PENDAL

Factsheet

Income & Fixed Interest

31 October 2023

Pendal Fixed Interest Fund

ARSN: 089 939 542

About the Fund

The Pendal Fixed Interest Fund (**Fund**) is an actively managed portfolio of primarily Australian fixed interest securities.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Bloomberg AusBond Composite 0+ Yr Index over the medium term. The return is expected to be comprised primarily of income. The suggested investment timeframe is three years or more.

Investment Approach

This Fund is designed for investors who want income, diversification across a broad range of cash and fixed interest securities and are prepared to accept some variability of returns. The Fund aims to take advantage of investment opportunities primarily within the Australian fixed interest market by investing in a combination of Commonwealth-government, semi-government and corporate debt and short-term money market securities.

Pendal's investment process for fixed interest aims to add value through multiple strategies and investment research. Pendal seeks to generate excess returns through strategies including active security and sector selection, duration, yield curve and credit management. Our investment approach for credit management seeks to identify opportunities on a sector, issuer and security basis by incorporating top-down and bottom-up research. Top-down research includes analysis of economic and market data, along with macro credit fundamentals such as company earnings, balance sheet health, default rates and equity volatility. The bottom-up research includes analysis of earnings and cashflow volatility, balance sheet, business diversity, industry and valuation.

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 Income & Fixed Interest team is a large team of dedicated investment professionals. The team also draws on a wide range of knowledge resources including Pendal's other specialist investment teams: Equity Strategies and Multi-Asset Strategies. The portfolio manager of the Fund is Tim Hext who has more than 34 years industry experience.

Fees and costs

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

Management fee[1]	0.45% pa

[1] This is the fee we charge for managing the assets and overseeing the operations of the Fund. The management fee is deducted from the Fund's assets and reflected in its unit price.

Other Information

Fund size (as at 31 October 2023)	$287 million
Date of inception	August 1992
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	RFA0813AU

[2] The buy-sell spread represents a contribution to the transaction costs incurred by the Fund, when the Fund is purchasing and selling assets. The buy-sell spread is generally incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	-1.86	-1.82	-1.85
3 months	-2.67	-2.56	-2.63
6 months	-5.36	-5.14	-5.20
1 year	-0.86	-0.41	-1.18
2 years (p.a)	-4.32	-3.88	-4.26
3 years (p.a)	-4.93	-4.48	-4.61
5 years (p.a)	-0.30	0.18	-0.13
Since Inception (p.a)	5.24	5.78	5.46

Source: Pendal as at 31 October 2023

"Post-fee" returns assume reinvestment of distributions and is calculated using exit prices. "Pre-fee" returns exclude the effects of management costs and any taxes. Returns for periods greater than one year are annualised. Fund inception: August 1992.

Past performance is not a reliable indicator of future performance.

The benchmark for this Fund has changed over time. The benchmark performance shown is that of the combined benchmarks that the fund has aimed to exceed over time.

Sector Allocation (as at 31 October 2023)

Government bonds	38.7%
Semi-Government bonds	25.1%
Corporate bonds	25.5%
Cash & other	10.6%

Portfolio Statistics (as at 31 October 2023)

Yield to Maturity[#]	5.10%
Running Yield[*]	3.66%
Modified duration	4.98 years
Credit spread duration	0.83 years
Weighted Average Maturity	6.37 years

[#] The portfolio yield to maturity is an estimate of the fund's internal rate of return. It is calculated as the yield to maturity of all securities comprised in the benchmark at the relevant time (sourced from Bloomberg), plus our estimate of the weighted average traded margin over the swap rate for each of those securities based on observed market prices. The portfolio yield to maturity does not represent the actual return of the fund over any period.

[*] The portfolio running yield is calculated as the weighted average coupon rate of the physical portfolio assuming all securities are held at par or face value. Carry/interest income from synthetic positions are excluded from this calculation. Running yield does not reflect the actual income return of the portfolio.

Risks

An investment in the Fund involves risk, including:

- **Market risk** - The risk associated with factors that can influence the direction and volatility of an overall market, as opposed to security-specific risks. These factors can affect one country or a number of countries.
- **Security specific risk** - The risk associated with an individual asset.
- **International investments risk** – The risk arising from political and economic uncertainties, interest rate movements and differences in regulatory supervision associated with international investments.
- **Currency risk -** Currency exchange rate fluctuation risk arising from investing across multiple countries.
- **Interest rate risk -** The risk associated with adverse changes in asset prices as a result of interest rate movements.
- **Credit risk -** The risk of an issuing entity defaulting on its obligation to pay interest/principal when due.
- **Liquidity risk -** The risk that an asset may not be converted to cash in a timely manner.
- **Derivative risk –** The risk arising from use of derivatives to manage exposures to investment markets.
- **Counterparty risk –** The risk of another party to a transaction failing to meet its obligations.

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

Market review

October was a poor month for bond markets. In almost a carbon copy of September, markets were largely unchanged for the first half of the month but collapsed in the second half. Unlike September though, the reasons for the selloff were less clear and numerous explanations were given for what was a surprise to most. In Australia three year bonds sold off 0.32% to 4.40%. 10 year bonds sold off more, moving up 0.43% to 4.92%, the highest level since early 2011. A decade long rally of over 4% in 10 year bonds has now been unwound in two years.

The key data release in Australia over October was the Q3 inflation numbers late in the month. The RBA has been on hold recently but expressing a low tolerance for inflation surprises. Unfortunately for the RBA their inflation forecasting has yet again been poor, changing their year end 2023 forecast down to an optimistic 3.9% in August. The Q3 number ended up coming in slightly higher at 1.2%, leaving the likely year end inflation rate closer to 4.2%. Whilst these are small differences in the scheme of things it will pressure the RBA into hiking, otherwise their rhetoric starts to look hollow.

The higher rates also put pressure on spreads in general. Semi government spreads were hit quite hard, out around 10 basis points on the month. This wiped out the positive performance through August and September. Swap spreads and credit markets also drifted wider but found some receiving and buying at the higher yields, limiting the spread movements.

Credit review

In October, credit spreads widened as investor sentiment weakened. The primary catalyst for this downturn in risk appetite can be attributed to the continued rise in global bond yields, and the events in the middle east with the conflict between Israel and Hamas driving wider geopolitical fears. On the flip side, dovish Central Bank rhetoric and a positive US earnings season supported markets.

The surprise Hamas attack on Israel drove market weakness. The prevailing concern lies in the potential for regional escalation from Iran or other influential actors such as Saudi Arabia and Qatar. A wider military conflict in the Middle East could lead to a reduction in oil supply, provoking a surge in crude oil prices.

Compounding this negative sentiment was the persistent increase in U.S. interest rates. The driver of rising yields has been the resilience of the U.S. economy, higher oil prices and the anticipation of substantial Treasury supply to fund the significant US fiscal spending. Key US economic indicators such as payrolls, producer price and GDP all exceeded expectations during the month.

Federal Reserve and ECB officials spoke about monetary policy being restrictive enough to lower inflation to their goals, and risks are now more evenly balanced relative to the past. This was viewed favourably by markets as it indicates that central banks may be close to the end of their hiking cycle.

A decent US Q3 earnings reporting season was also supportive. With just over half of the S&P 500 having reported by the end of October, 79% had beaten earnings expectations by an average of 8%. Actual sales growth was 2% with profit growth of 3% compared to the previous corresponding period.

Credit spreads were wider over the month. The Australian iTraxx index (series 40) traded in a 12bp range finishing 9bps wider to close at 97bps. Australian physical credit spreads moved out 2bp on average. The best performing sectors were infrastructure and resources that both tightened 3bps, whilst the worst performing sectors were supra-nationals and domestic banks that widened 4 & 2bps respectively. Semi-government bonds underperformed, moving out 9bps to commonwealth government bonds.

Fund performance

Bonds again performed poorly in the late part of October, meaning negative returns in the fund. The fund performed broadly in line the benchmark, with a number of strategies providing good results.

The fund entered the month short front end duration on the view that a November rate hike was a close call, and the markets had little priced in. The higher than expected Q3 CPI saw us cover this as markets were largely priced for a hike after. Long end duration was kept small and the fund has a number of very short term tactical positions that netted out for performance.

The fund also did well from a new 2054 bond issued by the AOFM (federal government issuer). The bond came cheaper than our analysis and ended the month at fair value. The fund also did well from some pre-hedging of the duration risk.

The fund entered October with a neutral position in semi government bonds. As we expected they did underperform and we took advantage of new issuance from QTC and the ACT to again go overweight at wider levels later in the month. Semi governments still have large borrowing programs to execute but bank balance sheets and new demand at these high yields are seeing decent support.

The fund is currently near benchmark on credit, given concerns on rates impacting markets. However, the potential for a credit friendly soft landing remains, so this is being reviewed. The fund had good performance from the credit holdings as the overweight to infrastructure and utilties again drove value.

Finally the global overlay had a negative impact. The fund remains paid short China rates as their data turns. However, this was not reflected by yields that were largely unchanged. Against this the fund is received short Australian rates which drifted higher, although are now at levels we are comfortable being long duration. Also there was small decay in defensive FX positions, whereby the fund is long Yen calls against short Euro calls. Outright levels were largely unchanged but the options saw further time decay.

Market outlook

Bond markets should find some support after the dramatic move higher in late October. Real yields and nominal yields are at levels last seen in 2011 and offering investors very attractive returns over inflation. The big question is how much is structural and how much is cyclical. We expect the answer is a bit of both and we see levels as now being cheap.

The inflation outlook over the next year will be more market friendly, although levels will remain above the RBA target band. Similar to the second half of the last decade though the RBA will look through inflation outcomes in the 3-4% band. Wages will be slower to moderate but they will as the cycle moves on.

We expect a rate hike in November, but for that to be the end of the cycle. The inflation profile for the next year will see quarterly outcomes slightly below 1% and for inflation to end 2024 nearer 3.5%. This will allow the RBA to spend most of 2024 with tight but stable rates holding back the economy. Potential US rate cuts in the second half of 2024 may see some speculation of lower rates in Australia but we see actual cuts as more an early 2025 event.

Credit outlook

We remain tactically positive on credit spreads given the continued fall in US core inflation and the resilience of the consumer. This easing of inflation concerns should see central banks ultimately reduce cash rates which should see soft economic landing as opposed to a harder landing, and in turn would be positive for risk assets.

We are still cautious medium term as tight labour markets globally could see services inflation remain sticky and would see Central Banks maintain cash rates higher for longer, which would translate into a deeper global economic growth slowdown and potential recession.

Tightening of credit lending globally is also a risk to growth.

Higher oil prices and geopolitical concerns remain a risk for inflation.

For more information please call **1300 346 821**,
contact your key account manager or visit **pendalgroup.com**

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