Pendal Sustainable Balanced

Quarterly Investment Option Update

31 March 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	27.1
Global shares	34	31.7
Australian property securities	2	2.0
Global property securities	0	0
Unlisted property and infrastructure	3	8.6
Growth alternatives	15	11.1
Australian fixed interest	7	7.7
Global fixed interest	8	8.7
Cash	5	3.0

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 underperformed its benchmark over the quarter as the security selection and active asset allocation processes detracted value.

In regard to security selection, underperformance by the international equity strategies was led by the Global Select strategy. Whilst owning none of the Western banks, some of its smaller and more economically sensitive stocks were detrimentally affected, such as United Rentals, Tenaris and TGP where each fell by more than 10% in March. For alternatives, the multi-asset target return fund underperformed traditional equity and bond asset classes which rallied strongly over the quarter.

The manager's active asset allocation positioning at the start of January moved back to a modest underweight position to equities, whilst maintaining a modest underweight position to bonds, commodities and volatility. Given the strong performance of equity markets over the quarter, the equity positioning detracted value. Further, the generally underweight position to commodities also detracted value, whilst nimble volatility positioning added material value over the quarter.

There were some slight changes to the equity positions over the quarter. As markets continued to rally, valuations again started to stretch upwards. With an outlook that appears to have more downside than upside risk, we've looked for opportunities to sell risk assets into a rally that doesn't appear to reflect medium term fundamentals. In this regard in January, Pendal introduced a valuation based underweight to the US Dow Jones Industrial Average index. In addition, in February Pendal crystalised profits on their overweight to Australian shares that was initiated in October, as it started to trade on the expensive side. Whilst in March, Pendal introduced an underweight to the Amsterdam IDX market index. In contrast to their valuation positioning, their trend-based equity positioning flipped early in the quarter from underweight to slightly overweight reflecting the positively trending markets this year. Overall, Pendal maintain the view that equities are marginally above fair value and their concerns around the lagging effects of substantial cumulative global interest rate hikes which could induce a recession. Given equity markets rallied over the quarter, their net underweight to equities detracted value over the quarter.

Pendal's bond positioning maintained a mild net underweight exposure over the quarter, despite some changes in composition. Pendal's modest net underweight position is being driven by their trend following process, where continued volatile rates markets has led to some turnover of positioning as their "volatility toggle" on various markets have been activated. During February Pendal removed their last valuation-based bond position, buying back the Canadian bond underweight at a materially lower level than Pendal sold it at back in August 2022. Pendal's bond positioning is neutral on Australian and Canadian markets that are closer to a pause on rate hikes, and underweight German, UK and US bonds which still have some potential hikes. Despite bond markets rallying over the quarter, their active bond positioning added some value mainly in the month of February as rates moved materially higher across key markets within this month.

Within alternatives, gains on Pendal's volatility positioning were offset by losses on their commodity positions. Most of the value-add from their volatility positioning came in January, as the VIX index dropped 10% contributing to performance given their short position. In addition further value was added in March where in the first half of the month, concerns around banking failures led to a step-change higher in their proprietary Pendal Risk Indicator. This and the substantial spike in realised market volatility triggered a long position on their VIX model. The timing proved accurate as market volatility continued to spike. A swift response from the US Treasury that limited the expected contagion led to the manager's Pendal Risk Indicator plunging, which in due course led to the removal of the long VIX position and a resultant strong positive return contribution. For commodities, industrial and precious metals rallied over the month of January on positive sentiment and a falling USD, leading to their short gold and copper positions detracting performance for this month and thus the quarter.

Pendal's active asset allocation positioning at the start of April remains marginally underweight equities and bonds however now neutral commodities. Overall, Pendal's positioning is as light as it has been for quite some time, with mild signal strength and what appears to be a potential turning point in the economic and market environment. As such Pendal remain cautiously set for now.

Market Commentary

Equities and bonds rode a roller-coaster over the first quarter of 2023. January was strong, with markets bullish on indications that US inflation was slowing faster than expected, providing scope for an end to the hiking cycle. This optimism faded in February as further evidence of ongoing strength in the US economy and tight labour markets saw hopes of a dovish tilt from central banks recede. March saw stress in the US and European banking systems and concerns over financial stability driving markets lower, before policy makers stepped in to shore up the system and restore confidence.

Despite this quarter's volatility, the MSCI World Developed Market Index rose 7.6% (in local currency terms).

Emerging markets underperformed, rising 3.8%, boosted by performance in Asia. In developed markets, Europe was the top performer as the Euro Stoxx (13.7%), French CAC 40 (13.1%) & German DAX (12.2%) all made strong gains. US equity markets also had a strong quarter with the S&P500 marching forward 7.5%, whilst the growth stock biased NASDAQ (20.8%) entered a bull market. In regard to size biases, large cap outperformed small cap.

The S&P/ASX 300 gained 3.3% this quarter. Consumer Discretionary (+10.8%) did best, helped by the consumer holding up better than expectations. Financials (-2.6%) was the bottom performing sector, dragged down by concerns over financial stability in Europe and the US.

Following a difficult calendar year in 2022 for bonds, most global yields fell in the March quarter, albeit experiencing a spike in February owing to better-than-expected economic data. The Bloomberg Global Aggregate Index (AUD Hedged) returned 2.4%.

Commodities had a more challenged start to the year when compared to equities and bonds. Unable to post a gain, the Bloomberg Commodity Index (-5.4%) retreated backward. Natural gas, thermal coal and nickel were a few of the bottom performing commodities. The VIX spiked briefly above 30 mid-March, before ending the quarter lower than it started. The US Dollar Index fell further, down -1.5% as downward momentum builds.

Outlook

Pendal are now seeing the financial system stress that often accompanies periods of financial tightening with bank runs and bailouts in the US and Europe and record declines in short end yields. Given policy makers seem to have successfully underpinned confidence in the financial system in response to this, the key issue is the transmission mechanism to the broader economy as smaller banks are major providers of credit.

The question becomes the extent to which any caution in the banking sector has a further slowing effect on US GDP (and globally) or starts to weigh on corporate earnings.

The most recent US payroll data and Household Surveys continue to paint a picture of an economy which is resilient, but there is increasing evidence of a softening trend. It remains to be seen whether this morphs into a recession later in the year.

Whilst Pendal still view equities as generally close to fair value, Pendal's concerns around the lagging effects of substantial cumulative global interest rate hikes, which could induce a recession, leads us to view that corporate earnings and thus equities have more downside risk than upside risk. The upside remains capped by global central banks' actions to contain inflation. For bonds, Pendal also view them as close to fair value, after such significant falls in bond prices last year whilst medium- to long-term inflation expectations remain reasonably pinned supporting real yields. Should the global economy incur a recession, Pendal expect bonds to provide defensiveness to the portfolio.

Overall, Pendal remain cautious on the near-term outlook as Pendal face a potential turning point in the economic and market environment. As such Pendal's positioning across the funds is modest as Pendal 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

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