Pendal Sustainable Balanced

Quarterly Investment Option Update

30 June 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	25.8
Global shares	34	33.0
Australian property securities	2	2.0
Global property securities	0	0
Unlisted property and infrastructure	2	8.4
Growth alternatives	16	10.3
Australian fixed interest	7	6.8
Global fixed interest	9	8.7
Cash	4	5.1

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 June quarter driven by security selection within the various asset classes, whilst the active asset allocation contribution was slightly negative.

In regard to security selection, underperformance came mainly from the Alternatives strategies which are benchmarked to a simple 50/50 traditional equity/bond benchmark. The Alternatives strategies are designed to provide a material level of diversification and protection vs traditional equity/bond market returns. Collectively the Alternatives strategies are naturally underweight the narrow group of stocks that drove traditional market returns over the period, resulting in the relative underperformance. The Sustainable Listed Investment Companies (LIC) were the main detractor within Alternatives, having struggled over the period due to a combination of political and macro risks denting sentiment towards the sector. However, we view the discounts to NAV across the sector are overdone, and that prices will move back towards their NAVs given their attractive features such as relatively low cash flow and NAV volatility through the economic cycle, inflation linkage, and exposure to long-term megatrends such as energy transition, digitalisation and technology disruption, and the ongoing provision and servicing of essential social infrastructure. Value was also detracted from the International equities asset class, as their two main developed markets strategies were underweight the seven large US technology companies that drove equity markets in response to exuberant sentiment around Artificial Intelligence.

Pendal's active asset allocation positioning at the start of April remained marginally underweight equities and bonds and was neutral commodities. Despite the positive return from equity markets over the quarter, Pendal's asset allocation positions contributed only a slightly net negative result to performance.

Pendal's equity positioning was held at a marginally underweight stance over the course of the quarter. Pendal's valuation-based equity positioning was underweight, as markets have rallied this year leading to valuations again stretching upwards. With a cyclical 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. Whilst Pendal'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 Pendal's valuation positioning, Pendal's trend-based equity positioning is slightly positive reflecting the positively trending markets this year. Over the quarter Pendal's equity positions contributed a negative amount mainly due to their net underweight position.

Pendal's bond positioning started and ended the quarter with a mild net underweight exposure. Pendal's 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 and a continuation of interest rate rises by central banks is leading to the underweight position. Pendal maintain no valuation-based bond positions given only modest valuation signals, as high bond yields relative to history are being offset by even higher cash yields as represented by inverted yield curves. Over the quarter the bonds return contribution was effectively flat, assisted by an underweight to UK Gilts but offset by Australian and Canadian bond positioning.

Within alternatives, commodity positions contributed a flat amount whilst the manager held no volatility position over the quarter. In regard to the commodity positions, a gain on a short copper positions added to returns whilst gold positioning detracted slightly.

Pendal's active asset allocation positioning at the start of July is marginally underweight equities, bonds and commodities. Overall, Pendal maintain their concerns around the lagging effects of substantial cumulative global interest rate hikes which could induce a recession. The economic environment has been supported year-to-date by pent-up COVID related demand for services and strong consumer savings buffers whilst the manufacturing sector has been in contraction. Pendal view this dynamic is at risk of turning. As such the manager remains cautiously set for now.

Market Commentary

The first half of the year saw US large caps come out on top despite a series of concerning events, government bonds meanwhile were uninspiring, and commodities negative. The Nasdaq had its best half in the history of the index. As Pendal head into the second half of the year, we're met with mixed macro, negative seasonality, lingering risks, but also a new mania triggered by AI hype and a coming full circle of investor sentiment from extreme bearish to now increasingly extreme bullish.

Global equity markets in the June quarter were led by the US large cap technology stocks. The Nasdaq's best half in its history was largely driven by the extraordinary upgrade in revenue guidance from US chip-maker NVIDIA on the back of AI-related demand, prompting a tide of optimism within the technology space. Market breadth was narrow however, with only 7 stocks driving the majority of market returns, being the so called "Magnificent Seven, in the first half of the year. Driven by the US technology stock outperformance, the MSCI Developed Markets

Index rose 7.3% in the quarter, outperforming the MSCI Emerging Markets (1.8%), in local currency terms. The Japanese market also provided solid gains, with the TOPIX index returning 14% over the quarter. In this tech driven dynamic, it was no surprise to see value and small cap stocks underperforming their growth and large cap counterparts.

Australian large caps advanced in June, extending their gains for the quarter, while small caps lagged their blue-chip peers. The S&P/ASX 300 returned 1.0% over the quarter with technology (18.5%) leading the charge and healthcare (-3.0%) dragging on the index.

Most global bond yields rose in the June quarter, and we saw a bear flattening of the yield curve (long dated yields rising less than short dated yields). US 2-year yields rose ~50bps more than US 10-year yields, as the macro headlines centered around the persistent and stickiness of core inflation with Central Banks continuing to hike rates. The rising yield curve contributed to the slight retracement of the Bloomberg Global Agg (Hedged) AUD (-0.3%).

Despite a race to the finish line, commodities overall had a difficult June quarter. Industrial metals, iron ore, precious metals, coal & oil each sold off with natural gas one of the few areas in the black. Consequently, the Bloomberg Commodity Index (AUD) shrunk -2.0%. In the risk-on environment, the VIX index fell from 19 to 14 volatility units.

Outlook

The key risk to markets remains a material earnings deceleration off the back of an economic downturn. At this point earnings, while softening at the margin, are holding up much better than many feared.

Recent data flow suggests some evidence of a slowing US economy, but a resilient consumer and strong labour market continues to see data fall slower than expected - resulting in increased investor expectations for a soft landing.

The US jobs market remains tight and wage growth remains sticky. The Fed's preferred measure of inflation, core PCE services prices ex-rent, rose in May albeit at its slowest pace since last July. Retail sales have slowed, but by less than expected, and were up sequentially month-on-month in June.

That said, monetary policy works with a lag and it is still too soon to make a clear call on how deep and prolonged an economic slowdown in either the US or Australia will be – and the degree to which it will ultimately drag on earnings. Pendal's economic cycle model has been positive year to date, however has recently turned slightly negative. The material economic risk is that the services sector which has been the primary economic driver, trends towards the manufacturing sector which is in contraction.

Whilst Pendal still view equities are generally close to fair value, their concerns around the lagging effects of substantial cumulative global interest rate hikes, regional banking risks and geopolitical risks, leads us to view that corporate earnings and thus equities have more downside risk than upside risk. However, Pendal will concede the risk of a deep recession is falling, supporting markets calendar year to date. 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 we face a potential turning point in the economic and market environment. As such their positioning across the funds is modest 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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