# Pendal Australian Equity

Quarterly Investment Option Update

31 December 2018

## 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 |

| Asset Allocation | Benchmark (%) | Actual (%) |
|---|---|---|
| Australian Shares | 100 | 96.23 |
| Cash | 0 | 3.77 |

| Sector Allocation | % |
|---|---|
| Cash & Short Term | 3.77 |
| Consumer Discretionary | 6.91 |
| Consumer Staples | 3.38 |
| Energy | 8.91 |
| Financials x Prop Trusts | 26.42 |
| Health Care | 11.82 |
| Industrials | 10.57 |
| Information Technology | 1.36 |
| Materials | 19.42 |
| Real Estate Investment Trusts | 2.57 |
| Communication Services | 4.47 |
| Utilities | 0.00 |
| Derivatives | 0.39 |

| Top Holdings | % |
|---|---|
| Commonwealth Bank of Australia | 8.91 |
| BHP Billiton Limited | 8.25 |
| CSL Limited | 7.73 |
| ANZ Banking Group Limited | 6.23 |
| Qantas Airways Limited | 4.37 |
| Westpac Banking Corporation | 3.78 |
| Telstra Corporation Limited | 3.40 |
| Amcor Limited | 3.20 |
| Santos Limited | 3.06 |
| Transurban Group | 2.69 |

## Portfolio Summary

Looking at sector performance more closely, all of the 11 GICS sectors finished the quarter lower, although some recorded smaller losses than others. Utilities (-3.1%) was the best performing sector, driven by AGL's (+5.6%) strong performance; whilst Energy (-21.6%) was the worst. Elsewhere, Financials (-7.7%) was the largest detractor from the index return over the quarter. Three of the big four banks posted losses, with CBA (+1.4%) being the exception. The Reserve Bank of New Zealand (RBNZ) released its initial consultation paper on banking system capital, which has direct implications for the Australian major banks that constitute the bulk of the Kiwi system via their subsidiaries. Outside of the banks, AMP (AMP, -23.2%) further added to the sector's woes over the quarter. The company's sale of its wealth protection and mature businesses was poorly received by market. Despite management's claim that the sales would help the company

## Investment Option Commentary

National airliner Qantas (QAN, -1.9%), one of Pendal's highest conviction holdings, outperformed the index over the quarter. In the absence of new company news, the oil price slump accounted for much of the gains. The market has held doubts over whether Qantas would be able to absorb the additional fuel costs as the oil price has been edging higher. Whilst the oil price is one factor that pendal monitor, their investment thesis is mainly predicated on the emergence of a stable duopoly in the Australian domestic market, which is supporting pricing and, in combination with strong cost control, is driving strong cash flow. Management are also allocating this capital well, returning it to shareholders via buybacks and dividends.

CYB Group (CYB), which owns regional UK bank brands such as Clydesdale Bank, fell 44.0% in the December quarter. The stock has been sliding in recent months owing to uncertainty around Brexit negotiations. The share price was also impacted by the latest earnings results and unpleasing developments on its Virgin Money acquisition discussed above. At an unchallenging valuation of 0.6x price/book and 7.0x price/earnings, the stock presents significant value given the longer-term outlook for reasonable earnings growth. The risk from Brexit is somewhat binary in the near term and any rapprochement between the European Union and UK Government could very well see the stock re-rate. However, without further clarity on expected synergies from the merger, the timeline for earnings-driven stock price gains appears to have been pushed out, given the near-term margin pressure.

## Market Commentary

The S&P/ASX 300 Price Index pulled back by 9.2% (-8.4%, Accumulation) over the course of the December quarter, marking the first negative year of the domestic equity market since 2011. The same index was 7.1% lower over the past 12 months, or -3.1% after accounting for dividends, as a result of market de-rating. The headline index now trades at a 13.8x next 12-months P/E multiple, compared to the16.3x it was trading at a year ago. The change in market sentiment overshadows the positive earnings change posted by companies, particularly in relation to resource companies, which have been benefiting from an elevated level of commodity prices. In contrast, Financials have been a large drag on all fronts over the year. Revelations from the Royal Commission saw investor confidence for the sector plunge to historical lows; whereas the earnings outlook also remains subdued due to limited mortgage growth and higher funding costs for banks.

## Outlook

One interesting feature of market volatility in the last few months of 2018 is that some of the hardest-hit stocks were those that had outperformed in the first three quarters of the year. The withdrawal of market liquidity is clearly having an effect on the elevated rating of the growth stocks which had done well earlier in the year. However, fears over trade and global growth are also dragging on value stocks as well; the price/earnings de-rating has been greatest in the cheapest decile of stocks. This material shift in the market is pertinent for the portfolio, which underperformed over the quarter, driven in part by a decline in stocks such as Nine Entertainment (NEC) and Aristocrat Leisure (ALL) which had helped it outperform over the earlier part of the year.

## 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 |

## Contact Details

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