Pendal Sustainable Balanced

Quarterly Investment Option Update

31 December 2023

Aim and Strategy

The option aims to provide a return (before fees, and expenses) that exceeds the option's benchmark over the medium to long term. The benchmark for the option is created from a weighted composite of market indices with reference to the option's neutral asset allocation. The option invests in Australian and international shares, Australian and international property securities, unlisted property (including infrastructure), Australian and international fixed interest, cash and alternative investments.

The option may also use derivatives. Sustainable and ethical investment practices are incorporated into the Australian and international shares, Australian and international fixed interest and part of the Alternative investment components of the option. Pendal actively seek exposure to securities and industries that demonstrate leading ESG and ethical practices and exclude companies not meeting the investable criteria.

Asset Allocation	Benchmark (%)	Actual (%)
Australian shares	26	27.4
Global shares	34	33.1
Australian property securities	2	2.4
Global property securities	0	0.0
Unlisted property and infrastructure	2	7.8
Growth alternatives	16	9.9
Australian fixed interest	7	8.7
Global fixed interest	9	9.0
Cash	4	1.7

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au/performance

Investment Option Overview

Investment Category	Multi-Sector
Suggested minimum investment timeframe	5 years
Relative risk rating	6 / High
Investment style	Active
Manager style	Single Manager

Investment Option Commentary

The portfolio outperformed its benchmark over the quarter driven by security selection within the various asset classes, whilst the active asset allocation across the various asset classes made a negative contribution.

Regarding security selection outperformance within Australian and International shares contributed. Overall, it was a good quarter for sustainable strategies. Typical underweights for sustainable strategies are the energy sector and also authoritarian nations within emerging markets, with both groups underperforming over the quarter. More specifically, outperformance from the Australian shares strategy was assisted by an underweight to energy stocks such as Woodside Energy, as well as overweights to iron ore stocks which followed the spot iron ore price higher over the quarter. Whilst within International shares, the Regnan Impact strategy added value due to its typical overweight to mid-cap stocks which significantly outperformed, along with some positive stock selection contributions.

Pendal's active asset allocation positioning at the start of October was underweight equities and bonds, and marginally overweight commodities. With equity markets up materially over the quarter the manager's active asset allocation detracted value.

Pendal's equity positioning started the quarter at an underweight stance and drifted less so over the quarter to an almost neutral position, as the manager's trend following model started to latched onto the positive price rally. The manager's valuation-based equity positioning remained underweight, as markets have rallied this year leading to valuations again stretching upwards. Whilst the manager's valuation based net equity position is slightly negative, within that net position are several "relative value" positions such as underweight the US and various continental European markets whilst overweight Japan and the UK. Pendal's best investment opportunities tend to arise when market valuation signals are confirmed by market trend signals. Over the quarter the portfolio's underweight to the US equity market drove most of the negative contribution from Pendal's equity positioning, whilst the portfolio's overweight to Japan positively offset marginally.

Pendal's bond positioning started the quarter with a mild net underweight exposure, however moved to an overweight stance by the end of the quarter. The change in position stance was driven by the manager's valuation model, as it took advantage of a material spike in bond yields and yield curve steepening in the middle of the October that provided a strong valuation score. Pendal's trend following became less underweight over the quarter, responding to the significant fall in bond yields over the quarter as markets started to price in controlled inflation expectations and a Fed peak and pivot. Overall for the quarter, the portfolio's bond positioning effectively made a neutral contribution to returns as the positive return valuation-based positions were washed out by negative trend following positions.

Pendal's active asset allocation positioning at the start of January has moved to neutral equities and overweight bonds. The manager maintains its concern around the lagging effects of substantial cumulative global interest rate hikes, with markets effectively pricing in perfection and substantial interest rates cuts by central banks. This current uncertain economic environment and modest investment signals, results in the manager's cautious and patient stance for now.

Market Commentary

Despite a sluggish start to the quarter, slowing US inflation and dovish signals from the Fed saw a shift in narrative to a greater chance of a "soft-landing" without driving the economy into recession, leading to a risk-on environment. Expectations for rate cuts in the US in 2024 were increased and brought forward, driving bonds & equities higher. The improvement in sentiment for equities was super-charged by an unwinding of large underweight positions in equities by systematic investment strategies.

The MSCI World Developed Markets index (local currency terms) gained double digits (10.0%) in the quarter driven by strong performance in the US. The MSCI Emerging Markets index also posted a strong quarter, gaining 5.6% in the calendar year's final quarter. The strength in the US was seen across the S&P500 (11.2%), Nasdaq (14.6%), and Dow Jones (12.5%), where each posted strong quarterly gains. In regard to style factors, as one might expect "growth" outperformed "value" amidst the bullish wave of optimism. Small caps, that are typically more leveraged to the economic cycle and often more indebted, outperformed their larger counterparts.

Improved sentiment in the US buoyed Australian equities as the S&P/ASX 300 finished up 8.4%. Sectors seen to benefit from the potential for lower interest rates performed best. Real Estate (+18.6%) and Health Care (+14.0%) were the top performing sectors while Energy (-9.0%) and Utilities (-2.06%) lagged most.

US and Australian 10-Year benchmark bond yields rallied materially as they fell -69bps and -53bps, respectively. This was largely driven by US bond markets and the expectation that the Fed will begin cutting rates at their March 2024 meeting as inflation settles nearer their target. The Bloomberg Global Aggregate AUD (Hedged) index as a result climbed 5.4%.

Commodities on aggregate sold off, with the Bloomberg Commodity Index closing the quarter down -4.6%, driven by the Energy subsector. OPEC+ output cuts did little to prop up oil prices as Brent Crude fell -19.2% in the quarter. Gold reached all-time highs in December, cementing its move above $2000 and returning 11.6% for the quarter. The VIX unsurprisingly dropped sharply to close out the quarter ~5 points lower in the risk-on dynamic, at a pre Covid pandemic low of 12.5 points.

Outlook

In the US, the chance of achieving the “soft landing” of bringing inflation under control without a deep recession has increased. Savings buffers and fiscal excesses built up during the COVID crisis, pent-up demand for services, and “termed-out” fixed rate debt at both a corporate level and on private mortgages, have blunted the typical interest rate transfer mechanism and acted to reduce / delay the impact of higher interest rates on the broader economy. However, the risk of mild recession in 2024 can’t be excluded, given the potential combination of the lagged effects of tighter monetary policy, waning fiscal spending and the run-down of excess savings. Whilst economic data so far has been supportive of the “soft landing” narrative, history is not.

The risk to Australia is more that of persistent inflation leading to the RBA leaving rates higher than expected in the short term, which could lead to a market de-rating. The new RBA governor has taken a hawkish tone. Furthermore, unlike the rest of the world, the nominal cash rate is below the inflation rate which suggests it may not be high enough to slow demand and lower inflation.

Whilst Pendal still view equity market valuations are generally close to fair in aggregate, US equities remain expensive driven by excitement around AI. Although economic conditions have been remarkably resilient in the face of rapid interest rate increases, risks remain skewed to the downside, and while Pendal are currently flat equities overall, there are a number of attractive relative value opportunities available between markets. For bonds, yields are broadly in line with the manager’s estimates of fair value, as attractive yield levels are offset by unattractive curve shapes. Whilst bonds yields are only priced at fair value, their higher levels vs the last decade means bonds would be expected to provide their traditional “risk off” portfolio benefits in the event of an equity market downturn.

Overall, the manager remains cautious on the near-term outlook as we face a potential turning point in the economic and market environment. Despite some attractive relative value trades, Pendal’s positioning across the funds is slightly defensive as they prefer at this point in time to be patient and wait for more attractive opportunities.

Availability

Product Name	APIR Code
SignatureSuper	AMP9559AU
SignatureSuper – Allocated Pension	AMP5144AU
SignatureSuper – Term Pension	AMP5144AU

Contact Details

Web: www.amp.com.au
Email: askamp@amp.com.au
Phone: 131 267

INSIGHTS
IDEAS
RESULTS