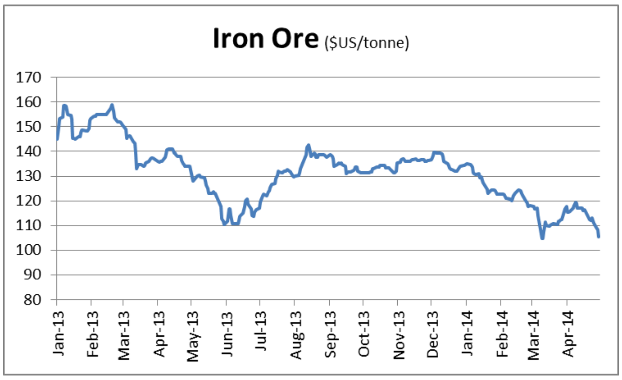
Monthly comment – April 2014
Alphinity Wholesale Concentrated Australian Share Fund

Pre-budget blues

Market comment

April went with a blur, the profusion of public holidays seeming to hurry things along. Global markets struggled a bit during the month but the plucky S&P/ASX300 (including dividends) ended up generating a positive return of almost 2%, at the upper end of global returns. The only standout positive markets in $A were Argentina (+7%) and Ukraine (+8%). Interestingly Russia's MICEX index was down a further 6% in April: Russia seems to have the upper hand in terms of territory acquisition but the markets suggest Ukraine is the winner. Resource-heavy markets generally did better: both Canada and Brazil were up about 3%.

Resource prices remained reasonably firm, with the exception of iron ore which fell by close to 10% in April after some disappointing Chinese economic releases. Gold ticked higher (by less than 1%) as did base metals: the LME base metals index rose about 2% although much of that was because of Nickel which was up by more than 15% in the month due to the ban on nickel ore exports from Indonesia starting to bite. Russia is also a major nickel producer and US sanctions on Russian companies may further impact supply.



Source: Bloomberg

Aluminium, copper and tin were largely unchanged while zinc and lead were a little higher. Oil prices were generally higher with Brent (UK) and TAPIS (the grade most relevant to Australian petrol prices) both up about 2%, but Texas light crude fell by about 2%.

The Australian economy continues to amble along, with inflation well under control. There is no pressure on short term interest rates and bond yields have continued their recent downward trend. The Abbot government's first federal budget will be unveiled in May – with all the speculation in the lead-up that it will involve significant fiscal tightening there will be little upward pressure on rates for some time. The $A fell about 1% against the Euro and Yen over the course of April but was essentially unchanged against most currencies.

There is an aphorism in the markets: "Sell in May and Go Away". Global equity markets in each of the last four Mays (in 2010, 2011, 2012 and 2013) were derailed: the first three largely because of debt and subsequent austerity issues in Greece, then the Cyprus crisis last year. It will be interesting to see if that part of the world will cause ructions yet again: it seems calmer this year but maybe the issues have just moved north. Only time will tell.

Portfolio comment

The portfolio outperformed the market nicely in April. Major bank ANZ was the biggest contributor to performance, as well as not owning either major bank NAB or global insurer QBE. Global fund manager Henderson was a small detractor.

Performance*	1 month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	Since inception^ % p.a.
Fund return (net)	2.5	8.1	11.7	20.2	11.5	13.3
S&P/ASX 200 Accumulation Index	1.8	7.1	10.5	16.9	9.3	11.0

*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 2014

Alphinity Wholesale Concentrated Australian Share Fund

Market outlook

With less than two months remaining of the current financial year it looks increasingly safe to conclude that this year will finally deliver overall corporate earnings growth at least in line with long term average of 7-8%. Following a substantial re-rating of the Australian share market over the last 18 months or so this is clearly good news, as earnings growth is ultimately what drives share market returns. Overall earnings expectations have held fairly steady in recent months however the composition has changed slightly.

Resources earnings, which delivered the greatest positive revisions in the February reporting season, have more recently come under renewed pressure due primarily to the fall in the iron ore price. Bank earnings on the hand have continued to strengthen as credit losses keep trending lower and overall cost control remains strong.

Investors are now increasingly turning their attention to FY15 and, as always, there are some positive and negative factors. While too early to be definitive, the Australian dollar has been more far more resilient than most observers had predicted and, if today's level around 92-93 cents to the US dollar holds over the next few months, this will dampen corporate earnings relative to current expectations. Consumer sentiment has deteriorated in the lead up to the Federal budget and, while we are yet to find out what will actually be in the budget, it is likely to be contractionary rather than expansionary.

On the positive side, the US economy appears to be rebounding after an unusually harsh winter and the Australian economy should benefit from a meaningful pick up in construction activity as the strong growth in building approvals evident over the last 12 months, with its usual lag, translates into housing starts. Current earnings growth expectations for FY15 are around 7%. This looks like a reasonable starting point but is in fact lower than what is typically the case at this time of the year. With valuations still around long term averages we believe the domestic equity market outlook remains positive.

Portfolio outlook

We remain optimistic about the Australian share market over the next 12-18 months, as discussed above, however as sentiment and even some growth drivers have come into question more recently we thought it might be useful to discuss market risks in our portfolios.

At Alphinity we always focus on identifying individual stock drivers rather than relying on broader macro thematics, and this helps us to avoid many pitfalls. The broader macro picture will always be one of the inputs into any company analysis and with the recent A$ strength confounding most investors, and the uncertainty around the federal budget also likely to at least temporarily impact consumer sentiment, balancing the short term against medium-term macro factors has become a bit more challenging.

It is likely that upward revisions to $A forecasts in the market over the next few months may impact some of the portfolio's holdings. However, we believe the portfolio should prove resilient as the companies therein are also seeing better underlying earnings momentum (Computershare, Aristocrat and James Hardie). Our domestically exposed Consumer Discretionary stocks (JB Hi-Fi, Flight Centre, Nine Entertainment), whilst not immune, are benefiting from internal growth drivers so should be able to withstand any slowdown in consumer spending that might follow the budget.

The outlook for the Resource sector has weakened over the last couple of months. The slowdown in Chinese growth, and importantly its resources intensity, is occurring at the same time as new supply is coming to the market. While this is to some extent already expected by the market, consensus expectations still look too high to us. We have been reducing our exposure to the sector, and to iron ore in particular, since late last year and our only overweights today are the well diversified BHP Billiton and Bluescope Steel, which is a net beneficiary of lower iron ore and coal prices. The portfolio stands to gain in relative terms should the slide in the iron ore price continue.

In the broader Materials sector our main exposure is instead to Building Materials through James Hardie and CSR, and while expectations have increased, we believe the fixed cost leverage and/or pricing power in both these businesses are not yet fully reflected in the market's earnings expectations.

Our equity market-leveraged stocks Henderson Group and Macquarie Group would suffer from a more sustained market selloff, but we think this is unlikely. Both companies are well diversified, geographically as well as by product, and are enjoying strong fund flows which should make them both less vulnerable than some to short term market volatility.

Finally, our more defensive stocks in the utility (APA, DUET Group) and REIT (Goodman Group, Westfield) sectors will have a stabilising impact on the portfolio.

In conclusion, we believe we have a good balance between short term and medium term growth drivers.

Alphinity INVESTMENT MANAGEMENT

Monthly comment – April 2014

Alphinity Wholesale Concentrated Australian Share Fund

BTW

Computer technologies have revolutionised most industries over the past half century but one that has been relatively immune has been construction: after all there is no substitute for manpower when carrying out that sort of work.

At least, not until now. 3D printing has so far largely been limited to producing single-use plastic firearms and tacky promotional products like business card holders, but the technology is quickly becoming more advanced.

For instance Boeing has said that some parts for its next generation aircraft will be printed in high-tech metal alloys, and has even speculated that one day entire wings could be made that way.

Then this month Chinese entrepreneur Ma Yihe, who has for some time been working on developing 3D printing techniques to build houses (see the video at http://xhne.ws/wbGsZ), managed to "print" ten small houses in a day.

Now, as you will see from the photo they were not particularly large or attractive houses. They were built from a mix of quick-drying cement and waste materials like recycled mine tailings. The 66m2 houses were very basic, but the important thing is that they were done so quickly, and with virtually no human involvement: the machine just sat there and churned them out, one after the other.

As labour presently constitutes a large proportion of the total cost of building, the potential to be able to replace it with a one-time capital item like a construction printer must have some global appeal, and particularly in China, which will before too long face worker shortages due to demographic shifts. Ma Yihe also sells it as being good for workers, who would no longer be exposed to breathing in dangerous dust or being injured from falling masonry. Of course they will no longer face being employed either.

While still in the very early stages, and we're sure he'd admit that much work still needs to be done on design and development, even these early prototypes could have potential for use in remote mining sites or as temporary relief in a disaster area.

Inevitably, this technology will be developed and refined, designs and techniques will become more sophisticated and, who knows, one day we may all be living in the high-rise printed apartments Ma Yihe believes he can produce!

Asset allocation	As at 30 April 2014 %	Range %
Securities	98.4	85-100
Cash	1.6	0-15

Top 5 active overweight positions	Index weight %	Active weight %
ANZ Banking Group	7.0	5.3
Westpac Banking Corporation	8.0	5.0
BHP Billiton	8.9	4.9
Telstra Corporation	4.8	3.2
Woodside Petroleum Limited	1.9	2.9

Fund details	
Manager inception date	1 September 2010
Fund inception date	1 November 2004
Fund size ($A)	$16.0m
APIR code	HOW0026AU
Fees	
2012/13 ICR	1.24%
Management fee	0.90% p.a.
Performance fee	15% of the Fund's daily return (after fees and expenses and after adding back any distributions paid) above the Performance Benchmark
Buy/sell spread	+0.30%/-0.30%

Alphinity Wholesale Concentrated Australian Share Fund

Traveller's Tale

Johan travelled to the US in April to visit a range of companies across five different states. He learnt much about the slow but steady improvement in the US economy, but also something about US gun laws, though came away more confused. In Chicago he came across many signs like this one:

When he asked why so many restaurants and shops had these signs at their entrance he was told it was because of a new gun law in the state of Illinois.

The law was conceived with the right intention - to reduce shootings - but as it turned out it actually enshrined the right by individuals to carry guns as long as the gun was concealed. Many venues don't think this made much sense: they didn't want any guns, displayed or concealed, on their premises.

Others have put up signs saying gun-carriers are welcome:

And the gun lobby has hit back, producing this rather passive-aggressive message to leave for the non-gun shop owner:

It's easy to speculate that an outright ban would be more effective than the signs, however initial signs are promising. Data shows that crime is down 25% in the first quarter of 2014 and that there were 90 fewer shootings despite the first licenses to carry concealed weapons being only issued in February. Go figure.