Quarterly comment – September 2013

Alphinity Wholesale Concentrated Australian Share Fund

The good old days

Market comment

It is hard to believe that the totemic event of the Global Financial Crisis – the collapse of US investment bank Lehman Brothers – occurred five years ago this month. It seems like only yesterday, and so much has happened since then. The US grappled with its problems quite early and came up with several versions of a solution that seems to have worked thus far in returning its economy to economic growth: Quantitative Easing. Europe followed the US into economic chaos, it circumstance complicated by the political – but not financial – confederation of Europe, until it came up with its own solution which now seems to be having some impact: Quantitative Easing. Japan had suffered its own brand of economic lethargy over the course of the 1990s and 2000s but last year came up with yet another idea for economic recovery which so far seems to be working: Quantitative Easing. The UK eased aggressively and now appears to be on the improve. Even Switzerland got into the QE act in 2011, to stem the rise of its currency against the Euro: clearly the business we should have been investing in is currency printing machines!

Just about the only serious economy that hasn't resorted to QE is Australia, although the Reserve Bank of Australia (RBA) must have been tempted when the $A hit $US1.10 last year. The dollar has corrected a bit since then but remains stubbornly above $US0.90, up about 4% this month but fairly flat for the quarter. Against the Euro and Pound, however, the $A has softened a bit – clearly it has been a $US issue.

The Australian share market (S&P/ASX 300 Accumulation Index including dividends) was up 2.2% for the month and more than 10% for the quarter: a good start to the financial year and in fact the best quarterly move since the bounce out of the initial GFC panic in 2009. The ASX300 finished the month at the highest level in five years, and once dividends are included, the highest point ever.

Our market was one of the better performers globally in the quarter just finished, although we were pipped by the poorer Euro economies bouncing back. Greece and Spain were both up about 20% in $A, Italy +16%, and Germany, China and the UK all up about 10%. The US and Japan were up 'only' 4-5% during the quarter in $A terms.

After all the worries in recent months QE Tapering ended up not happening, at least in September. It has only been delayed, maybe to the end of the year, but the market rallied all the same. This shouldn't surprise anyone: remember the Fiscal Cliff? The Sequester? They were also supposed to bring chaos to the markets but no one

Fund details

Alphinity Wholesale Concentrated Australian Share Fund	
APIR code	HOW0026AU
FUM ($A million)	15.9
Asset allocation	Australian equity: 97.6%, Cash: 2.4%

Fund performance* – as at 30 September 2013

	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	3 years (% p.a.)	Since inception (% p.a.)
Alphinity Wholesale Concentrated Australian Share Fund	11.1	29.2	23.7	11.3	12.8
S&P/ASX 200 Accumulation Index	10.2	24.3	19.5	9.3	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 September 2013

Alphinity Wholesale Concentrated Australian Share Fund

Issuer name	Index weight	Active weight
Westpac Banking Corporation	8.0%	5.3%
BHP Billiton Limited	9.0%	4.6%
Australia And New Zealand Banking Group Ltd	6.6%	4.5%
Telstra Corporation Limited	4.8%	3.2%
Insurance Australia Group Limited	1.0%	2.9%

seems too fussed about them anymore. The next two immediate economic concerns in the US are the stalemate over passing its federal budget, which threatens shutting-down government services, and then its federal debt which will hit the mandated $16.7 trillion ceiling some time in October (that puts our own $300 billion ceiling into a little perspective). If the past is any guide, the market will probably do all its worrying beforehand then absorb the events themselves with aplomb.

Portfolio comment

The portfolio outperformed even the strong market over both the month and quarter. In September the best contributors were global fund manager Henderson Group and electronics retailer JB Hi Fi as well as being underweight major bank Commonwealth and global health company CSL. The only detractor of size was being underweight NAB. Over the quarter Henderson also featured on the positive side, along with casino operator Crown Resorts, retailer JB Hi Fi, global travel company Flight Centre, and being underweight CSL and major bank CBA. Property companies Goodman Group, GPT and Westfield detracted over the quarter, along with the NAB underweight.

Market outlook

Last month we discussed the August reporting season and concluded that prospects for earnings growth of 6-8%, or in-line with historical averages, looked reasonable. Low interest rates supporting stronger housing construction activity, a positive translation effect from a weaker A$ on Australian overseas earnings, and stronger global growth were some of the foundations for this cautious optimism. The upcoming annual general meeting (AGM) season, when companies will have a few months of trading behind them, as well as three of the major banks reporting full year results should give us a good indication of how listed corporate Australia is tracking.

Since the August reporting season the A$ has rebounded a little but is still trading well below last year's average. Signs of a rebound in the housing market have strengthened and this, together with the longest election campaign in history now being behind us, appears to be having a positive impact on both business and consumer confidence. On the global front, leading indicators such as Purchasing Manager Indices have strengthened in several regions (US, Europe and China).

While there will always be some positive and negative surprises in AGM commentaries from individual companies, we expect that management comments will on the whole be supportive of our 6-8% EPS growth outlook. The current political standoff in the US has the potential to throw us all back into economic turmoil but it is difficult, especially after all the recent last-minute compromises, to believe that politicians on either side will want to leave a government shut-down and credit default as their legacy. With markets close to record highs, however, the situation nonetheless serves as a timely reminder that while QE has brought some much-needed stability and growth back into economies in the US and elsewhere, large structural issues such as excessive Government debt remain and will take many years to deal with. Historically low interest rates and subdued economic growth rates are likely to persist as these issues are addressed.

Portfolio outlook

The portfolio remains well diversified and exposed to companies that are exhibiting on average better earnings revisions than the market, which is typically a good indicator of future positive earnings surprises. Having trimmed some of our 'yield' stocks during the year and added to stocks whose ability to deliver earnings ahead of expectations are a bit more reliant on the broader economic outlook, we have resisted taking this thematic too far given the still slow pace of economic recovery and attractive dividend yields on offer.

An example of this gradual shift is our switch in the REIT sector away from GPT towards Mirvac. GPT has been a strong performer since our initial investment in September 2010. Its management's focus on selling non-core assets at above market expectations and more in line with book values and repairing the balance sheet has been a successful strategy which has seen the gap between the shareprice and the underlying value of its asset close. In a period in which the overall market struggled to deliver any earnings growth, GPT's earnings per share growth (EPS) of 5-7% has also been attractive. With the bulk of the non-core asset sales behind it and facing a more subdued office and retail market, EPS growth is now slowing to 3-4%. The stock is trading on 13.8x forward earnings (adjusted to a June year-end) with a dividend yield of 5.6%. Mirvac also has some exposure to challenging office and retail conditions but also has good leverage to the improving residential property market, particularly in NSW and in multi-residential, two of the strongest market segments in the recovery to date and EPS growth in FY14 should be more than 10%. Mirvac is trading at 14.3x forward earnings a dividend yield of 5.1%: only a modest premium to GPT for a more attractive growth profile.

Traveller's tales

Stephane was back in China in September to visit users of the commodities Australia produces, but it wasn't all smooth sailing. 'All roads lead to Kito', is what it felt like when trying to meet with four ceramic tile makers in the Guangzhou region in Southern China.

After leaving the hotel bright and early at 7am to reach an 8.30 meeting, Stephane found himself still on the road at 9.30 with an increasingly loud and aggressive driver blaming his many wrong turns on the GPS. Having missed the first meeting he reached the second, with Guangdong Kito Ceramics (pictured, with nicely tiled walls), only half an hour late. Reassured, the guide asked the driver to carefully map the route for the next two stops while they were in the meeting. This instruction must have been lost in translation as when they left Kito for the next meeting – supposedly 30 minutes away – the same heated exchanges started emanating between the driver and the guide. 45 minutes later and after multiple turns into tiny lanes and despite constant assertions from the driver that they were about to reach their destination, they arrived back at Kito! This sight triggered both frustration and laughter, but the third meeting had to be cancelled.

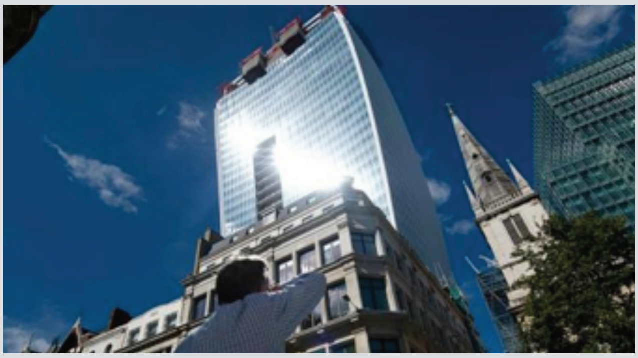
Getting to the day's fourth and final meeting before catching a late afternoon flight to Changsha became the objective, but once more typical alpha-male behaviour was exhibited with more shouting, more assertions that 'all is fine', and an ongoing refusal to ask anyone for directions. 30 minutes into this Stephane gave up on that meeting too and was now seriously wondering whether he would even make his flight. The driver proceeded to ignore the multiple road signs for the airport (which were the only signs Stephane could read!).

Stephane only made it to one of the four meetings he'd planned and had spent 7+ hours driving around. Such are the challenges of travelling – fortunately the other days in China were far more successful and insightful.

BTW

London is home to any number of very impressive buildings. Of course there are all the historic ones we are all familiar with: St Paul's, Buckingham Palace, Westminster and so on. The few decades after World War II are best forgotten but the new millennium has brought with it a resurgence in architecture in The City, some with cutesy nick-names including The Gherkin and The Shard. It is the most recent addition, The Walkie Talkie (pictured) which is still under construction but already causing a few 'issues'. Arguably less creative than the other two, it is its profile that is problematic.

According to BBC News, a motorist recently returned to his car (a Jag in that part of town naturally) which had been parked nearby to find that various parts – including, cruelly, the badge – had been melted by sun being reflected and concentrated by the Walkie Talkie's concave windows. Perhaps understandably, the designers seem to have failed to consider the possibility of a hot spot. Although the extraordinary climatic condition leading to this event – a sunny day – is not expected to reoccur for some time, some remedial action will be required before the building's completion. Until then, the city has dealt with the situation by placing more stringent time limits on the parking spots affected.



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