Monthly Comment – July 2016
Alphinity Wholesale Australian Share Fund

Turn bullish

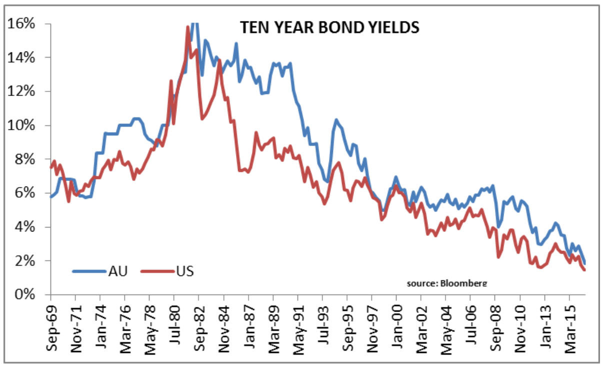
Market comment

Brexit was quickly forgotten in July, at least for the moment, and domestic attention turned to the election and the interminable wait to find out who had actually won. The polls were correct: the election result was on a knife's edge. The Turnbull government was eventually found to have been re-elected with the slimmest majority and with a different mix in the Senate than it would have hoped for, the previous "eclectic" collection of cross-bench Senators replaced by an even larger and more eclectic set. While this new situation is probably not great for sensible, decisive or quick action by our elected representatives, the equity markets here and overseas rampaged on.

The ASX300 (including dividends) was up 6.4% in July, which was better than every offshore market other than Brazil, which was up 7%. Every market we follow was higher in its local currency. When converted into $A, most European bourses were between 2% and 5% higher and the US about 2%. Asian markets were generally 1% to 4% higher, while Japan rose 5%. The UK bounced back a little from its Brexit-shocked levels at the end of June: the FTSE100 rose 1% while the broader and more domestically-focused FTSE250 was up 4%; both however are still well down over a year (-14% and -18% respectively) partly as a result of the very weak Pound. It has fallen by almost 17% since the start of June.

The Australian market was overwhelmingly strong: Consumer and Resource stocks were up about 8% overall and every sector apart from Energy was up at least 4%. Energy stocks marked time even though the Tapis crude oil price fell 18% in the month: oil now seems to be reflecting the excess supply position the world is facing. The prices of iron ore, coking coal and thermal coal rose by between 5 and 10%.

Australian ten year bonds finished the month at another historic low, 1.87%, and the spread to the US 10 year is the lowest for years. Low absolute rates are having a noticeable impact on the value of shares with high dividends – it tends to makes people a little more willing to step up the risk curve in order to obtain a bit of yield. This was exacerbated in early August when the Reserve Bank elected to cut the cash rate to its own new low of 1.5%.



The $A appreciated about 2% against the $US, Euro and Yuan and 1% against the Yen. Finishing the month at $US0.76, the dollar remains stubbornly high and must be frustrating policy-makers at the Reserve Bank.

Portfolio comment

The Fund performed a little better than the very strong market in July with only a few meaningful contributors or detractors. The biggest positive was the Fund's positions in gaming machine manufacturer Aristocrat Leisure and iron ore miner Fortescue Metals. The only notable detractor was Syrah Resources.

Performance*	1 month %	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	Since inception^ % p.a.
Fund return (net)	6.5	7.1	1.0	7.6	10.4	9.4
S&P/ASX 300 Accumulation Index	6.4	7.0	2.9	8.1	9.4	8.6

*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 Fund and started the transitioning of the portfolios to a structure consistent with Alphinity's investment views. The transition was completed on 31 August 2010. The inception date for the returns for the Fund 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

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Market outlook

The new financial year has started with a highly unusual combination of macro settings. On the one hand, there are some tentative signs of improved global growth being inferred by leading indicators such as PMI data and global earnings revisions. On the other hand, bond yields are close to record lows which would typically signal a worsening global growth outlook.

Our interpretation of these conflicting signals is that neither should be relied on too heavily. Economic data are yet to reflect the impact of Brexit to any meaningful extent, and the improved earnings revisions have to date been almost exclusively limited to the Resource and Energy sectors, and Energy earnings are already at risk from the latest slump in the oil price. Bond yields in the US and Australia, on the other hand, are being pulled down by the negative interest rate settings in Japan and Europe rather than deteriorating economic performance.

Equity investors' reactions so far this year has been broadly positive and it may be that a slightly improved earnings outlook combined with a lack of compelling alternative investment opportunities will support equity markets for the rest of the year. However, as we have pointed out so many times over the last few years, it wouldn't take much in the way of weaker economic data for investors to start worrying about economic growth again instead of cheering the lower-for-longer interest rates.

Fund details	
Manager inception date	1 September 2010
Fund inception date	31 October 1994
Fund size	$138.1M
APIR code	PAM0001AU

Asset allocation	31 July 2016 %	Range %
Securities	97.5	90-100
Cash	2.5	0-10

Top 5 active overweight positions as at 31 July 2016	Index weight %	Active weight %
Aristocrat Leisure	0.6	2.4
Goodman Group	0.8	2.4
Brambles	1.4	1.6
Sydney Airport	1.1	1.5
Adelaide Brighton Cement	0.2	1.5

Portfolio outlook

Domestic equity investors are currently debating the resurgence of the Resources sector. While the primary drivers - a weaker US$ and fiscal stimulus in China - are difficult to be too definitive about, a sector leadership change appears to have occurred for now. This has been made easier by the fact that the headwinds continue to build for the Australian bank sector in the form of increasing bad debts, low credit growth, increased funding costs and further capital requirements.

The Alphinity portfolio has steadily increased its exposure to the Resources sector over much of the past year, beginning with the addition of iron ore-exposed companies to the portfolio in October 2015, and starts the new financial year with an overweight position. We see further potential for earnings upgrades as analyst price expectations, for the first time in at least three years, lag current spot prices. We do however acknowledge that there are still structural issues in China, that currency moves are unpredictable and that there is additional supply coming to the market over the next 12 months so the position will require close monitoring.

The portfolio's overweight to the Resource sector is offset by a relatively neutral exposure to some of the yield-sensitive parts of the Australian market, with the exception of Banks and Telstra where a deteriorating earnings outlook makes us more cautious. Without a more broad-based economic recovery, which at this stage looks unlikely, we expect bond yields to remain low and "yield proxies" in the equity market to continue to look attractive to both local and global investors. This broader portfolio setting, in combination with some individual key holdings such as Fortescue Mining, Aristocrat and Brambles, has worked well in recent months and we look forward to reporting on our findings from the domestic reporting season in the next monthly.

Fees	
2014/15 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%

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BTW

It was a bit of a surprise that markets were as strong as they were in July: there were so many reasons not to be bullish. First of all our own election, the result not being as decisive – either way – as anyone would have wanted, after which Australia's prime credit rating came under threat of downgrade. Then there were a whole bunch of terrible things that happened overseas: terrorist attacks in France and Germany, social unrest in the USA with black people being killed by police and police being killed in retaliation; the fairly surreal US political conventions, and of course the attempted coup in Turkey.

"Turkey? Who cares about Turkey?" you might ask. Well, being at the intersection of Europe and Asia, sharing borders with exciting places like Syria, Iran and Iraq and hosting a significant US military presence, Turkey is quite a strategic part of the world. It has lots of friends, lots of enemies and quite a few frenemies as well. It has a population of 75 million and has been a thoroughfare for much of the recent wave of Middle Eastern refugees heading for Europe. It had just traversed a period of significant tension with Russia after it shot down a Russian fighter jet in November last year which had apparently strayed into Turkish airspace, which was only patched up in June.

Anyway, a bunch of soldiers over-ran the state-run TV station on July 15 and forced the newsreader to announce that the government had been overthrown and the military was now in charge. Or were they? Apparently not all the military was convinced and the coup-leaders backed down when it became evident that the public was also not behind them. Then came the rather comical sight of someone on TV holding an iPhone showing Erdogan reassuring his countrymen that all would be well. This is possibly the first time a coup has been foiled over Facetime.

Of course Turkey has had coups before. If you put "military coup Turkey" into Google it comes up with some options: do you mean 1960? 1980? 2016? 1997? 1971? Some say it was a protest by a section of the military against an increasing level of religious influence in laws and practices in what had been established as a secular state. People blamed for the coup included retired US General, J.F. Campbell, who denied any involvement. He even had an iron-clad alibi: he was having drinks with US shock-jock Geraldo Rivera in New York at the time: "*I absolutely vouch for General Campbell*," Rivera said. "*The only thing we were overthrowing were a series of Stella Artois [beers].*" [Reuters]

Erdogan was soon restored to power, but then the retribution began. According to the BBC around 60,000 people were swiftly either rounded up or suspended from their posts. 7500 soldiers, including more than 100 Generals and Admirals, have been detained. 1700 have since been dishonourably discharged, including 40% of the most senior officers. 8000 police have been removed from their posts, and 1000 of them detained. 3000 members of the judiciary, including 1500 judges, have been suspended. 15,000 education ministry officials have lost their jobs. 21,000 school teachers have had their licences revoked. More than 1500 university deans have been asked to resign. 1500 finance ministry staff have been removed. 492 clerics, preachers and religious teachers have been fired. 393 social policy ministry staff have been dismissed. 257 prime minister's office staff have been removed. 100 intelligence officials have been suspended. These are amazing numbers of people, you do wonder if they all could have been part of a grand conspiracy, and where all those who have been detained are being kept! And what an amazing range of occupations: why were educators targeted? Finance ministry staff? And who is now doing the work of these people?

It all feels a little bit like this might have been a great excuse to clean out a bunch of people who may not have been completely on board with Erdogan's strategic direction. He has since proposed changing the constitution to ensure that the national intelligence agency and the army's most senior officer report directly to him, which would seem to cement his power irreversibly. The world will be watching with interest the direction in which this increasingly powerful president takes this important country.

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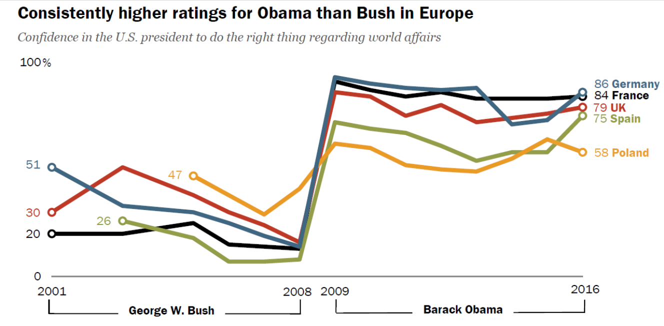
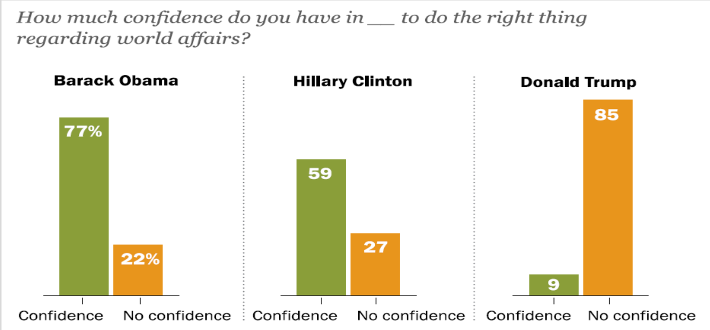
Alphinity Wholesale Australian Share Fund

BTW2

It is a curious thing that retiring President Barack Obama has always been more popular outside the USA than within it. Notwithstanding the fact that he was re-elected in 2012, there remains a solid minority within the US that regards Obama with deep suspicion. Outside the US however he is greatly admired, especially compared with the low benchmark set by his predecessor as the chart below shows, courtesy of the Pew Research Center (pewresearch.org).



Pew, a Washington DC-based "non-partisan fact-tank", has for years surveyed about a thousand people randomly selected in each of ten European countries, Australia, Japan, China, India, Canada and the US itself, about attitudes towards the USA. As the US election draws inexorably closer, the world is looking on with amazement and a degree of trepidation at the prospect of a much-bankrupted reality TV star as the next president. The other chart sums up the European countries' view: fine with Obama, a little unsure about Hillary – but positively panicky about Trump!



What do Australians think of the USA? Mixed: 68% said Americans were Optimistic, 68% also said Hardworking, but only 40% said they were Tolerant (Americans rated themselves a bit higher at 74%, 80% and 65% respectively). On the negative side, 69% of Australians thought Americans were Arrogant, 58% said Greedy and 68% said Violent. The US self-assessment was again slightly better: 55%, 57% and 42%.

It may not appear like it but we still quite like America: 60% of Australians have a favourable view of the US, with only 34% unfavourable. This was fairly constant across nations although there were some outliers: in Greece 58% said unfavourable: what did the US do to Greece? It must be a long-held grudge as Greeks have felt that negative for several years. China was the next most negative at 44%, although interestingly the young in China have a far more favourable view of the US than their elders: 60% of 18-34 year olds look fondly at Americans as against only 35% of those over 50. This may provide some hope for the future as the two nations increasingly butt heads over the South China Sea.

Alphinity Investment Management

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