Pendal Australian Equity

Quarterly Investment Option Update

31 December 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	98.2
Cash	0	1.8

Sector Allocation	%
Cash & Short Term	1.80
Consumer Discretionary	8.14
Consumer Staple	3.85
Energy	6.49
Financials x Prop Trusts	25.42
Health Care	9.68
Industrials	5.62
Information Technology	5.58
Materials	21.27
Real Estate Investment Trusts	3.28
Communication Services	8.96
Utilities	0.00
Futures	-0.09

Top Holdings	%
CSL Limited	8.49
BHP Billiton Limited	8.45
Commonwealth Bank of Australia Ltd	6.02
Telstra Corporation Limited	5.92
Westpac Banking Corporation	5.02
Xero Limited	4.46
ANZ Banking Group Limited	4.12
Santos Limited	4.07
Qantas Airways Limited	3.54
James Hardie Industries Plc	3.50

Investment Option Commentary

The Fund performed broadly in line with the Index over the December quarter.

Key contributors Underweight Afterpay (APT, -31.6%)
Buy-now-pay-later (BNPL) company APT fell alongside its soon-to-be parent, Block Inc (formerly Square) which is listed in the US. Concerns over the degree to which real rates will need to rise in order to contain inflation are weighing on the more speculative and highly-valued parts of the technology sector. At the same time the market is wary about increased regulation of the BNPL sector in the US.

Overweight Metcash (MTS, +13.2%)
Wholesaler MTS delivered a well-received half yearly result, which saw 8% upgrades to consensus earnings expectations for the full year. The IGA business held earnings flat, which was a good result given the high base effect. Meanwhile hardware and liquor continue to deliver solid growth. The latter two divisions now constitute the majority of earnings. Key detractors

Overweight Santos (SYO, -12.0%)
Santos gave back some gains after a strong run, as concerns over the impact of Omicron on global demand weighed on the oil price. Operationally, STO delivered record quarterly sales and free cash flow in Q3 CY2021. Management noted they are on track to deliver US$1.3bn in free cash flow for the full year. The manager continues to see material valuation upside in STO after a period in which the oil price and performance of Australian energy stocks has disconnected.

Overweight Qantas (QAN, -11.6%)
The uncertainty around Omicron's effect on travel weighed on QAN, which gave back some of the gains it had made in a rebound from mid-year. There was some speculation earlier in the quarter around a possible capital raise. However management subsequently announced the sale of a property asset for $800m, with the proceeds used to pay down some of the debt accumulated during the Covid period.

Market Commentary

Australian equities staged a decent finish to 2021 despite concerns over a renewed surge in Covid cases and a more hawkish turn from Fed in response to inflationary pressures. It was helped by a US earnings season which suggested strong underlying demand.

The S&P/ASX 300 rose 2.2% in the quarter, to deliver 17.5% for the full year.

The market is focused on two key issues; the latest surge in Covid cases and the outlook for inflation and interest rates.

At this point the emphasis seems to be on data suggesting that omicron, while more virulent that previous strains, has a more benign health outcome. As a result the surge in new cases has not weighed on market sentiment. There is still risk around this issue, given that its transmissibility could still result in economic disruption and pressure on health care systems even if it is less severe than other variants.

On rates, the Fed took a more hawkish turn in December, flagging that QE would cease by the end of March 2023, potentially opening the door to rate hikes. It has also walked back from the notion of current inflation as being "transitory." This has raised the possibility of higher real interest rates, which saw growth sectors underperform.

There was a reasonable degree of dispersion among sectors. Energy (-7.5%) was the weakest sector. This was driven by a sharp drop in the price of Brent crude oil in November, largely on concerns over the potential impact of Omicron on global growth and demand.

Technology (-4.6%) was the worst performed, as the potential for higher real rates dragged on growth stocks. Afterpay (APT), the largest stock in the sector, was down -31.6% for the quarter on the combination of the headwind from rates as well as signs of regulatory pressure on the buy now pay later sector in the US.

Materials (+12.7%) was also strong as the iron ore miners bounced back after a soft period on signs that Beijing is easing policy pressure on the property sector. BHP (BHP) gained 10.3% and Fortescue Metals (FMG) 28.4%.

Utilities rose 11.4% with broad-based support.

Outlook

Covid and inflation have been the two big issues to watch all year. Both have taken significant turns in recent weeks, leaving the outlook for next year as uncertain as ever.

This does not mean that the outlook is necessarily negative. Rather, the potential paths the market head down next year look very different.

On Covid, the globe could be in the early phases of the largest wave. This could put substantial strain on healthcare systems, prompting renewed restrictions which could drag on the economy and escalate supply chain problems. Alternatively the world may discover that the effects of the vaccines, anti-virals and potentially lower severity of Omicron means the virus becomes more benign, to be handled without restrictions.

On inflation and rates, the market could see economic strength and a tight labour market sustain inflationary pressures. This could prompt both the Fed and markets to realise that higher real rates are needed, prompting a sell-off in equities and growth stocks in particular. Alternatively, the market may see inflationary pressures ease as supply chains resolve themselves, people reenter the labour force and structural factors such as tech and debt re-assert. In this scenario growth and earnings are good and the manager see bonds and equities rally with growth resuming leadership.

Now is not the time to be making a high conviction binary call on either of these issues. Pendal expects for a far better understanding of the covid issue in coming weeks, while the rates issue will take much of next year to play out.

The portfolios are low on thematic risk at this point. Instead Pendal is looking for features such as good cash flow, strong stock specific stories and good franchise strength. The manager is maintaining a modest tilt to re-opening plays given the poor sentiment currently, but are mindful of the near term path given the potential for more negative short term news flow.

Overall Pendal believes the market environment is still reasonably constructive. Growth is strong, companies have pricing power, rates remain very low and sentiment is not over-confident.

In the near term the Covid case spike could hold market back. The early read on omicron would suggest any further sell-off would be an opportunity for bombed-out cyclicals.

The medium term issue is that the market may be underestimating the policy response required to contain inflation. In this environment a focus on higher-returning, good quality franchise positions is an important part of the portfolio.

Availability

Product name	APIR
SignatureSuper*	AMP2190AU
SignatureSuper Allocated Pension*	AMP7415AU
SignatureSuper Term Pension*	AMP7415AU
Flexible Lifetime Investment (Series 1)**	AMP0835AU
Flexible Lifetime Investment (Series 2)**	AMP1405AU

* Closed to new investors
** Closed to new and existing investors

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