Alphinity INVESTMENT MANAGEMENT

Monthly comment – April 2015
Alphinity Wholesale Australian Share Fund

April Showers

Market comment

April brought significant and quite disruptive "weather events" across the east coast of Australia, but also looks to have staved-off for now the onset of the drought-inducing El Nino effect. Residents of Sydney had to endure three times April's average rainfall, including a small cyclone and a damaging hail storm. Brisbane was little better with the highest April rainfall in 20 years.

The Australian share market was also somewhat soggy, giving back a little of the first quarter's strong gains in April. It fell by 1.6% (S&P/ASX300 including dividends) in the month, after conflicting economic news out of the US at the very end of the month wiped away the modest gains it had eked out to that point. Financials, Health Care and IT companies in particular struggled, while there was a recovery in resource-related stocks – particularly energy stocks – after a long period of poor performance. High-yielding sectors did poorly in April after US bonds sold off somewhat, closely followed by bonds in Australia and many other parts of the world.

Australia's small loss was better than the returns in $A from some major offshore markets: a surprising 5% rise in the $A meant investing in the US and Germany would have returned -3% in the month. The various Chinese markets did much better with increases between 9% and 14% in April, no doubt assisted by stimulus being applied by the Chinese government in order to address weakness in its economy. Chinese shares listed on the Shanghai market have now more than doubled in the past year, and their Hong Kong compatriots are not far behind.

Commodity prices recovered a little of their recent falls in April, assisted by the Chinese economic stimulus mentioned above, which consisted of lowering bank reserve requirements in order to encourage lending.

Iron Ore rose by 9%, base metals bounced sharply with nickel and zinc both up about 14%, and copper and aluminium were up 5% and 8%. The price of crude oil rose by more than 20% in April.

Portfolio comment

The portfolio underperformed the overall market slightly in April. Copper miner Oz Minerals, gas pipeline company APA and TV broadcaster Nine Entertainment were the biggest winners in the month, however not owning energy exposures Oil Search and Santos detracted from returns.

Market outlook

Interest rates are likely to remain at the forefront of equity investors' minds over coming months. While economic data in the US have been weaker than many expected in the first quarter of the year, there are signs suggesting that, as has been the case in the last few years, its Q1 will prove to be only a temporary setback in the moderate economic expansion which will, later this year, cause the US Federal Reserve to start raising interest rates. As discussed last month, there is a reasonable degree of uncertainty around how the US economy and the equity market will react to higher cash rates.

Performance*	1 month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	Since inception^ % p.a.
Fund return (net)	-2.2	4.7	8.6	10.2	16.1	11.9
S&P/ASX 300 Accumulation Index	-1.6	5.1	10.2	10.2	14.2	10.6

*Returns are calculated after fees have been deducted, assuming reinvestment of distributions. No allowance is made for tax. Past performance is not a reliable indicator of future performance.
^The Fund changed investment manager and investment methodology on 12 July 2010, at which time Alphinity Investment Management commenced managing the Funds and started the transitioning of the portfolios to a structure consistent with Alphinity's investment views. The transition was completed on 31 August 2010. Therefore, the inception date for the returns for the Funds is 1 September 2010. For performance relating to previous periods, please contact the Fidante Partners Investor Services team on 13 51 53 (during Sydney business hours).

Alphinity INVESTMENT MANAGEMENT

Monthly comment – April 2015

Alphinity Wholesale Australian Share Fund

Longer-dated bond yields have risen meaningfully across the globe over the last few weeks. This is perhaps a little counterintuitive given the timing of higher US short-term rates may have been pushed out by the weak economic start to the year. However, the equity markets' reaction so far both in the US and here in Australia highlights the extent of nervousness about higher interest rates, for the equity market in general and the yield-sensitive sectors in particular.

Of course, our own Reserve Bank's recent rate cut is welcome news that should support the economy and the equity market. The rebound in commodity prices has also been positive for the Resource sectors over the last month. However, we remain cautious around the sustainability of this rally given that the oversupply of iron ore in particular looks set to increase even further over the next 12 months.

Trying to predict short term market movements is fraught with danger and, as equity investors, trying to predict bond yields probably even more so. Nonetheless, it is in our view difficult to see bond yields rising too sharply. After all, Europe and Japan are still in the midst of massive money printing exercises and rising bond yields are typically associated with positive corporate earnings revisions – something we are seeing few signs of at this point. With the current degree of uncertainty equity markets are likely to remain volatile in coming months, but we would be surprised to see a more significant correction take place.

Portfolio outlook

Conflicting macro signals are currently dominating portfolio returns, with higher-risk equities and commodities outperforming despite economic data and global earnings revisions continuing to point to slowing, not accelerating, economic growth. A recent research trip to China has strengthened our belief in the Fund's underweight to the Metals & Mining sector. This position has been a solid contributor to relative returns over the last 12 months, but quite volatile more recently.

Our underweight in the Energy sector and our exposure to higher quality Oil & Gas companies with strong balance sheets also detracted from performance last month, as oil prices continued to rebound. We are not changing our sector positioning as the price rally looks overdone relative to global oil inventories which continue to build. However, we do note that the demand/supply imbalance in energy markets is potentially easier to address than the oversupply of iron ore, for example.

Lower oil prices have a greater propensity to stimulate demand compared with iron ore, the demand for which is more susceptible to waning steel requirements in China. On the supply side, the cost curve for oil has increased in recent years, as most of the supply growth has been from high-cost US shale fields: the lower oil price is leading to production cutbacks from high cost producers such as these. The cost curve for iron ore, in contrast, has instead shifted down as most of the capacity expansions have been in the low-cost regions of WA and Brazil, further supported by weaker currencies.

The Fund retains its bias towards quality companies with higher profitability and lower balance sheet risk. This bias, together with our focus on companies that can achieve earnings growth ahead of market expectations, has delivered outperformance in most market conditions. We expect this to continue to be the case in future periods, especially considering the slowing economic backdrop that typically favours quality over risk.

Asset allocation	As at 30 April 2015 %	Range %
Securities	98.5	90-100
Cash	1.5	0-10

Top 5 active overweight positions as at 30 April 2015	Index weight %	Active weight %
Macquarie Group Ltd	1.7	2.0
Goodman Group	0.7	2.0
Aristocrat Leisure Limited	0.3	1.8
APA Group	0.7	1.7
AMP Limited	1.3	1.5

Fund details	
Manager inception date	1 September 2010
Fund inception date	31 October 1994
Fund size ($A)	126.8M
APIR code	PAM0001AU

Fees	
2013/14 ICR	0.90%
Management fee	0.90% p.a. of the net asset value of the Fund
Performance fee	Nil
Buy/sell spread	+0.20%/-0.20%

![Alphinity Investment Management]

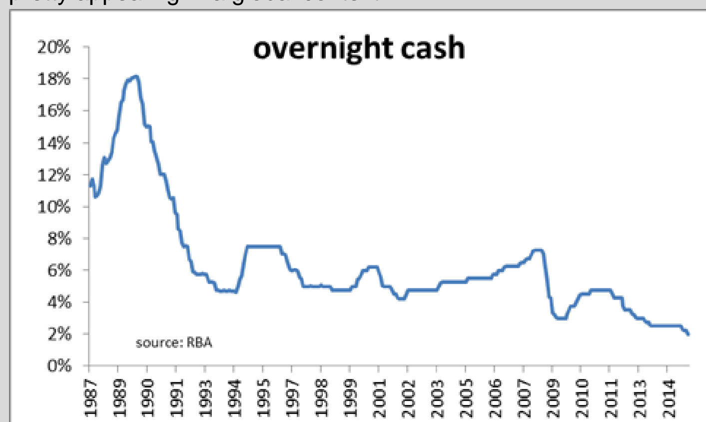
Monthly comment – April 2015
Alphinity Wholesale Australian Share Fund

BTW

We do not provide personal financial advice in this publication, as Alphinity is not a financial advisor, but we do try to point out important developments in market when they occur and one of those is interest rates. As short term interest rates in Australian have dropped further from what we thought were already ultra-low levels, falling income has been producing a degree of anxiety in those with capital, particularly retirees.

As short term interest rates in Australian have dropped further from what we thought were already ultra-low levels, falling income has been producing a degree of anxiety in those with capital, particularly retirees.

Some historical perspective: it seems like a long time ago now but the last recession in 1991, "the recession we had to have" according to the then Treasurer, was triggered by the extremely high interest rates put in place by the Reserve Bank in an attempt to control double-digit inflation. The cost of overnight inter-bank borrowing reached 18% in the late 1980s, and funding costs for companies and individuals often exceeded 20%. Those high rates eventually killed inflation when the recession hit, at a huge cost to employment, but this allowed rates to fall below 5% in 1993. It then oscillated mostly between 5% and 7% for the next 15 years until the GFC compelled still lower rates in an attempt to stave off catastrophe, reaching 3% in 2009. Although at that point rates were very low compared to Australia's history, they still looked pretty appealing in a global context.



The $A rose to unhelpful levels and the RBA has had to resort to a historically-low (but still fairly high globally) 2% at the beginning of May.

Cash is in one sense a "riskless" instrument, in that unless the body to whom you are lending goes bust you'll always get your initial capital back, at least in nominal terms.However inflation eats away at the purchasing power of that capital, so the greater risk you run is diminishing value.

The micro outcome of lower rates is that someone who has (say) $1m to invest might have earned $47,500 in 2011 but will get only $20,000 today – a severe loss of income. This has forced many to look "up the risk curve" at assets which provide better yields, albeit with more capital volatility and a degree of capital risk. We've been banging on for months about how appealing the yield is from equities even at the current market level – about double that of cash even before franking – but as always an average is made up of highs and lows. Some shares pay no dividend at all, others have quite high dividends. Maybe a good strategy might be to invest all your money in high-dividend paying companies: what could possibly go wrong?

A lot as it turns out. We do occasionally see listings of high yielding stocks in the newspapers but the problem is that these are either backward looking or someone's guess about the future (sorry, forecast). If you're buying shares today do you really care what a company paid last year? Not at all – you want to know what it will pay this year and following. If it is the same or higher, great. There are however a multitude of reasons why a company's dividend might be lower. Did it pay a one-off special dividend last year? Is its earnings under pressure which may mean it will need to cut its dividend, or even forego a dividend completely? Or is there some other reason? And it is very important not to lose sight of the capital value – there's not much point getting a nice dividend if the asset you own falls in value by more.

The message is: don't go blindly buying shares for the dividend yield alone. Dividends and their associated franking form an important component of the total return from shares, but it is important to make an assessment of how sustainable the dividend is for each individual company and retain some diversification. Not to mention make a careful assessment of the risk of capital deterioration, or preferably the scope for capital growth. That's what Alphinity is doing day after day, on your behalf.

Monthly comment – April 2015
Alphinity Wholesale Australian Share Fund

Traveller's Tale

During his latest escapade in China, Stephane met with some property developers at the site that will contain Beijing's tallest tower.

Some builders were having a smoko (literally) in front of a poster which laid-out a vision of how the city would look in the future. Most of the buildings depicted are yet to be built, and some have quite amazing designs.

When asked how long it would take to realise this vision, the developer swiftly responded: "18-24 months"! This is a pace we are not too familiar with in Australia.

Putting this in context however is the recent record achieved in Changsha in the south east of China. A 57-storey skyscraper was recently built by a company called Broad Sustainable Building in just 19 working days. This 80,000m^2 fully energy- and CO_2-efficient building has 19 atriums (atria?), 800 apartments and office space for 4000 people. Apparently the air inside the building will be "100 times cleaner" than the air outside! It used factory-produced modules which were made over several months and then assembled Lego-like in the 19 days, and required 15,000 fewer concrete trucks on site than a traditional build. It also released much less dust into the air, an important advantage in pollution-ridden China.

You can see a time-lapse video of the construction at https://www.youtube.com/watch?v=ryFNLxksO7U.

Reassuringly, the company said "the structure is safe and can withstand earthquakes". The same company is now working on another project in Changsha, which will be the world's tallest building at 220 floors. They estimate it will take three months.

Alphinity Investment Management

Level 12, 179 Elizabeth Street
Sydney NSW 2000
T 02 9994 7200
F 02 994 6692
W www.alphinity.com.au

Unless otherwise specified, any information contained in this publication is current as at the date of this report and is provided by Fidante Partners Limited (ABN 94 002 835 592, AFSL 234668) the issuer of the Alphinity Australian Share Fund (ARSN 092 999 301) and the Alphinity Concentrated Australian Share Fund (ARSN 089 715 659) (Fund). References to Alphinity Wholesale Australian Share Fund and the Alphinity Wholesale Concentrated Australian Share Fund are to the wholesale class unit in the relevant fund and references to the Alphinity Australian Share Fund and the Alphinity Concentrated Australian Share Fund are to the retail class unit in the relevant fund. Alphinity Investment Management Limited (ABN 12 140 833 709, AFSL 356895) is the investment manager of the Fund. It should be regarded as general information only rather than advice. It has been prepared without taking account of any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs. Each person should obtain the relevant Product Disclosure Statement (PDS) relating to the Fund and consider that PDS before making any decision about the Fund. A copy of the PDS can be obtained from your financial adviser, our Investor Services team on 13 51 53, or on our website www.fidante.com.au. If you acquire or hold the product, we and/or a Fidante Partners related company will receive fees and other benefits which are generally disclosed in the PDS or other disclosure document for the product. Neither Fidante Partners nor a Fidante Partners related company and our respective employees receive any specific remuneration for any advice provided to you. However, financial advisers (including some Fidante Partners related companies) may receive fees or commissions if they provide advice to you or arrange for you to invest in the Fund. Alphinity Investment Management, some or all Fidante Partners related companies and directors of those companies may benefit from fees, commissions and other benefits received by another group company.