Monthly comment – June 2014
Alphinity Wholesale Socially Responsible Share Fund

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Market comment

The Australian share market (ASX300 including dividends) struggled a bit in June, finishing the month down 1.5%. Over the quarter ending June it was up about 1%, slightly underperforming other major markets like Japan (2.5%), US and UK (3-4%), and major resource-competing markets Canada and Brazil (6-8%) but beating most of continental Europe. Over the financial year ending June the ASX300 Accumulation Index was up more than 17% (and your Fund up almost 20%) for the second consecutive year. Some global markets did better than ours but most of the major markets were in the 20s. Currency did not have a major impact on market returns this time: the $A was fairly stable over the year. The biggest return of the year was delivered by Argentina. Its market was up 165% in local currency, and even though its Peso more than halved against the $A, that 72% return was still quite impressive. One would need a very high risk tolerance to have bought Argentina a year ago however.

Commodity prices were mixed over the quarter. The oil price was quite firm, rising about 5% thanks to political strife in some oil-producing regions, and base metals were also up: zinc by 12%, aluminium 7% and copper 6%. Gold was up a more modest 3%. The most important bulk commodities for Australia however were all lower: iron ore fell by 20% in the quarter, the hard coking coal required for steel manufacture by 5% and electricity-generating thermal coal by 9%.

Domestic economics were reasonably benign, with the exception of sentiment. A poorly-received federal budget, combined with unseasonably-warm early-winter weather in some parts of the country, seems to have caused a consumer strike that resulted in a degree of heartburn for some retailers. It seems there is little chance of interest rates going up in this context: indeed there remains an outside chance that a further rate cut might take place to stimulate activity.

What will the new financial year bring? Well, no one here has a properly-functioning crystal ball but based on the prevailing market multiple (about 14x forward earnings, in line with long term averages), likely aggregate corporate earnings growth of 5-7%, and likely dividends of 4-5% (with the additional tax benefit of franking for those who can make use of it), it is feasible that the market in FY15 is in line for another year of advancement: maybe not as much as FY13 and FY14 but still in the double digits, which should compare very well to the returns possible from bonds or annuities.

Portfolio comment

The Fund outperformed the market modestly in the June quarter and continues to build on its strong relative returns over longer periods. The best contributors during the period were in the energy space: NZ power generator Genesis Energy, gas explorer Oil Search and utility Duet. Offsetting those however were stocks in the consumer discretionary area: global travel provider Flight Centre and diversified retailer Super Retail Group. For the year ended June, the best performers in the portfolio were UK financial services company Henderson Group and global investment bank Macquarie, while not owning Fortescue Metals helped a lot. Super Retail was the main detractor over the year.

Performance*	1 month %	Quarter %	1 year %	2 years % p.a.	3 years % p.a.	Since inception^ % p.a.
Fund return (net)	-1.6	1.0	17.8	21.8	11.4	11.2
S&P/ASX 300 Accumulation Index	-1.4	0.9	17.3	19.6	9.9	10.0
Active return (net)	-0.2	0.1	0.6	2.2	1.4	1.3

*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

At the end of another strong financial year in the equity markets, largely thanks to low interest rates, an improving US economy and falling volatility, our attention will be on the full year company reporting season starting in August. With the Australian market having lost some momentum into the end of the year following the 'tough' budget in May, slowing consumer sentiment and a slew of profit warnings across consumer and mining related businesses, it is reporting season that is likely to provide the direction for the market in the months ahead.

While many of the potential disappointers have already come clean on likely earnings misses, July inevitably throws up a few more as companies put their accounts together and realise the inevitable. Outlook comments will be heavily scrutinised given some of the uncertainties hanging over the Australian economy in particular.

That said, we still see the market as roughly fair value, being underpinned by an extended period of low interest rates and a degree of earnings growth emerging in pockets of the market. We see a more 'normal' year ahead for the equity market underpinned by mid-single digit earnings growth, plus low to mid-single digit dividend yields. While the market may continue to consolidate while it waits for reporting season, we expect it to grind higher over the next year. The most important global macro theme over the next 12 months will be the pace of improvement in the US economy and the subsequent rhetoric around the expected pace of interest rate normalisation there. As long as any rate rises are based on stronger economic growth, not higher inflation, the market should be able to digest them without too much difficulty.

In Australia, the issue will be around how the economy handles tight fiscal conditions at a time of rapidly contracting capital expenditure in the mining industry and a persistently high A$. Both of these themes are likely to bring about opportunities in this 'low valuation dispersion' market.

Fund details	
Manager inception date	1 September 2010
Fund inception date	30 June 2000
Fund size	$14.6M
APIR code	HOW0121AU
Fees	
Management fee	0.90% p.a.
Performance fee	Nil
Buy/sell spread	+0.30%/-0.30%

Portfolio outlook

The last quarter of FY14 was characterised by so-called value stocks outperforming. While there are of course always stocks that will re-rate as operational performance improves, or as the market realises that that they are simply trading too cheaply, value stocks outperforming as a category typically is as much a reflection of sentiment as anything else: investors in a "risk on" mode. As we wrote in our last monthly, this is not unusual in a low volatility environment and while it is difficult to predict how long such sentiment will last, our experience is that the sustained outperformance of a stock is driven by how well the company delivers on earnings expectations. The portfolio remains positioned in companies that, in our view, exhibit an attractive combination of valuation support and the probability of delivering earnings ahead of expectations.

The upcoming reporting season will be a good test of how well-founded some of the optimism at the lower end of the quality spectrum is. While the Alphinity funds have shown their ability to outperform in most market conditions, we believe that as the market takes a more discriminating approach to company performance should benefit our portfolios over the second half of 2014.

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

Top 5 active overweight positions	Index weight %	Active weight %
Telstra Corporation Limited	4.8	2.5
GDI Property Group Ltd	0.0	2.3
Genesis Energy Ltd	0.0	1.8
Goodman Group	0.6	1.7
Woodside Petroleum Limited	2.1	1.7

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BTW

Who wants to be a millionaire? Most people probably do at some level and Alphinity is working, day by day, to build wealth through the equity market. And if money could indeed buy happiness, as some would like to posit, there are many more potentially happy people in the world each year.

A recent study by CapGemini and RBC concluded that the number of millionaires in the world (that is, people with $US1 million of investable assets) is increasing at a rapid rate. There were apparently 13,700,000 millionaires in the world at the end of 2013, an increase of two million in just a year. The aggregate wealth of all those millionaires was $US52 trillion, which is up a staggering $US20 trillion since December 2008.

Four million of the world's millionaires live in the US (up 17% in a year) and 2.3 million are in Japan (up 22%, largely thanks to its surging stock market): both countries have been the world leaders for as long as the study has been going. Germany is next, with 1.1 million (up 11%), followed by China with 758,000 (up 18%). Those top four countries make up 60% of the world's millionaires. Little Australia fares reasonably well - in 9th place with 219,000 - but this number only went up by 6% over the year, some of which can probably be explained by the lower $A which fell by 17% in 2013 and would have knocked a few people off the list.

It also concluded that there are 128,000 Ultra-High Net Worth Individuals, with assets of $US30 million plus. Although these represent less than 1% of the total, between them they control more than a third of that $52 trillion.

Along similar lines, the annual BRW Rich 200 list was also released in June. The lower iron ore price made a small dent in the estimated wealth of richest member (from $22 to $20 billion) but most experienced increases and the aggregate wealth of the 200 rose to $A194 billion from $A177 billion last year. Average wealth was up 10% to $970 million. There are 39 billionaires, 25 men and 14 women, and their average age is 64. The youngest debutant was 30 and the oldest 81. Five on last year's list had died, demonstrating that not even great wealth can stave-off the inevitable.

So with all this wealth around, there must be a lot of happy people, right? Not necessarily, and you only need to look at recent activity in the Australian courts to see members of at least one ultra-wealthy family that has torn itself apart over their respective "rights". It seems the wealthy have as many (although maybe different) concerns as you and me. Yet another report, this time by global wealth advisory firm WithersWorldwide, sought to determine what it means to be wealthy in the 21st Century by surveying 4500 mid-tier millionaires (with more than $US10m to invest) from Asia, Europe and the Americas. It looked at issues that worry wealthy people, and the biggest concern of more than a third of them was their health. 15% however were more worried about legacy: that their children "will lack the drive and ambition to get ahead" – even ahead of family or marital breakdown – and the larger the wealth, the greater this concern was.

It has been thought for ages that the wealth lifecycle for families is often "rags to rags in three generations": the first establishes wealth, the second builds on that wealth, then the third generation squanders it. It makes some intuitive sense: by the third generation there is little recognition of the struggle involved by the first two, they have probably had an easier life experience and possibly even a sense of entitlement that works against the work ethic required to drive the wealth on. But obviously it is something the wealth originators are keen to stop happening. The Withers report says:

Some have focused on how to inject purpose back into the family formally through family mission statements, governance strategies, leadership training and education. Others have sought to get back into business, using their wealth to establish new family-owned enterprises. Others still are looking to leverage their wealth for social good through philanthropy or through social investment that allows them to give back or re-invest in wider society. Rather than counting their money, the most successful are making their money count by taking practical and incremental steps to be economically and socially active.

Good advice for those troubled by great wealth.

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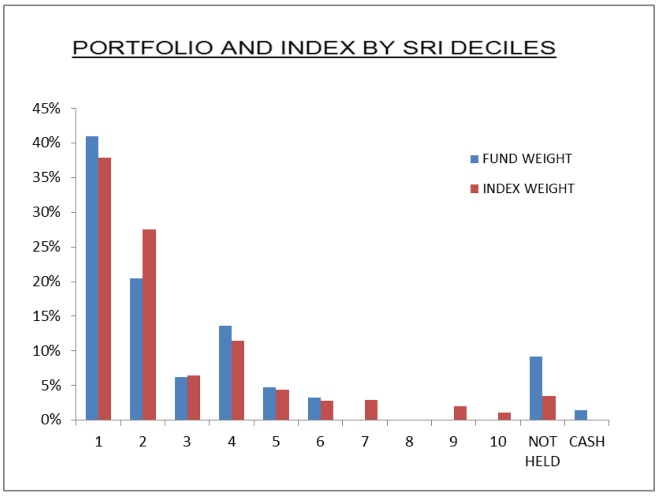
Sustainability score

Alphinity's external advisor, CAER, assesses the Alphinity Socially Responsible Share Fund portfolio on a monthly basis to ensure that it complies with the Fund guidelines, and tests the Fund's holdings as to the sustainability of the companies held according to ESG criteria. The data to the end of March shows that the Fund had Environmental factors 37% better than the market; Social factors 36% better than the market; and Governance factors 29% better than the market. The Fund's overall Sustainability Score was 77%, which compares very favourably to the ASX300 of 52%. The chart below shows the portfolio's weighting by sustainability deciles. The fund presently contains a number of stocks either not yet rated by CAER or which are under review.



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