Quarterly comment – December 2013
Alphinity Wholesale Socially Responsible Share Fund

Alphinity Socially Responsible Share Fund

Market comment

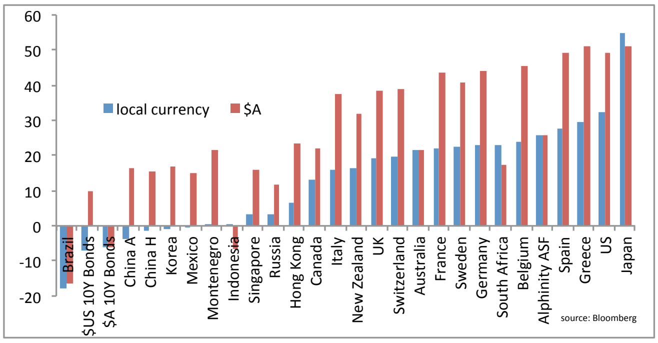
The Australian share market performed well over the quarter to the end of December, rising by 4% (S&P/ASX 300 Accumulation Index including dividends), and continuing the strong run it has made since mid-2012. The equity market again returned 20% over calendar year 2013, and the Fund exceeded this nicely.

The quarter was dominated by AGMs, the AUD, and IPOs. Annual General Meeting season was quite mixed, with a number of companies using it as an opportunity to warn the market to expect less optimistic earnings than at result time in August. Thankfully your fund did not have any profit-warning companies in its portfolio.

The Australian Dollar had been sitting around parity with the $US for a couple of years but cracked through that level in May, and sat in the mid-90s until September, despite the best efforts of the Reserve Bank both verbally and through monetary policy. Ongoing evidence of a rebounding US economy and the beginning of the end of extreme monetary stimulus there meant the $US has regained some strength, which has sent the $A below 90c at year end. We] have opined in the past and continue to believe that a lower currency will be good for the earnings of many Australian companies, most of which have significant operations outside Australia. We expect this to be a recurring theme at the upcoming February reporting season.

Initial Public Offerings occurred mainly towards the end of the quarter and contained some interesting trends. These are explored a little in BTW.

Global equities also performed well in the September quarter as the concerns affecting markets in the first half of the year dissipated, and the weakening $A added to returns of most further. The adjacent chart shows the returns that were achieved in various markets. Most commodities were largely unchanged over the quarter, with the exception of Gold which fell quite sharply in $US (-9%) but less so in $A (-5%).



Fund details

Alphinity Wholesale Socially Responsible Share Fund	
APIR code	HOW0121AU
FUM (AUD million)	14.3
Asset allocation	Australian equity: 99.3%, Cash: 0.7%

Fund performance* – as at 31 December 2013

	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	3 years (% p.a.)	Since inception (%)
Alphinity Wholesale Socially Responsible Share Fund	3.8	22.0	22.5	10.4	12.0
S&P/ASX 300 Accumulation Index	3.4	19.7	19.7	8.5	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 31 December 2013
Alphinity Wholesale Socially Responsible Share Fund

	Index weight (%)	Active weight (%)
Telstra Corporation Limited	0.8	2.0
Insurance Australia Group Limited	1.0	2.3
GDI Property Group	6.6	1.7
Aurizon Holdings Limited	0.8	2.2
Australia and New Zealand Banking Group	4.9	2.3

Portfolio comment

The Fund outperformed the market in the December quarter and continues to build on its strong relative returns over longer periods. The best contributors in the quarter were global fund manager Henderson Group, and not owning either supermarket retailer Woolworths or gold miner Newcrest. The Fund's position in office manager GDI Property Group and not owning diversified conglomerate Wesfarmers both modestly detracted from returns during the quarter. Henderson was also the best contributor over the whole year, followed by iron ore miner Fortescue Metals, global travel group Flight Centre, global investment bank Macquarie Group and not owning gold producer Newcrest Mining. The largest detractors from performance in 2013 were positions in diversified miner Rio Tinto and gold producer Medusa.

Market outlook

Notwithstanding its wobble at the start of December, the equity market's ascent in recent months has had a cyclical flavour. While Tapering, which will reduce liquidity, may be a negative for riskier assets and economically sensitive stocks, investors appear to have formed the view that the modest amount of tapering announced by the Fed to date will not derail an improved US and global growth outlook in 2014. Some observers are even talking about the prospect of synchronised global growth, a term we haven't heard for some time. We agree that the prospects for growth look better in the coming year. The US should benefit from less drag from fiscal tightening, China looks set to continue growing even if at a slower rate, and even Europe is showing signs of coming off the bottom: all up there remains the prospect of a moderate rate of growth in global economic activity. Moderating that is high public debt in many economies which may mean continued fiscal tightness, and with ample capacity in most industries globally it is equally difficult to argue for a significant upswing in business investment.

At home, a modest improvement in growth also looks like a plausible scenario. The Reserve Bank of Australia's rate cuts are finally having a positive impact on consumer confidence and activity. After a few years with an elevated household savings rate, Australians finally appear more willing to loosen the purse string somewhat and this should continue to help the housing market in particular, with flow on benefits to general consumer spending. The offset, of course, is an ongoing slowdown in mining investment but at this stage with commodity prices in general holding up quite well the slowdown has been orderly.

The prospects for better general economic growth are well aligned with corporate earnings which, after some disappointing years, looks to be on track for mid-single digit growth. Should the weaker $A be maintained there will be a positive translation effect on overseas earnings, which will augment earnings growth from the improved domestic demand outlook. So while we would temper some of the more optimistic market forecasts for both global and domestic economic growth, with share market valuations trading around long term averages, arguably lower risk of earnings disappointment, and the continued tailwind from money flows out of lower returning asset classes, the Australian share market looks well positioned for another year of solid returns.

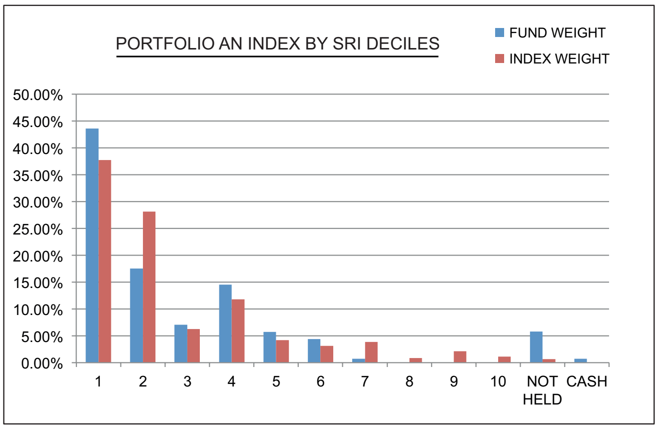
Portfolio outlook

The New Year often begins with a spurt of market activity as investors look to position their portfolios for the coming 12 months. Given the current sentiment as discussed above, it wouldn't surprise us if investors initially seek to increase their exposure cyclical to cyclical stocks. Alphinity gradually built a slight cyclical skew into its portfolios over the course of 2013, especially in the second half. Given our view that economic growth will be better in 2014 but not greatly so, we are unlikely to significantly increase this bias other than for stock specific reasons. Instead, as is typically the case, our portfolio remains well diversified across major sectors of the market with our active positions primarily taken within sectors. Over time this has proven to be a less volatile and more reliable way of generating outperformance than through significant sector skews. Our largest sector overweights remain Energy and Consumer Discretionary while Health Care has become our second largest underweight after Consumer Staples.

The portfolio produced very solid absolute and relative investment performance over the last 12 months, including in the final quarter of 2013. As we don't envisage a major shift - up or down - in the macro outlook, any repositioning of the portfolio is likely to continue to be gradual. We look forward to the upcoming interim reporting season which is now only a few weeks away. It typically shows which companies are delivering on earnings and which aren't.

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 most recent data shows that the Fund had Environmental factors 33% better than the market; Social factors 32% better than the market; and Governance factors 25% better than the market. The Fund's overall Sustainability Score was 72%, which compares favourably to the S&P/ASX 300 Accumulation Index of 52%. The chart below shows the portfolio's weighting by sustainability deciles relative to the market. The fund currently contains a number of new stocks not yet rated by CAER, which has come about by way of de-merger or acquisition in IPOs. Our own research suggests that when ratings are provided in coming months these stocks will be at least in-line with the average of the existing portfolio.



Traveller's tales

Stephane went to the USA in December as part of a BHP Billiton roadshow of its shale oil and gas assets. He was intrigued by a sign in the foyer of one oil company in Houston prohibiting weapons. That a sign is necessary says something about the US gun culture, of which Texas is possibly the epicenter, but the wording is also a bit disturbing: you can't possess concealed handguns, but would it be OK to have them openly displayed? He was afraid to ask.

It was a very bearable 10-15˚C in Houston but a lot less balmy when he went to New York to meet with other companies in the broader resource and energy space. Most inhabitants of cold places say that there's no such thing as bad weather, just the wrong clothes. New

York in the snow is a very beautiful place but unless you have the proper winter attire – an area in which most Australians fall down – it can be very cold indeed.

BTW

IPOs came back with a vengeance in 2013 but not all were successful – that is if you define success as being a good investment for the buyer as we would. If you define it as getting the maximum amount possible for the seller, some were very successful indeed. That tension has always been at play in this sort of activity but normally the need for capital outweighs any greed on the part of the seller. By our count (and thanks to our quant friends at Macquarie who have been tracking these things) there were 61 IPOs over the course of 2013, half of which hit the screens in the final quarter and a quarter in December. Many were very small: two thirds raised less than $100m. Only 15 raised more than $200m and seven exceeded $500m, and the two over $1 billion were both NZ electricity privatisations. In total, $11 billion was raised in 2013 across the 61 IPOs and a total of $356m of profit was made by the buyers: a paltry 3.2% return.

Of the larger floats (greater than $200m) there were mixed outcomes: six resulted in positive returns of 8% or more up to the year end, and four of those six were 40%+. Eight however were negative, the worst two losing around 20%.

The smaller IPOs (<$200m) were interesting even just from an entertainment standpoint. It was very much a binary outcome with a few doubling or more but some also down by as much as 94% from the issue price. Were you investing in small resource plays you would not have had much joy: eight of the ten IPOs that lost more than 35% were in that line of business.

Our favourite however is an Adelaide-based Asian media play which raised $3.5 million at 20c, listed in February, traded a few thousand shares a couple of days later and has not traded since. The best bid in the screen at the end of December was 2c. The most dramatic was an IT stock that was sold at 50c, hit $2.60 on day 1, but finished the year at 'only' $1.38 – still almost treble the issue price. This would have been more impressive had it not been just 7.6% of the company that was sold into the IPO but it seems the lesson of US internet IPOs has been well learned: keep the supply of stock very short and the price has a better chance of zooming.

Once upon a time being allocated stock in an IPO was considered being given 'free money', but many in the current vintage have been the exact opposite. Our investment banking friends tell us there is a large pipeline of IPOs preparing to hit the market in the first few months of 2014, but considering the performance to date there will likely be little support from investors unless pricing improves a lot.

Alphinity Investment Management

Level 15, 255 Pitt Street
Sydney NSW 2000

T 02 9994 7200

F 02 9994 6692

W www.alphinity.com.au

16379/0114