Monthly comment – November 2014
Alphinity Wholesale Concentrated Australian Share Fund

Vicissitudes

Market comment

November was a negative month for the local market, and the S&P/ASX300 (including dividends) fell by 3.2%, continuing the recent pattern of sharp monthly ups and downs: it has been oscillating in a fairly narrow range all year. Australia unfortunately lagged most major equity markets in November, especially once the softening $A is factored in. Much of the blame can be attributed to the struggling resource market as China's economy shifts away from being as resource-intensive as it once was. Base metals prices were generally lower, iron ore and coal prices kept falling, as did the oil price which flowed on to oil and gas stocks: all of these are considered negative for Australia.

The prize for the best stock market in November went to China which returned +14% in $A, and Germany wasn't far behind at +10%. In fact most of Europe was up mid-single digit percent, as was the US S&P500. Even Japan managed +4% despite its economy slipping back into recession.

Oil prices continued to tank, falling by a further 15% in November to finish at multi-year lows: we update the chart from last month's report just to show how bad it looks at present. There are a number of factors behind this fall, including the US becoming more self-sufficient, some new discoveries and a degree of excess production by traditional producers. However, should the oil price weakness be sustained the resulting decrease in fuel prices in most countries should be incrementally positive for economic growth in 2015.

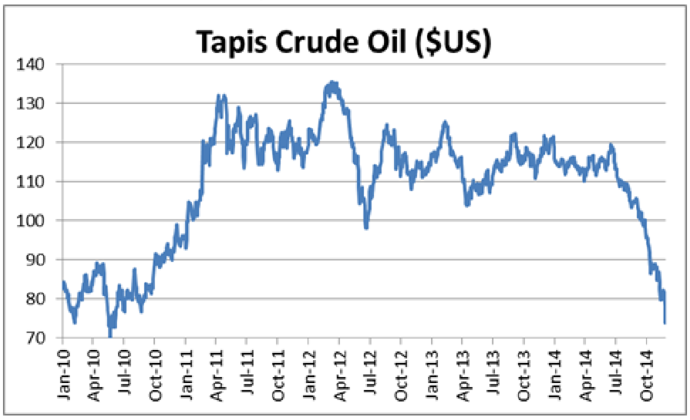
Portfolio comment

The portfolio performed very well against the market in November. Positives included gaming company Aristocrat Leisure and not owning gas producer Santos or supermarket retailer Woolworths, both of which underperformed appreciably. No positions detracted from the Fund's performance in a meaningful way.

Market outlook

November provided further evidence that the Australian equity market looks to be range-bound in the short term, with solid support from an attractive dividend yield (especially compared to traditional yield assets) offset by a difficult earnings outlook. The sharp decline in the oil price following OPEC's decision to not cut back on production but leave it to the higher cost producers in North America to balance the market, has curiously added another twist to both factors.

Lower oil prices will, if sustained, contribute to the already benign inflation outlook and the "lower for longer" interest rate argument. At the same time, earnings downgrades for oil producers and associated industry sectors will put additional pressure on an already uncertain FY15 earnings outlook. Of course a fall in the oil price, while bad for the oil and gas sector, should over the medium term provide welcome relief to input costs for many other industries and add meaningfully to the disposable income for consumers in Australia and elsewhere. Together with the continued slide in the A$ this should brighten the earnings outlook for corporate Australia in the second half of the financial year and potentially provide the backdrop for a sustained lift in equity returns.



Source: Bloomberg

Performance*	1 month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	Since inception^ % p.a.
Fund return (net)	-2.3	-3.9	4.2	15.2	16.3	11.0
S&P/ASX 200 Accumulation Index	-3.3	-4.4	4.3	13.4	13.8	9.3

*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).

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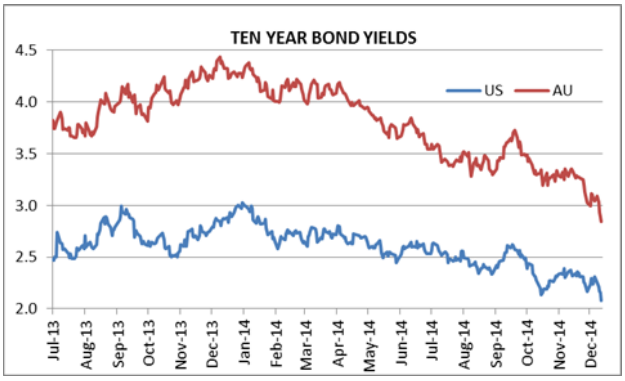
Market outlook (cont.)

While the rout in the oil price has been grabbing headlines recently, the strength of the US and Australian bond markets over the last 12 months has been even more remarkable. Despite the US economy having largely continued on its path of recovery, the yield on US 10 year bonds has been declining for most of the year. And even though that yield (just over 2%) is still well above the 1.6% low it reached before the 'taper tantrum' 18 months ago, this development has been a surprise to most. Australian 10 year bonds have a strong correlation with the US so, from a bond perspective, it's almost more important to understand what is going on in the US economy than here.

The lacklustre performance of the Australian economy and thus corporate earnings growth has arguably meant that bond yields, instead of being one of several factors influencing the equity market as is usually the case, have been by far the most influential factor in individual stock returns with yield stocks (infrastructure, utilities, property trusts and banks) being the definite winners. Few would argue that these stocks are cheap today so any continued outperformance hinges on US bond yields staying close to record lows and corporate earnings growth remaining subdued.



Source: Bloomberg

While it's always difficult to time the turn in longer term trends, higher interest rates in the US at some point over the next 12 months is looking increasingly likely to us. US unemployment, a key target for the US Federal Reserve, is now below 6%. Higher rates should be enough for some of the heat to go out of the yield stocks sometime in 2015, especially if lower oil prices and the fall in the A$ by then has started to make some positive impact on the Australian economy.

Portfolio outlook

At Alphinity, bottom up earnings drivers always take priority over top down macro factors in our stock selection. Having said that, macro factors such as those discussed above are important to consider and have played an unusually important role in determining stock winners over the year. While our portfolios have benefited greatly from the rally in "yield stocks" since the equity market started its most recent ascent three years ago, the outcome this year has been more neutral as we have gradually exited some of these stocks on valuation grounds.

Looking into 2015, retaining a neutral stance or even increasing the yield tilt in the short term appears prudent until either a stronger economic picture in Australia emerges or the timing of higher US interest rates becomes more certain. Even when considering top down factors in stock selection, we aim to identify stocks that also fit our criteria of positive earnings momentum. Stocks such as APA Group, Commonwealth Bank, Goodman Group and Telstra all fit both criteria. The overall portfolio characteristics remain favourable for further good performance in the new year.

Fees	
2013/14 ICR	1.23%
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	+0.20%/-0.20%

Fund details	
Manager inception date	1 September 2010
Fund inception date	1 November 2004
Fund size ($A)	13.4m
APIR code	HOW0026AU

Asset allocation	As at 30 November 2014 %	Range %
Securities	1.4	90-100
Cash	98.6	0-10

Top 5 active overweight positions as at 30 November 2014	Index weight %	Active weight %
Westpac Banking Corporation	7.7	5.2
CBA	9.9	4.8
Telstra Corporation Limited	5.4	3.9
Goodman Group	0.6	3.5
Aristocrat Leisure Limited	0.3	2.6

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BTW

Alphinity loves global gabfests as much as anyone and November seemed to be replete with them. Not only was there the APEC meeting in Beijing, which had its own specially designed venue, immediately after that Australia was honoured to host the meeting of G20 leaders in Brisbane. We were pleased for our Queensland cousins to be strutting the world stage, and especially glad that it wasn't happening in Sydney: the memory of APEC 2007 is seared into our minds.

The collection of world leaders assembled in one place however was very impressive, as was the way the organisation of the event was conducted, but one of the challenges the city faced was accommodating the leaders adequately. Much as we love Brisbane, we know from experience that the array of top class hotels in that city befitting plutocrats such as these is quite limited, so we were interested to see where everyone stayed. Thankfully one of the UK tabloids was able to help us out.

The Daily Mail compiled a list of where the major world leaders were staying along with the cost of the room involved. As one would expect, the "leader of the free world" US president Barack Obama had the most expensive room: the newly-refurbished Presidential Suite at the Marriott Hotel, 130m^2 of luxury on the top floor overlooking the Brisbane River for about $2500 a night. At least that's the rack rate: Mr Obama probably paid a bit over considering the US Secret Service took over and stripped the entire top floor, apparently removing all beds and mirrors on that floor to make sure there were no surveillance devices installed.

The next most expensive room was Chinese President Xi Jinping's $1700 suite at the Stamford Plaza – a good value option as at 250m^2 it was considerably larger than Obama's and included a heated terrace and a baby grand piano (although we were not informed whether President Xi made use of that feature).

UK Prime Minister David Cameron went for a more dignified option, a suite at the mahogany-panelled and heritage-listed Treasury Hotel, about $1250.

Most-watched man of the gathering Vlad Putin (pictured) rather surprisingly went with a king suite at the Hilton, a snip at just over $600 a night. He made some unexpectedly gracious comments about the G20 and its host before leaving a day early, supposedly "to catch up on some sleep": not a great advertisement for the quality of the Hilton's beds.


Photo: Associated Press

Given the budget black hole facing Australia we were pleased to see our PM Tony Abbott spend only $300 a night at Rydges, a locally-owned hotel chain; although we're pretty sure he could have bunked down at the Queensland Governor's house for free. But the prize for thrift surely goes to Japanese PM Shinzo Abe. He stayed at the mid-scale Novotel, which charges only $200 a night.

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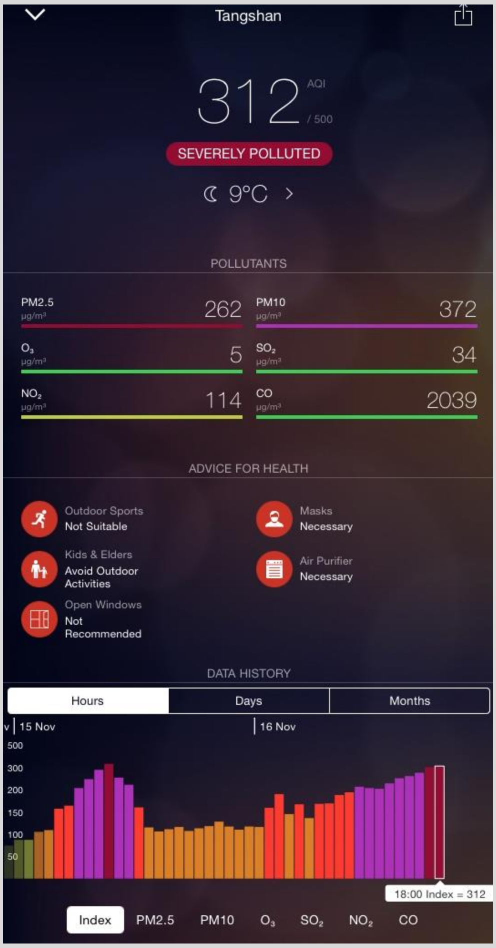
Traveller's Tale

Blue sky in Beijing typically augurs some cloudy days for Australian commodity producers. Stephane's latest trip to China in November not only painted a lukewarm picture on the demand outlook, it also provided a chilly perspective on how serious Beijing was about providing an unpolluted welcome to APEC leaders. While those leaders were enjoying nicely heated accommodation, less well-connected travellers such as humble fund managers had to face the cold fact that in order to cut pollution, electricity generation also had to be cut! This meant non-APEC hotels had minimal power even to warm the common areas like the lobby, let alone the rooms.

Stephane was amazed to witness the immediate return of the pollution, almost as soon as the APEC leaders had boarded their planes. He was at a major cement and steel production centre located in Tangshan, less than 200km from Beijing, on the last day of APEC and the furnaces started ramping up again that afternoon. By 8pm, when our traveller was starting to make his way back to Beijing on the fast train, the smell of the air had distinctly changed and particles were again visible. Within 48 hours the usual layer of smog was enveloping Beijing, and "APEC Blue" days were no more.

A few days later, Tangshan won the title as the most polluted city in China, and this screen-shot from a phone pollution app demonstrates just how bad it was.



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