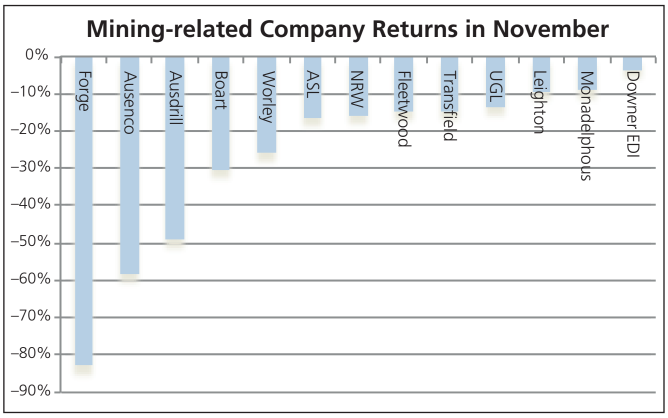
Monthly comment – November 2013
Alphinity Wholesale Australian Share Fund

Incredibly Propitious Opportunities

Market comment

The S&P/ASX 300 Accumulation Index (including dividends) fell by a little over 1% in November, breaking its recent strong run. Most global equity markets did a bit better but largely due to the $A which fell sharply during the month. More frequent and stronger statements by the Reserve Bank Governor regarding over-valuation helped send the $A down by four cents, which added about 5% (in $A) to the otherwise modest positive returns of most of the major global share markets. Chinese stocks bounced back from prior months poor performance to record 7-10% gains, and Japanese stocks were up 9% in both Yen and $A. Geopolitics came into play during the month with Iran receiving temporary approval for a 'peaceful' nuclear program and Japan and China squabbling over the ownership of some uninhabited islands in the East China Sea that may or may not be sitting on top of a bunch of oil and gas. The markets however seem fairly unconcerned at this point.

The Australian market overall may have been fairly flat in November but there were some very meaningful movements among individual shares. The Annual General Meeting season was essentially wrapped up during the month and the accompanying trading statements created excitement in some quarters. A number of stocks hit air pockets for various reasons but thankfully none were in the Fund. Stocks serving the mining sector performed particularly poorly, with some share prices falling by ~50% and one by more than 80%. Thankfully the Fund has been underweight mining services and its single exposure, Downer EDI which also makes things like roads and trains rather than just mining services, was the best performer of the sector at –3%.



Our lives have been quite busy looking at the many new companies about to hit the screens. After a few years during which you could count the number of IPOs (Initial Public Offerings) on one hand, why all of a sudden, have new companies been coming at us with unseemly haste? It probably has something to do with the fact that the market is up a lot, and some business owners feel it is a good time to sell. If we were cynical, we might say that the IPO process often appears to be a mechanism for enriching vendors, investment bankers and management teams, while possibly giving new investors access to the last few percent of any remaining upside. We spent a lot of time trying to sort the wheat from the chaff: only time will tell how well

Fund details

Alphinity Wholesale Australian Share Fund	
APIR code	PAM0001AU
FUM ($A million)	124.8
Asset allocation	Australian equity: 98.3%, Cash: 1.7%

Fund performance* – as at 30 November 2013

	1 month (%)	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	3 years (% p.a.)	Since inception (% p.a.)
Alphinity Wholesale Australian Share Fund	–0.7	6.3	27.8	22.7	12.2	13.0
S&P/ASX 300 Accumulation Index	–1.4	4.7	22.7	18.4	9.5	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 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 2013
Alphinity Wholesale Australian Share Fund

Issuer name	Index weight	Active weight
Insurance Australia Group Limited	0.9%	1.8%
Goodman Group	0.6%	1.6%
Woodside Petroleum Limited	1.8%	1.4%
Australia and New Zealand Banking Group Limited	6.6%	1.4%
JB Hi-Fi Limited	0.1%	1.2%

we've succeeded but, to paraphrase John West, sometimes it's the stocks it rejects that makes Alphinity able to consistently outperform. One thing that may turn out to be true for some of the new issues is, It's Probably Overpriced!

Portfolio comment

The portfolio outperformed appreciably in November, with good contributions from global investment bank Macquarie Group and building materials company James Hardie. The underweight position in gold producer Newcrest Mining again added value. There were no individually meaningful detractors.

Market outlook

Following a stellar run since mid-2012, the Australian equity market appears to have paused in order to determine the earnings outlook for corporate Australia and the impact on global markets of renewed tapering talk, especially in light of recent positive US macro data. Over the last year the market has re-rated back to around historical average valuation metrics. So, while not outright expensive, after such a strong year some consolidation seems logical. The tapering talk has, just like earlier this year, resulted in further weakening of the $A. If sustained, this will be positive for Australian company earnings. However in the short term, somewhat ironically, foreign investors fearful of further currency weakness are likely to take profits thus putting pressure on the local bourse. Another complication is the impact that the anticipation of monetary tapering in the USA appears to be having on Australian government bonds. The Australian ten-year bond yield has jumped from a low of just over 3% in May to almost 4.5%: an even larger rise than for US Government bonds.

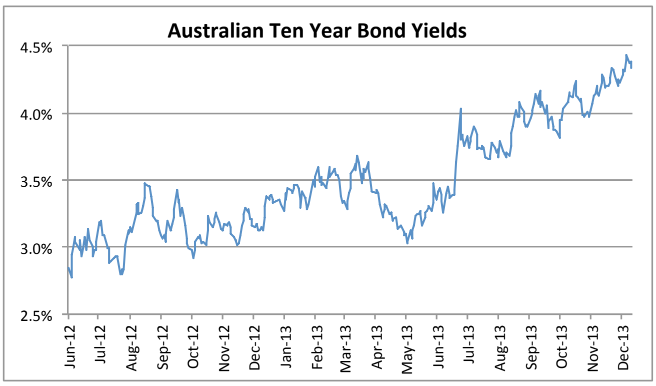
The rise in bond yields reduces the relative appeal of yield-sensitive stocks such as Banks and Utilities. If maintained, it will eventually also make funding more expensive with potential negative flow-on effects on economic growth. This comes at a precarious time for the Australian economy as the transition from resource-led growth to housing construction and other parts of the economy looks to be gaining some traction.

In summary, although we expect there to be increased market volatility in coming months, after what has essentially been a steady climb since May, the earnings growth outlook continues to look supportive and low double-digit total returns from the equity market looks plausible in 2014.

Portfolio outlook

As we commented last month, delivering or exceeding the market's earnings expectation is an important driver of shareprice performance. This is true at most times but is especially so in the currently market environment: a period of strong equity market performance despite relatively modest macro-economic momentum.

The recently concluded AGM season has given us additional confidence that the portfolio is well positioned with a solid combination of attractive valuations, low earnings risk and good balance sheet quality. Recent portfolio activity has been focused on locking in some of the profits in companies that have had particularly strong shareprice rallies. As such we have trimmed somewhat our holdings in equity market leveraged companies Henderson Group and Macquarie Group. Proceeds have been invested across several sectors and companies including BHP Billiton, Amcor, Telstra and ANZ Bank.



BTW

With the carbon tax presently under attack in parliament, we thought it might be interesting to put Australia's emissions into perspective. There are many resources of variable quality online, but one which has good provenance is **www.globalcarbonatlas.org/?q=emissions**, which is backed by the CSIRO and many other international scientific organisations. It has a very cool interactive map and 50 years of data showing the emissions of more than 200 countries. A few interesting facts emerge:

- In 1960, global emissions of CO_2 was estimated to be 9103 million tonnes; in 2012 it was 33423mt
- In 2011, China alone emitted 9093mt – as much as the whole world did 50 years ago
- In 2012, China emitted 9627mt – an increase of 534mt over the prior year
- In 2012, the world's total CO_2 emissions increased by 748mt, so China represented more than 70% of the increase. Since 1990, there has only been four years in which China's share of the world's increase in carbon emissions has been lower than 40% (1996, 1997, 1999 and 2000). In 1993, 1994 and 2009 China was well over 100% (i.e. world emissions fell but China still increased)
- In 2012, Australia's entire yearly CO_2 emissions was 371mt, substantially less than the increase in China's. Australia emitted less than 4% of China's total carbon dioxide, well below the relative peak of 1967 when we emitted 30% of China
- In 1960, China's emissions represented 8.6% of the world's total while the USA's was 31.2%
- In 2012, China's emissions represented 28.8% of the world's total while the USA's was 15.3%
- Measured on the basis of carbon intensity (i.e. CO_2 emissions per unit of GDP), China generated 2.1kg, five times that of Australia and the USA (both 0.4kg)
- Australia is famous for its high per-capita CO_2 emissions: at 16 tonnes per person per annum we are up there with carbon-rich USA and Canada although well below a bunch of oil-producing nations. Qatar takes the 'prize' at 44 tonnes per person. Australia's per-capita emissions peaked at 18.5 tonnes in 1998.

What sense do we make of all this? One might conclude that anything we do will make little difference to the global carbon emissions situation. Could Australia have stopped emitting CO_2 entirely in 2012, China's increase would have exceeded our savings by mid-September. The USA, despite refusing to ratify Kyoto in the 1990s and being notoriously slow about addressing emissions at a federal level, has actually reduced its CO_2 emissions back to the level it reached in 1994. Part of this has been through using better technology in its power stations although there's also nothing like a good recession to get emissions down. We'll see what happens when the more robust US economy shows up in the figures, but the gas boom going on there at present suggests these savings may be enduring. China, on the other hand, has been in the process of dragging its vast population out of poverty. We can't begrudge its people aspiring to a lifestyle closer to that which we Westerners enjoy – we're just not sure that the world can cope with the environmental impact of achieving it.

Notwithstanding its likely limited impact, the moral case remains for Australia to take some sort of action. Could it be Direct Action? It's too early to tell, but the government's proposed scrapping of the existing carbon tax seems to be a retrograde step. China exports everything you can think of to the rest of the world, and in any case much of the carbon it is consuming comes from Australia and the US. China has also been quite active in building power sources which don't use (or use less) fossil fuel, but it is difficult to envisage enough wind, solar or hydro projects to achieve the level of industrial production required to appreciably raise living standards.

There are no easy answers but it is clear that any solution needs to be of a global nature, which is notoriously difficult to achieve, and that any action taken by an individual country as small in the scheme of things as Australia – while creditable – must be put into global context.

Traveller's Tales

While the Alphinity team tries to be as cost-conscious as it can when traveling (and we can confirm that it is a long way to New York in economy!), there are times when we just have to sample the best a foreign city has to offer. Such was the case when Andrew found himself visiting companies in the Chicago suburbs in November. When a well-fed company representative suggested they hold the meeting at a nearby restaurant which he reckoned was the number one-rated eatery in Chicago, how could he refuse? (He looked it up subsequently: it is actually Number 3 but close enough when ranked out of 8000 options). Considering it was 3pm and Andrew had just finished another 'small' American lunch he was concerned at his capacity to eat again, but surely the number 1 (or 3)-rated restaurant in Chicago shouldn't be passed up. Besides, 'there isn't much of a line today' although this may have to do with the fact that it was 0° Celsius outside!

While only a short wait, the restaurant was packed with hot dog-loving Americans. 'Hot Dougs', as it turns out, is a Chicago institution with every kind of hot dog you can imagine, including Szechuan duck, The Elvis, and The Bo

Derek ('mighty mighty hot!'). It is a great business model. Cheap rent in the suburbs, low input costs, hot dogs with cool names and strange toppings selling at high margins and close at 4pm: people queue around the block even in the harsh Chicago winters to eat there. And local dedication to the 'Sausage Superstore' is extreme: Andrew spied one rather substantial woman shuffle in on her walking frame to get a hot dog: on her arm was a large Hot Doug's tattoo. Apparently if you have the tattoo you get to eat for free. Luckily you don't have to include the Hot Doug motto, 'There are no two finer words in the English language than 'Encased Meats' my friend'.

Alphinity Investment Management

Level 15, 255 Pitt Street
Sydney NSW 2000
T 02 9994 7200
F 02 9994 6692
W www.alphinity.com.au

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