Pendal Australian Equity

Quarterly Investment Option Update

30 September 2021

Aim and Strategy

To provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 (TR) 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, franchise and management quality and risk factors (both financial and non-financial risk).

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au/performance

Investment Option Overview

Investment Category	Australian Shares
Suggested Investment timeframe	5 years
Relative risk rating	7 / Very high
Investment style	Core
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	100	97.86
Cash	0	2.14

Sector Allocation	%
Cash & Short Term	1.62%
Consumer Discretionary	6.82%
Consumer Staple	3.32%
Energy	6.77%
Financials x Prop Trusts	27.51%
Health Care	9.87%
Industrials	6.68%
Information Technology	6.69%
Materials	19.34%
Real Estate Investment Trusts	2.84%
Communication Services	8.47%
Utilities	0.00%
Futures	0.06%

Top Holdings	%
CSL Limited	8.06%
BHP Billiton Limited	7.68%
Commonwealth Bank of Australia Ltd	7.18%
Westpac Banking Corporation	6.36%
Telstra Corporation Limited	5.87%
ANZ Banking Group Limited	4.66%
Xero Limited	4.32%
Qantas Airways Limited	4.15%
Santos Limited	3.90%
James Hardie Industries Plc	3.19%

Investment Option Commentary

The Fund finished the quarter behind the index, although it recouped much of the underperformance earlier in the quarter with a good September. Several of the portfolio's re-opening related names helped drive returns. However the position in iron ore – and not owning Sydney Airport – detracted.

Contributors

Overweight Qantas (QAN, +21.7%)

QAN delivered a well-received result, where the market was reassured by the strength of the June quarter, which was largely unaffected by domestic restrictions. Management was able to demonstrate very strong results in that period and a material reduction in debt. This suggests a strong rebound in demand as and when restrictions roll off. The stock continued to do well as vaccination rates have brought the end of lockdown nearer.

Underweight Rio Tinto (RIO, -15.9%)

The sharp drop in the iron ore price dragged on miners. This dragged on the portfolio's positions in BHP and Fortescue, but there was some offset by the underweight in RIO. The miners remain enormously cash generative even at thes reduced prices, while the fund manager also sees reasonable support for demand as economies begin to reopen following the Delta variant. The preference remains for BHP and Fortescue over Rio Tinto.

Detractors

Overweight BHP (BHP, -17.6%)

There are a lot of fluctuating issues in China at the moment, including a slowing economy, the likely default of property developer Evergrande, and the broad shift in direction to one of "common prosperity." The resulting uncertainty weighed on the iron ore price – and BHP's stock price. This weakness was compounded by the news that the company is looking to collapse the dual-listed structure, creating selling pressure on the Australian line of stock. This is despite a strong set of operational results for BHP. The fund manager sees iron ore fundamentals as relatively well supported despite this uncertainty. BHP continues to deliver strong cash flow and is yielding ~10%.

Underweight Sydney Airport (SYD, +42.3%)

The low cost of capital has prompted a surge in corporate activity, of which the takeover bid for SYD from a consortium of pension funds was the largest example. The initial bid, subsequently revised upwards, was at a 40% premium which values it at 25x EBITDA versus a historical trading range of 18-21x. Not owning SYD was a drag on relative performance.

Market Commentary

The Australian equity market gained 1.79% for the third quarter (S&P/ASX 300) despite the pull back in September.

There were multiple factors at play during this period. It began with the resurgence in the Covid Delta variant – both domestically and internationally – which saw restrictions dialled back up and a negative impact upon economic activity.

Domestic reporting season proved reasonable. It was notable that many of the sectors and companies hit hardest by Covid disruptions were able to deliver well-received updates. A key element in this was the strength of 2Q CY2021, which was largely unencumbered by Covid restrictions and where activity and demand were both strong. This speak to the strength of underlying demand once restrictions are rolled back.

Outlook

At this point the market is focused on the fear of stagflation – rising prices coupled with falling growth.

There are several factors driving this concern. These include persistent supply chain bottlenecks, the potential impact on export volumes from Chinese power shortages, and a more hawkish tone on inflation from Fed Chair Powell.

OPEC's decision not to add any additional supply to the oil market beyond already-planned increases, despite evidence demand is re-accelerating as the delta wave fades, has added fuel to this fire.

This is seeing a rotation away from growth stocks – as a result of higher bond yields - towards re-opening plays and companies which offer some protection against inflation.

The inflation debate remains a live one. At this point, it is being driven by cost pressures in input prices and by shortages. The question is whether this will fade as supply chains are restored and high prices dampen demand, resolving the issue.

In this respect, the fund manager notes that some key issues affecting the Chinese part of the equation – particularly power outages – are largely within Beijing's control.

The risk is that expectations of inflation translate into materially higher wages. This in turn can drive more demand, pushing up prices and evolving into the wage-price spiral which is usually resolved by central bank tightening.

This is a key issue to watch and the impact on US labour supply from unemployment insurance payments rolling off will be important.

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

*Closed to all investors

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