Quarterly comment – June 2013

Alphinity Wholesale Concentrated Australian Share Fund

Downhill run

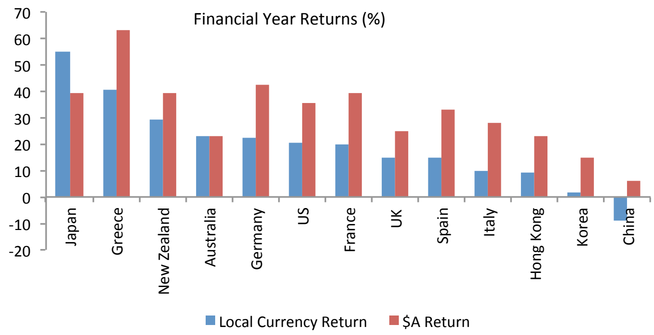
Market comment

Share markets remained volatile on the downhill run in to the end of the financial year. The S&P/ASX300 (including dividends) fell by 2.5% in June but felt somewhat worse than that at times during the month. Part of the blame for the volatility can be attributed to that nerdy bunch called bond fund managers: bond yields rose sharply in Australia, US, UK and other places. Rising bond yields causes capital losses for investors and the 1% rise in ten year bonds – as has happened in Australia since mid-May – equates to about a 10% capital loss, roughly equivalent to the fall in the share market over the same period.

The $A fell sharply against the $US and more modestly against other currencies. Part of this was related to Australia's fundamentals (lower cash rates, soft commodity prices, China concerns, weakening economic activity), but part also to a strengthening US economy which drove the $US higher against the Euro, Pound and Yen.

Australian market movements over the June quarter were exciting to say the least: a very strong April was more than offset by a fairly depressing May and June. In aggregate, the market fell by 2.8% over the quarter and is now only up 5% for the calendar year to date. The Fund has outperformed the market to the extent that absolute gains are still reasonable: in the context of three year bonds yielding below 3%, an 8% return in six months is quite appealing and more than compensates for the volatility.

The financial year was pretty good for Australian equities in aggregate, notwithstanding the final two months. As the chart shows, the ASX300's 22.8% increase was towards the higher end of the local currency returns of many other markets. The falling $A boost foreign market returns – highlights included Spain (33%), the US (35%), Japan (39%), Germany (42%), but the best was the winner of last year's wooden spoon, Greece (63%!).



Fund details

Alphinity Wholesale Concentrated Australian Share Fund	
APIR code	HOW0026AU
FUM ($A million)	15.2
Asset allocation	Australian equity: 98.7%, Cash: 1.3%

Fund performance* – as at 30 June 2013

	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	Since inception (% p.a.)
Alphinity Wholesale Concentrated Australian Share Fund	–2.3	26.4	8.9	9.9
S&P/ASX 200 Accumulation Index	–2.5	22.8	7.0	7.9

***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 June 2013

Alphinity Wholesale Concentrated Australian Share Fund

Issuer name	Index weight	Active weight
ANZ Banking Group	7.6%	5.1%
Westpac Banking Corporation	6.7%	6.2%
Insurance Australia Limited	1.0%	3.6%
Goodman Group	1.0%	3.7%
Telstra Corporation Ltd	5.1%	2.5%

Portfolio comment

The portfolio lagged the market slightly in June with positives from major banks ANZ and Westpac, electronics retailer JB Hifi and not owning gold miner Newcrest offset by property developer Lend Lease, financial services company AMP, petrol producer Caltex and being underweight in major bank NAB.

The Fund outperformed over the entire June quarter, the best contribution to performance was from sleep device maker Resmed and global travel company Flight Centre and from not owning Newcrest; the biggest detractors were engineering group Downer, global resource company Rio Tinto and Lend Lease.

Market outlook

Recent macro data and market behaviour suggest that the increased level of volatility recently seen in equity markets will continue in coming months. However the key positive development that we highlighted in our market outlook commentary last month – the positive impact on aggregated market earnings from a weaker Australian dollar – has continued to build with key AUD/USD exchange rate falling a further 4.5% during the month of June. The decline was just over 12% for the entire June quarter. We believe this rapid change in demand for the $A is yet to be fully reflected in market earnings expectations.

The decline in the exchange rate has of course largely been driven by the potential (not actual) tapering of monetary stimulus by the US Federal Reserve which has caused bond yields to climb and other consequences of excess liquidity in global financial market to partly go in reverse. Nonetheless, with the market now back at around 13x 1-year forward earnings and a dividend yield of 5%, downside to the equity market appears limited and we expect that the support from the currency tailwind and the strengthening US economic outlook – which in the end is a prerequisite for the Fed to taper – will ultimately win out.

Portfolio outlook

Higher bond yields (although still low compared to historical levels) and the beginning of the end of quantitative easing (at least in the US) will, in our view, continue to favour companies able to deliver earnings growth – especially those that can deliver earnings growth above market expectations. As always, which companies are able to do so is an evolving narrative. Companies with unique earnings drivers should continue to do well, and we believe the Fund's portfolio is well exposed to such companies, including insurer IAG, industrial property developer Goodman Group, casino operator Crown, travel operator Flight Centre, electronics retailer JB Hi-Fi and online advertiser Carsales.com.

The weaker A$ is, as discussed above, also looking increasingly as if it will be an important earnings driver for some companies. While making investment decisions on a currency view alone is risky, due to the inherently unpredictable nature of FX movements, we have increasingly been positioning the portfolio towards companies that are executing well operationally, but have the currency as an additional tailwind. We have maintained our longstanding exposures to a number of $A beneficiaries including healthcare companies CSL and ResMed, and have added to fund manager Henderson Group. We have also in recent months added steel manufacturer Bluescope Steel and oil & gas producer OilSearch to the portfolio and increased our position in global insurer QBE. These are all companies that have good potential but will also benefit from the weak A$ should it be sustained or fall even further. Our key sectoral underweight remains consumer staples, in which many of the companies have expensive valuations, low earnings growth and ongoing earnings downgrades.

The overall portfolio is trading at a slight discount to the market's earnings multiple but with stronger earnings momentum, higher profitability (return on equity) and lower gearing: these are all characteristics that we believe should continue to perform well even in the current climate.

BTW

The Organisation for Economic Cooperation and Development (OECD) conducts an annual survey of the quality of life in the 36 most advanced economies on 11 categories such as income, jobs, health, environment and so on. Its very funky interactive website www.oecdbetterlifeindex.org could occupy you for hours, providing a wealth of information and even allowing you to construct your own country ranking by weighting the categories according to their importance to you.

The 2012 report for Australia concludes that things here are still pretty good. Our overall quality of life is the highest in the survey, ranking a fraction ahead of Sweden, Norway, Canada and Switzerland. It is consistent high rankings across most criteria rather than any particular attribute that takes Australia to the top. Turkey was worst, and that was before the social unrest that flared up this year had taken place. When it comes to overall satisfaction, 84% of Australians say they have more positive experiences in a day than negative.

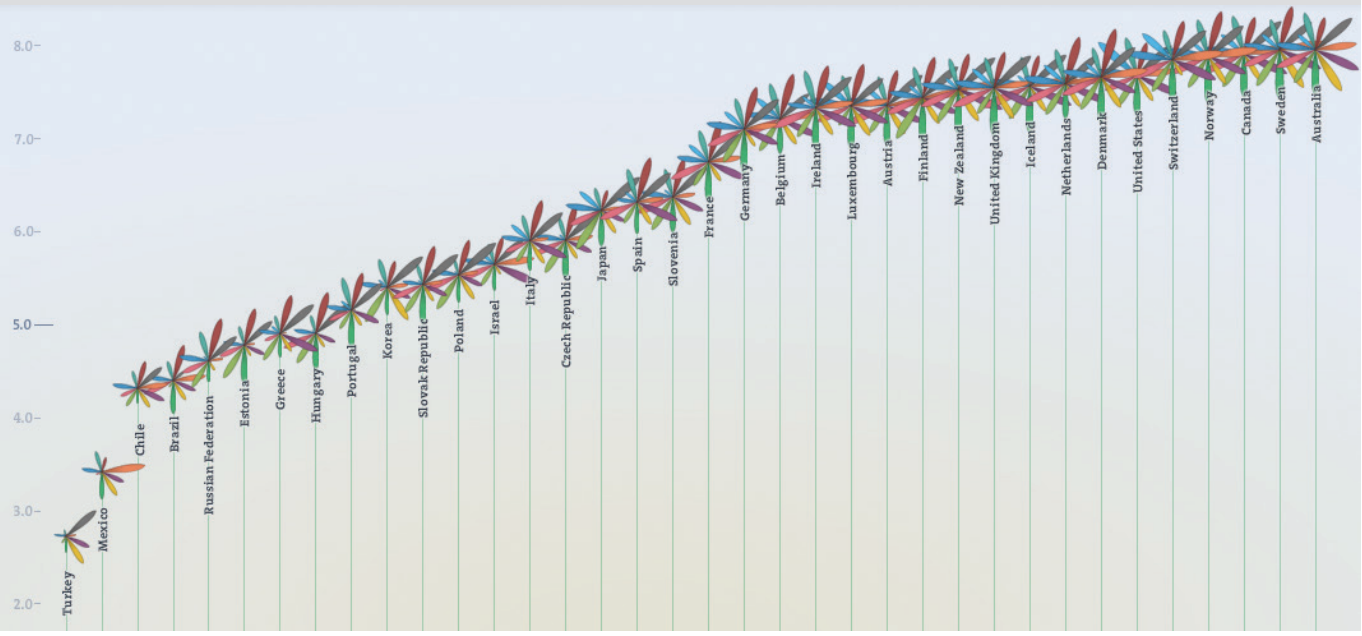
Civic engagement (ie peoples' involvement with democracy) seems to be our greatest strength, the only one where we come first among the nations – although maybe compulsory voting has something to do with this. 71% of people say they trust the country's political institutions – it will be interesting to see if the recent machinations in Canberra make any impact on the next report.

One of the better-rating categories is housing where we come fourth, behind (but essentially equal to) Ireland, Canada and the USA. Maybe that's because our dwellings average 2.3 rooms per person, the second-highest in the group and much more comfortable than the last-placed Russian Federation which has 0.9 rooms. We spend 19% of our disposable income on housing, which is surprisingly slightly below the cohort average of 21%. But 90% of Australian are apparently happy with their housing situation, above the OECD average of 87%.

Women, it seems, are more content than men in most places: the only countries where men's satisfaction is higher are Greece, Italy, Slovenia and Switzerland, although to be fair most of those differences are marginal. Women however are meaningfully happier than men in most places.

Work-life balance is Australia's weakest category relative to other countries: we rank 25th in the amount of time devoted to leisure (14.4 hours per day – this includes sleep time – half an hour less than average) while our working hours come out slightly below average (1693 per year: OECD average is 1776). While women and men are roughly equal in leisure time, men fared markedly worse in hours worked. 14% of employees work more than 50 hours a week – 21% of men and 6% of women – which is way over the OECD average of 9%. We're not sure this is a stat to be proud of.

Despite the negativity that seems to be so pervasive in Australia, it is sometimes helpful to be reminded just how good it is to be living here. All we need now is to work a little less and enjoy our lives a bit more to cement our position at the top. Don't worry, be happy!



Source: OECD

Traveller's tales

Bruce visited Europe in June to see a bunch of media, retail and property companies and, while there, attended a conference of global consumer companies in Paris. Arriving at Gare du Nord with a host of people off the very impressive Eurostar train from London, he ended up in a lengthy taxi queue. While waiting, he was approached by a bloke with a motor bike helmet offering an alternative. 'Moto Taxi?' he asked? Despite politely refusing, he insisted 'Moto Taxi?' Bruce pointed to his suitcase, large enough to take clothing for a two-week trip in varying climates, expecting this would be a deal-breaker. With a Gallic shrug he said, en Anglais, 'No problem, I can take that. It is an hour to wait for a car'.

As it turned out, the wait was less than half that and in any case Bruce's risk tolerance, not to mention travel insurance, didn't extend to weaving through lunchtime Paris traffic on a motorbike, grasping a Frenchman, with a suitcase balanced on the back. The driver of the Citroen van he eventually entered had about the same level of English as Bruce's French but they set off regardless.

His GPS would not accept the hotel address, for some reason, so after aimlessly driving around the streets of Paris in the general direction of the hotel, Bruce eventually convinced the driver to let him out and – assisted by the excellent mapping function on his iPad – covered the remaining few hundred metres on foot.

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