBE	QBE Insurance Group Limited	0.09%
IGO	*IGO Limited (not held)*	*0.08%*

Top 5 detractors – monthly

Code	Name	Value Added
FMG	*Fortescue Metals Group Ltd (not held)*	*-0.17%*
AKE	Allkem Limited	-0.16%
RIO	*Rio Tinto Limited (not held)*	*-0.14%*
CSL	CSL Limited	-0.12%
ORA	Orora Ltd.	-0.11%

Top 5 contributors – 1 year

Code	Name	Value Added
XRO	Xero Limited	1.10%
QBE	QBE Insurance Group Limited	0.67%
NXT	Nextdc Limited	0.34%
NST	Northern Star Resources Ltd	0.30%
BHP	BHP Group Ltd	0.28%

Top 5 detractors – 1 year

Code	Name	Value Added
QAN	Qantas Airways Limited	-0.80%
FMG	*Fortescue Metals Group Ltd (not held)*	*-0.66%*
RIO	*Rio Tinto Limited (not held)*	*-0.58%*
CSL	CSL Limited	-0.55%
AKE	Allkem Limited	-0.39%

Source: Pendal as at 31 October 2023

Underweight positions are in italics.

Stock specific drivers of monthly performance relative to benchmark

Three largest contributors

Overweight Northern Star (NST, +11.76%)

The gold price rose 7.3% in October, helped by geopolitical instability, which saw the gold miners such as the portfolio's position in Northern Star (NST) outperform. NST's quarterly production report was among the best in the sector although it missed consensus expected production by 4%, with costs 4% higher. Management retained full year guidance, expecting better production in the second half of the year.

Underweight Liontown Resources (LTR, -45.24%)

The challenging headwind of softer lithium prices was exacerbated in Liontown's case by the news that US miner Albermarle was withdrawing its indicative takeover offer. The company raised equity capital and negotiated a debt package to fund the Kathleen Valley lithium project in Western Australia, which is due to start production in mid-2024. The portfolio does not hold Liontown.

Overweight Telstra (TLS, -1.04%)

Some minor disappointment around its fixed-line business in its FY23 result, as well as broader weakness in some higher-yield names, has weighed on Telstra in recent months. However it held up better than the market in October, with management reaffirming FY24 guidance at its AGM update. We continue to see TLS as a preferred defensive exposure, with its dividend yield underpinned by a return to profitability in its mobile phone division.

Three largest detractors

Underweight Fortescue Metals (FMG, +6.60%)

The underweight in iron ore miner Fortescue Metals dragged as the iron ore price remained resilient and the market is looking for further economic stimulus from Beijing. The portfolio owns BHP in preference to Fortescue Metals given the high degree of uncertainty around capex and expected return for Fortescue Future Industries projects – the first of which are expected to be announced later this year.

Overweight Allkem (AKE, -18.88%)

The exposure to lithium miner Allkem detracted as the broader sector remains under pricing pressure given an excess of material in the battery metals supply chain. That said, this drag was more than offset by the underweight exposure to other lithium miners such as Liontown (LTR), IGO (IGO) and Pilbara Minerals (PLS). We maintain a positive medium term view on the sector and regard AKE as among the highest-quality exposures, however the supply/demand imbalance may see further near-term softness.

Underweight Rio Tinto (RIO, +3.55%)

Rio Tinto outperformed as the iron ore price remains elevated and resilient despite weakness in the Chinese property sector. The market has been holding out hope for further stimulus from Beijing to support economic growth. The portfolio holds BHP in the iron ore space, which has less headwind from the need to replace production and more exposure to copper. This offset much of the drag from the underweight in Rio Tinto.

Performance and outlook

The portfolio finished slightly ahead of the index for the month, before fees. Several of the more defensive exposures helped, while the modest underweight in iron ore miners detracted.

At this point, our base case remains that both the US and Australian economies continue to "muddle through" with low growth.

The Australian economy is being supported by population growth, a weaker currency, resilient commodity prices and government spending. At this point, consumers have been able to withstand the "mortgage cliff" of variable home loans re-sets better than many feared, although there are strains in some parts of the household sector. Further, domestic real interest rates (ie nominal rates minus inflation) are lower than other developed markets.

In the US, the chance of achieving the "soft landing" of bringing inflation under control without a deep recession has increased.

However the risk of mild recession in early 2024 remains, given the potential combination of the lagged effects of tighter monetary policy, waning fiscal spending and the run-down of excess savings. Potential headwinds from higher oil prices and/or a government shutdown also remain wildcards.

The risk to Australia is more that of persistent inflation leading to the RBA ratcheting rates higher than expected in the next six months, which could lead to a market de-rating.

Other considerations are:

1. Geopolitical risk. Further instability in the Middle East could disrupt oil markets. We are also wary that Russia may seek to restrict oil supply and cause further instability in a US election year.

2. China. The economy is weak, but this is well known. At this point it appears policy will be sufficient to underpin growth, but not lead to an acceleration.

The S&P/ASX 200 is trading at around 15x next twelve month P/E. We see this as consistent with the level of interest rates. The market multiple could fall on a material shift in expectations around higher rates. Conversely, if perceived risk around the economic outlook diminished, this could support a gradual re-rating.

Consensus earnings growth for the market for the next twelve months is around zero. Industrials are expected to grow earnings in mid-to-high single digits, but this is offset by expectations of falling earnings in the resource sector.

Importantly, at this point we are not seeing any signs of economic weakness affecting revisions.

Given the context of continued uncertainty in the potential economic environment, we continue to focus portfolio risk primarily on stock and industry-specifics, rather than style or other macro thematic factors. As always, our aim is to mainly drive performance via insight at the company level.

In this vein, we note that sector-level dispersion has fallen and stock-level dispersion has risen over the course of 2023, suggesting we are possibly moving into an environment which is better for stock picking.

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**

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