Monthly comment – November 2012

Alphinity Wholesale Australian Share Fund

Approaching the cliff

Market comment

The US presidential election came and went without too many surprises: the incumbent was re-elected, as usually happens. Leadership change took place in China but without as much soul-searching, hoopla or angst. Of more concern is the increasingly imminent 'Fiscal Cliff': the US has a legislated federal debt ceiling of $16.4 trillion (that's $US16,400,000,000,000) which, at current spending levels, will be reached in the next few months. This will roughly coincide with a series of automatic tax increases and spending cuts that will take place at year end unless legislation is passed, which would put at risk the economic recovery presently under way in the USA. We expect that, as has happened in the past, a series of last minute negotiations will enable the USA to 'kick the can' down the road a little bit further, yet again delaying dealing with the underlying issues of spending too much and/or taxing too little. If a compromise is not reached before the deadline, there is a couple of months leeway before serious damage is done to the real economy, but the markets are unlikely to be very forgiving.

The Australian share market spent most of the month below October's close but rallied into month-end, finishing fractionally higher for the month: the ASX300 was up 0.6% including dividends. The best performing sectors were health care and consumer discretionary, while energy lagged a little, however the disparities were less extreme that we've become accustomed to recently.

The US share market initially reacted quite negatively to Obama's 'four more years' but had made it up by the end of the month: the S&P500 rose by 0.5% over the month. Major international markets were generally slightly stronger: UK up 1.5%, Germany 2%, France 3.7%. Japan's share market was very strong, rising 5.8% as the Yen slumped after its government called a snap election, raising some hope that the policies contributing to that country's long-term economic malaise might be addressed. Greater China was mixed however: Hong Kong up 1.8% but Shanghai fell –4.3%.

Portfolio comment

The portfolio performed well in November, although its out-performance came from a broad spread of small positions. The best contributors were casino operator Crown and logistics property company Goodman Group. Global insurer QBE was hurt by the aftermath of bad weather in North America in October, but its impact on the portfolio was minimal.

Fund details

Alphinity Wholesale Australian Share Fund	
APIR code	PAM0001AU
FUM ($A million)	113.7
Asset allocation	Australian equity: 98.3%, Cash: 1.7%

Fund performance* – as at 30 November 2012

	1 month (%)	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	Since inception (% p.a.)
Alphinity Wholesale Australian Share Fund	0.9	6.1	17.8	5.1	6.9
S&P/ASX 300 Accumulation Index	0.4	5.6	14.2	3.5	5.6

* **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 for previous periods please contact Fidante's Investor Services team on 13 51 53 (during Sydney business hours).

Top 5 active overweight positions as at 30 November 2012

Alphinity Wholesale Australian Share Fund

Issuer name	Index weight	Active weight
Lend Lease Group	0.4%	2.2%
Insurance Australia Group	0.9%	2.0%
Woodside Petroleum Ltd	1.9%	1.8%
Rio Tinto Limited	2.3%	1.8%
Westpac Banking Corporation	7.1%	1.7%

Market outlook

While gains were modest in November, it is interesting to note that the Australian share market has now delivered six consecutive monthly gains. As discussed in previous market outlook comments, these gains have arguably been driven more by the lack of attractive alternatives as bond yields and cash deposit rates continue to compress than an improved corporate earnings outlook. Indeed, overall market earnings expectations continue to be under downward pressure. These dynamics appear to have the potential to continue, especially as the Reserve Bank of Australia has now noticeably shifted from wanting the non-mining sectors to grow below trend (to keep the overall economy from overheating due to the mining boom) to now recognising that, with the end of the mining capex cycle in sight, other parts of the economy will need to recover in order to pick up the slack. Valuations of some parts of the market are becoming stretched, and there are still few signs of the consumer responding to the interest rates cuts that have taken place over the past year. However, the lack of attractive alternatives leads us to believe that this time the equity market may be more patient in its yearning for higher earnings than it has over the last few years.

Portfolio outlook

Over the last few months, we have been selling out of some of the more expensive defensive and/or high yielding stocks in the portfolio, such as Transurban Group and (more recently) Sydney Airport. We have also reduced our bank positions to the point we are now modestly underweight. However this has been primarily on valuation grounds, and we believe it would be premature to call an end to the global search for yield. Interest rates are likely to remain very low for some time, so we are maintaining the portfolio's exposure to companies that, in our view, offer better value and but still have the ability to steadily grow their dividends over the coming years. Companies such as Telstra, Duet Group and some of the REITs such as GPT and Goodman Group fit this description.

In the resource sector, we have reduced the portfolio's underweight to the benchmark primarily by adding to its holding in BHP Billiton. We expect strong balance sheets and diversified commodities exposure to be key differentiating factors of resource company performance in a more finely balanced demand/supply environment going forward.

While companies with unique earnings drivers remain at the core of the portfolio (for example Lend Lease, IAG, Goodman Group and Crown), we have also been looking for companies already showing signs of improved operational performance which may benefit from the lower domestic interest rate environment. We have added modest positions in Myer and CSR on this basis. Whilst we have avoided investing in traditional retailers for some time, Myer's combination of inexpensive valuation and very low market expectations of future earnings growth points to the potential for it to be in the early stages of an upgrade cycle which, we have found, is usually an indicator of good performance to come.

Traveller's tales

Bruce went to Japan and China in November looking at sheds. Big sheds. Really big sheds actually. Goodman Group has contributed nicely to Alphinity's funds performance during 2012, and the company organised a day in both Tokyo and Shanghai to show investors what it does – develop and own modern warehouses – and allow them to get some idea of the remaining potential in those regions. In addition, he spent a day in each city with Goodman's major competitor in the region – Global Logistics Properties (GLP) – and met with a smaller unlisted competitor in order to test what everyone was saying.

Land is scarce and valuable in Japan, and multi-level warehouses have become commonplace: four or five stories with spiral ramps to get the trucks up. The quality of construction needs to be extremely high to withstand not just the weight of the goods and trucks, but also include extra features to withstand the regular seismic activity. Despite an economy which has been stagnant for some years, the issues of obsolescence and increasing two-way trade means there is significant demand for modern logistics facilities there.

The differences just across the sea in China were stark. Chinese contruction tends to be, as is often portrayed, a bit 'rough and ready' and much of the existing space is therefore not usable for modern logistics: installing nine-metre high pallet racking on an undulating concrete floor is a recipe for disaster. Goodman, GLP and others are in the process of building millions of square metres of modern space in order to fulfil demand, which is largely being driven by online shopping both in China and offshore.

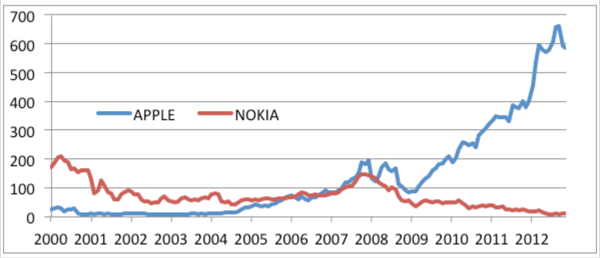
There is increasingly emerging a value distinction between 'warehousing' (i.e. a shed in which to store stuff) and 'logistics' (a building to facilitate the rapid movement of goods) and Goodman is well positioned to benefit from this. The remaining opportunity is so large that there is plenty of room for a number of players to do very well.

One GLP warehouse in Shanghai was occupied by a Chinese online apparel company: in keeping with the funky online image, the workers zoomed about the large expanse of smooth concrete floor on rollerblades!

BTW

We recently wrote about the phenomenon that is Apple. When its market capitalisation recently peaked at $US664 billion it was – for a while – the largest company in the world. Since September, a little of the shine has come off Apple shares despite some very successful product launches in the interim (including iPhone 5, iPad mini and a new line of iPods), and Apple's market cap has sunk to 'only' $551 billion, a fall of $113 billion. It is interesting to note that only a decade ago, Finnish company Nokia was the global market leader in the mobile phones. At its peak, which coincided with the crescendo of the tech bubble in 2000, Nokia traded at $US56 a share giving it a total value exceeding $US200 billion. Nokia is now trading at not much more than $US3 a share, giving it a $US12 billion total value. Apple didn't even make mobile phones five years ago, but now dwarfs the previous market leader. This gives an idea of how fickle success can be in the world of technology: in the past two months Apple has lost almost ten Nokias.

Market Capitalisation ($USbillion)



As an aside, have you ever thought 'I'd give my right arm for a new iWhatever'? Well, a teenager in China went further, probably too far. According to the Sydney Morning Herald (quoting Chinese news agency Xinhua), an 18-year-old named Wang Shangkun sold one of his kidneys in April last year for ¥22,000 (about $A3,350), and used the proceeds to buy an iPad and an iPhone. That's commitment to the brand! It didn't turn out very well for the teenager: he suffered renal failure, and this month seven people involved in the deal, including the surgeon (but no Apple execs we're sure), were sentenced to jail.

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