Pendal Australian Equity

Quarterly Investment Option Update

31 December 2019

Aim and Strategy

To provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 Accumulation Index over the medium to long term. It is an actively managed portfolio of Australian shares that has the potential for long-term capital growth and tax effective income and offers diversification across a broad range of Australian companies and industries.

This strategy may also hold cash and may use derivatives for managing market exposure. The investment manager's process for Australian shares is based on a core investment style and aims to add value through active stock selection and fundamental company research which focuses on four key factors: valuation, financial risk, franchise and management quality.

Investment Option Performance

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

Investment Option Overview

Investment Category	Australian Shares
Suggested Investment timeframe	5 years
Relative risk rating	6 / High
Investment style	Core
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	100	97.46
Cash	0	2.54

Sector Allocation	%
Financials x Prop Trusts	24.52
Materials	19.57
Health Care	11.71
Industrials	11.49
Energy	8.09
Consumer Discretionary	5.84
Communication Services	7.14
Cash & Short Term	2.54
Consumer Staples	2.44
Real Estate Investment Trusts	4.16
Information Technology	2.33
Derivatives	0.18
Utilities	0.00

Top Holdings	%
CSL Limited	8.52
Commonwealth Bank of Australia Limited	6.59
BHP Billiton Limited	6.53
Telstra Corporation Limited	5.02
ANZ Banking Group Limited	4.64
Qantas Airways Limited	4.00
Westpac Banking Corporation	3.78
Santos Limited	3.27
Macquarie Group Limited	3.19
Transurban Group	3.13

Investment Option Commentary

The Fund outperformed its benchmark over the December quarter.

Qantas (QAN, +13.0%) announced new long-term margin targets at its investor day in November, with a strategy to lift the Qantas domestic margin from 12% to 18% and Jetstar's domestic margin from 14% to 22% in 2024. This would be considered a stretch by many people. However these targets are also in line with margins in other domestic markets with a stable industry structure. Even if these targets are not achieved, there is a sense that efforts to do so will still lead to material margin improvement. The national airliner remains one of our highest conviction positions.

Pendal's preferred growth company, CSL (+18.0%) performed strongly, amid some selective selloffs amongst the growth cohort. Many of the stocks within this cohort are on challenging valuations, however Pendal believe CSL to be among the few where genuine underlying growth can justify a higher valuation rating. Its most recent result demonstrated strength in its core IG business, where it continues to win share from competitors and benefit from an improving product mix. Its Speciality businesses also continue to do well.

MTS delivered a decent full year result. Crucially, it delivered underlying food sales growth for the first time in 2012. This indicates that the recent work management have done to improve and focus the offering and service has started to bear fruit. The markets' response suggests that it remains wary of the outlook for independent supermarkets despite the improving trend, while the contract loss with 7-Eleven also seems to weigh on investors' minds. Pendal retain confidence in the company's outlook.

ANZ (-10.9%) reported full year results in October. While the issues facing banks on revenue, earnings and capital are well known, ANZ's result still came as a slightly negative surprise. Some of this is due to ANZ's relatively large exposure to institutional loans, part of which is Asian-based and has the additional pressure from falling global rates. ANZ has also been the only bank attempting to reduce costs in an absolute sense in recent years. It has been successful in reducing costs from over $9bn to $8.6bn currently – towards a stated target of $8bn. However management flagged that while the long-term target remained, costs were likely to rise over the next year. Capital provided one of the few bright spots. Changes to the Reserve Bank of New Zealand's treatment of capital are likely to eat into the previously large surplus ANZ enjoyed, but there are solid indications they will be able to manage the position while maintaining dividends for the moment. ANZ's result painted a clear picture of the tough environment for banks, in which Pendal remain underweight.

Market Commentary

The Australian equity market had a choppy quarter. The market made a strong recovery after a sharp initial fall, but then a softer end to the year meant that the S&P/ASX 300 Accumulation index rose 0.71% for the quarter. Overall, the Australian equity market delivered strong returns in 2019, with the S&P/ASX 300 Accumulation index gaining +23.8%. Aggregate index earnings declined over the year, despite an expansion in the resource sector. As such, the year's gains were driven by a valuation re-rating, helped in turn by lower interest rates and bond yields.

The US and China announced that they had agreed to the first phase of a new trade deal. While the agreement is thus far short on detail – and only partially rolls back the most recent set of tariffs, it served to deescalate tension and uncertainty. Iron ore gained +4.5% in December in response. Materials (+4.8%) had a decent quarter as a result. BHP (BHP) gained 6.0%, Rio Tinto (RIO) was up 8.3% while Fortescue Metals was up 21.5%.

Outlook

At the outset of 2020, some of the risk to global growth from US-China trade seems to have receded. Pendal are mindful that the strategic arm wrestle between the two countries is likely to be a structural feature of markets and a source of periodic volatility, however for the moment the outlook here is less uncertain. The domestic economic outlook remains muted. Tax and interest rate cuts seem to have helped stem a further decline, however many companies are still feeling the pressure from a lack of growth in demand. The lack of a strong cyclical tailwind emphasises the importance of management quality and business strategy – and the ability to allocate accordingly.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP0860AU
AMP Flexible Super - Retirement account	AMP1340AU
AMP Flexible Super - Super account	AMP1469AU
CustomSuper	AMP0860AU
Flexible Lifetime - Allocated Pension	AMP0875AU
Flexible Lifetime - Term Pension	AMP0916AU
Flexible Lifetime Investment	AMP0835AU
Flexible Lifetime Investment (Series 2)	AMP1405AU

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