

Pendal Sustainable Balanced

Quarterly Investment Option Update

30 September 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	25.6
Global shares	34	31.3
Australian property securities	2	1.8
Global property securities	0	1.2
Unlisted property and infrastructure	2	8.0
Growth alternatives	16	8.9
Australian fixed interest	7	7.3
Global fixed interest	9	8.7
Cash	4	7.2

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 September quarter as a negative contribution from security selection exceeded a positive contribution from active asset allocation.

In regard to security selection, underperformance came mainly from the International and Australian shares asset classes and to a lesser degree the Alternatives asset class. Within International shares, the main negative contributor was the Regnan Impact strategy which underperformed in September with overweight to mid-cap Health Care stocks. Underperformance in Australian shares was also mainly attributed to the month of September driven by overweight positions to Orora, Qantas and Xero, whilst ESG screens also contributed negatively as screened stocks BHP, Santos and Metcash dented relative performance. For the Alternatives asset class, underperformance was attributed to the Sustainable Listed Investment Companies (LICs). The LICs have struggled over the calendar year due a combination of political and macro risks denting sentiment towards the sector, however Pandal view the discounts to NAV across the sector are overdone.

Pandal's active asset allocation positioning at the start of July was underweight equities, bonds and commodities. With markets within these broad equity and bond asset class groups down materially over the quarter, the manager's active asset allocation added material value.

Pandal's equity positioning was held at a marginally underweight stance over the course of the quarter. The manager's valuation-based equity positioning was 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. In contrast to their valuation positioning, Pandal's trend-based equity positioning is slightly positive reflecting the positively trending markets this year. Pandal find the best investment opportunities tend to arise when market valuation signals are confirmed by market trend signals. Over the quarter Pandal's equity positions contributed a positive amount, driven by the general underweight to equity markets and also the relative value positioning.

Pandal's bond positioning held a mild net underweight exposure over the quarter. Their bond positioning is currently being driven by their trend following process, where the increasing in bond yields in response to additional concerns around sticky core inflation, higher for longer cash rates, and US debt issuance has driven poor bond market returns. Pandal maintain no valuation-based bond positions given only modest valuation signals, as high real and nominal bond yields relative to history are being offset by even higher cash and short term yields as represented by inverted yield curves. Over the quarter the bond positions' return contribution was positive.

Within alternatives, the manager's commodities positioning provided a net neutral contribution.

Pandal's active asset allocation positioning at the start of October remains underweight equities, bonds and commodities. The manager maintains their concerns around the lagging effects of substantial cumulative global interest rate hikes coupled with weak economic growth in China and Europe. The economic environment has been supported by the services sector, whilst the manufacturing sector has been in contraction, and a dulled transmission mechanism. Pandal view the risk is more that the services sector could turn towards the manufacturing sector, as opposed to the other way around. This current uncertain economic environment and modest investment signals, results in Pandal's cautious and patient stance for now.

Market Commentary

Q3 saw a poor performance for markets, driven mainly by the dynamics within the month of September. The declines had several causes, but an important one was the growing sense that central banks were likely to keep interest rates higher for longer, alongside a \$20/bbl rise in oil prices over the quarter. At the Fed's September meeting, the FOMC raised their median dot for the fed funds rate at the end of 2024 by 50bps, suggesting that there would be fewer cuts next year than previously thought. Brent Crude oil prices were up +27.2% to \$95.31/bbl, which is the biggest quarterly rise since Q1 2022 when Russia's invasion of Ukraine began. The biggest story of Q3 however was the massive bond sell-off, which sent yields and volatility thereof up to multi-year highs around the world.

The MSCI World Developed Markets index fell -2.5% over the September quarter (in local currency terms). The MSCI Emerging Markets index fared better, falling -1.3%. In the US, the S&P500 closed down -3.7%, the Nasdaq -2.9%, and Dow Jones -2.6% on the quarter. Style factors saw growth materially underperforming value on higher bond yields. Small caps, that are typically more leveraged to the economic cycle and often more indebted, underperformed their larger counterparts.

The ASX/S&P 200 TR index started the quarter well, supported by Financials & Energy, however finished down on the quarter (-0.8%). Energy, the top performing sector, delivered double digit performance (+11.2%) while

Consumer Staples & Information Technology were the biggest drags.

The US 10-year Treasury yield ended the quarter up +73.5bps at 4.57%, and at the intraday peak on September 28 it was as high as 4.69%, which we haven't seen since 2007. Yields moved higher across the curve but there was also a substantial curve steepening. That left yields on 2-year Treasuries up +14.8bps to 5.04%, whilst those on 30-year Treasuries saw their biggest quarterly increase since Q1 2009, with a rise of +83.9bps to 4.70%. It was much the same story elsewhere too, with the 10yr German & Japanese benchmark yields up +44.8bps to 2.84% and +36.5bps to 0.76%, respectively.

The Bloomberg Commodity Index rose over 3.3% over the quarter. The main contributor to the positive performance was energy which spiked 18%, with supply cuts from Saudi Arabia and Russia being the strongest catalysts as demand persisted globally, whilst the Agriculture and Precious Metals subindices fell circa 5%. The VIX ended the period at 17.5 points, 4 points higher than at the start of the quarter.

Outlook

Risk assets sit at an interesting juncture after falling over the last month.

The bullish perspective is this is a period of consolidation at a seasonally weak time of year. From here, this could see US inflation and wage growth continue to slow while the economy holds up, which may mean no recession. In this case, interest rates may have peaked, implying that earnings are set to grow and valuation ratings rise, lifting markets higher.

The alternative bearish case is that bond yields, the US dollar and the oil price have all been moving higher, which have historically been warning signals for the market. Higher oil prices means that inflation in the US, while softening, may not fall as fast as the market wants. There is also risk that the delayed effects of monetary tightening will lead to the economy slowing more materially than expected, putting pressure on earnings.

Whilst Pandal 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 Pandal are only marginally underweight 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, although there are some signs of value appearing in select markets. Inflation is gradually moderating; however, core inflation remains uncomfortably high & oil remains a risk. Nonetheless, higher yields now provide a cushion against further downside risk, and in addition bonds would be expected to provide their traditional "risk off" portfolio benefits in the event of an equity market downturn.

Overall, Pandal remain 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, Pandal'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

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