Pendal Sustainable Balanced

Quarterly Investment Option Update

31 December 2021

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	27.6%
Global shares	34	31.5%
Australian property securities	2	1.5%
Global property securities	0	1.0%
Unlisted property and infrastructure	3	7.8%
Growth alternatives	15	11.2%
Australian fixed interest	8	6.6%
Global fixed interest	7	5.4%
Cash	5	7.4%

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 fund outperformed the benchmark over the December quarter.

Active positioning at the start of Q4 was a little more "risk-on" than Q3 and contributed very strongly to portfolio returns. The portfolio was positioned with overweights in a range of under-valued equity markets, underweights in the most expensive equity markets, long equity volatility carry and overweight markets exhibiting strong upward trends. Fixed income positions were underweight in most markets.

In equities, active positioning driven by valuation insights held overweights in Mexico's Bolsa, UK's FTSE indices and global listed property, and a long position in the futures of EURO STOXX 50 dividends paid in the calendar year 2024, all of which screened amongst the most attractive markets in the universe monitored by the manager. The portfolio has earned strong returns all year from equity volatility carry through VIX futures, however the risk allocation was reduced at the start of the quarter. On the defensive side, the fund held short positions in the French CAC 40 and US S&P-500 ESG, to which was added a short position in FTSE Taiwan, as these markets are considered expensive within Pendal's valuation framework. During the quarter the overweight global listed property and EURO STOXX 50 dividends positions were closed, locking in substantial profits, as these investments had reached fair value.

The trend-following overlay continues to hold overweights to S&P-500 ESG, partly offsetting the abovementioned valuation underweight, Australia's S&P/ASX-200 and the STOXX® Europe 600 ESG-X index. In fixed income, the underweight positions from both trend-following and valuation frameworks were increased over the quarter, with trend-following models moving to their maximum underweight in all markets. In valuation-driven positioning, underweights are held in US, Italian and UK 10-year bonds.

In commodities the portfolio remained long copper, with both trend and commodity basis signals pointing to higher prices. In addition to an expectation of delivering positive returns, this position offers potential protection against rising inflation. Gold positioning was mixed as the price remained generally trendless over the past year, however a high-conviction short was established during December. Substantial profits were generated from a long position in European Carbon allowances, with the profits eventually being locked in when high realised volatility led the portfolio management team to move to a more cautious outlook.

Active positioning at the start of Q1 is slightly positive in growth assets and very negative on bond markets.

Market Commentary

Australian equities staged a decent finish to 2021 despite concerns over a renewed surge in Covid cases and a more hawkish turn from Fed in response to inflationary pressures. The S&P/ASX 300 rose 2.2% in the quarter, to deliver 17.5% for the full year.

The market is focused on two key issues; the latest surge in Covid cases and the outlook for inflation and interest rates. At this point the emphasis seems to be on data suggesting that Omicron, while more virulent that previous strains, has a more benign health outcome. As a result the surge in new cases has not weighed on market sentiment. There is still risk around this issue, given that its transmissibility could result in economic disruption and pressure on health care systems even if it is less severe than other variants.

On rates, the Fed took a more hawkish turn in December, flagging that QE would cease by the end of March 2023, potentially opening the door to rate hikes. It has also walked back from the notion of current inflation as being "transitory." This has raised the possibility of higher real interest rates, which saw growth sectors underperform.

Outlook

Covid and inflation have been the two big issues to watch all year. Both have taken significant turns in recent weeks, leaving the outlook for next year as uncertain as ever. This does not mean that the outlook is necessarily negative. Rather, the potential paths we head down next year look very different. On Covid, this could be the early stage of the largest wave. This could put substantial strain on healthcare systems, prompting renewed restrictions which could drag on the economy and escalate supply chain problems. Alternatively, the effects of the vaccines, anti-virals and potentially lower severity of Omicron means the virus becomes more benign, to be handled without restrictions.

On inflation and rates, economic strength and a tight labour market may lead to sustained inflationary pressures. This could prompt both the Fed and markets to realise that higher real rates are needed, prompting a sell-off in equities and growth stocks in particular. Alternatively, inflationary pressures may ease as supply chains resolve themselves, people re-enter the labour force, and structural factors such as tech and debt re-assert themselves. In this scenario growth and earnings are good and bonds and equities rally with growth resuming leadership.

Now is not the time to be making a high conviction binary call on either of these issues. Overall the manager believes the market environment is still reasonably constructive. Growth is strong, companies have pricing power, rates remain very low and sentiment is not over-confident. In the near term the Covid case spike could hold markets back. The medium term issue is that the market may be underestimating the policy response required to contain inflation.

Availability

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

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