Quarterly comment – June 2012
Alphinity Wholesale Socially Responsible Share Fund

Alphinity Socially Responsible Share Fund

Market comment

A great deal of volatility occurred over the June quarter but the fund performed quite well regardless. For the third year in a row, Greece's financial and political situation caused the world to sit up, take notice and panic a bit. In the end, the election turned out as well as could be expected for markets, although one would be brave to say that the turmoil there is finished.

Over the June quarter, the ASX300 (including dividends) fell by 5%. This was fairly similar to the major overseas markets: the US S&P500 fell 3.3%, UK's FTSE100 –4%, France's CAC40 –8.5%, Germany's DAX –12%. Greece's ASE fell 19% for the quarter despite bouncing 20% after the election in June. In Asia, Japan fell 7.4%, Hong Kong –3.2%, but Shanghai fell by less than 1%. The $A was essentially flat over the quarter, with early weakness largely reversing in June. Bond yields fell significantly over the period, to the lowest levels in living memory: ten year yields finished the quarter below 3% and three year bonds below 2.5%. Cash rates were lowered from 4.25% in April to 3.75% in May and then 3.5% in June.

Commodities were also volatile during the June quarter, as doubts around the sustainability of China's economic growth waxed and waned. Oil fell sharply (Brent crude –22%), gold fell by 4%, and the index of base metals maintained by the LME fell by more than 9%. Spot iron ore prices also fell by 9% despite volumes being shipped into China growing quite strongly.

Portfolio comment

The portfolio performed well in the June quarter, with good contributions from global logistics property developer Goodman Group, telecoms company Telstra, automotive sales website carsales.com.au, and the underweight position in Qantas. Detractors were largely resource related in a period during which resources struggled: the three which detracted most were consumables manufacturer Bradken, diversified resource company Rio Tinto and iron ore producer Arrium (previously Onesteel). Not owning Woolworths and Wesfarmers, both of which are excluded from the fund due to their ownership and operation of gaming machines, detracted meaningfully from returns in this quarter in which markets fell.

Fund details

Alphinity Wholesale Socially Responsible Share Fund	
APIR code	HOW0121AU
FUM (AUD million)	14.4
Asset allocation	Australian equity: 98.5%, Cash: 1.5%

Fund performance* – as at 30 June 2012

	Quarter (%)	1 year (% p.a.)	Since inception (%)
Alphinity Wholesale Socially Responsible Share Fund	–4.4	–6.8	0.7
S&P/ASX 300 Accumulation Index	–5.0	–7.0	0.4

*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).

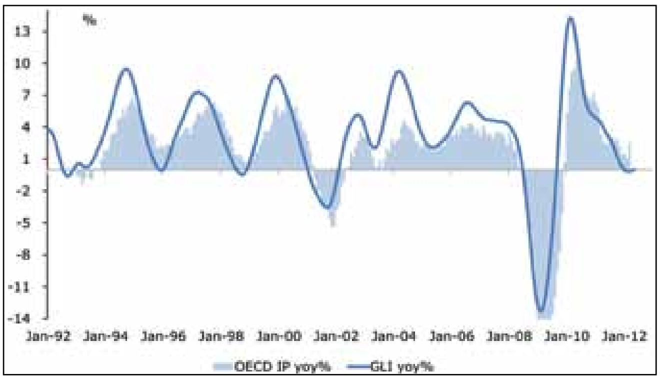
Top 5 active overweight positions as at 30 June 2012

Alphinity Wholesale Socially Responsible Share Fund

	Index weight (%)	Active weight (%)
Rio Tinto Limited	2.5	2.3
Goodman Group	0.5	2.0
Westpac Banking Corporation	6.4	1.6
Insurance Australia Group Limited	0.7	1.6
Resmed Inc	0.2	1.4

Market outlook

Are we there yet? Regular readers of Alphinity's monthly reports would be familiar with our view that the Australian equity market on the one hand is cheap, but on the other hand is being held back by the paucity of overall earnings growth. Various stimulus or policy measures, such as rate cuts in Europe and/or China, QEIII in the US etc., may boost market sentiment to varying degrees but in the end we need earnings growth to resume for markets to make sustainable gains. Given the present attractive valuation metrics, once earnings bottom and start growing the upside is likely to be substantial. So the question is, how close are we to this point? In our view the answer both from a top-down perspective and a bottom-up perspective is that earnings risk is still firmly to the downside. As highlighted in the chart below, global leading indicators (GLI) of industrial production (IP) in OECD countries have been slowing for some time, and are approaching levels that in the past have been associated with declining IP. While this chart does not include Asia and many of the other faster growing parts of the world, global growth is unlikely to surprise positively in the near term.



Source: Goldman Sachs

What about the effects of the domestic rate cuts? It is now more than six months since the first rate cut in the current cycle and by now we would typically have expected to start to see some positive impact. At this point, the most positive interpretation of the data is that things are mixed. Retail sales are showing some tentative signs of stronger growth, though given the heavy discounting there must be considerable risk to retail margins. Construction activity is showing no signs of improving, albeit some of the weakness may be weather related, and both consumer and business sentiment remain low. There may be multiple reasons for this: the banks not having passed in full the Reserve Bank cuts, political uncertainty, the carbon tax; but the result still appears to be disappointing.

From a bottom-up perspective we reach a similar conclusion. At Alphinity, we spend a lot of time talking to company management and industry contacts to understand company and industry trends. While management does not always have a better understanding of what the future holds, they do (in most cases) know what current trading conditions are and what their order books look like. After talking to well in excess of 50 companies over the last couple of months, it is difficult to identify many companies or sectors where the operating environment appears to be improving. For sure, there are individual companies that are continuing to do well and some sectors, such as insurance, where the earnings cycle looks to have turned, but there are not enough of them to get much comfort around the earnings outlook for the overall market.

With the lack of positive factors to point to other than that the market is 'cheap' and perhaps that bonds are 'expensive', a range-bound market seems a reasonable assumption.

Portfolio outlook

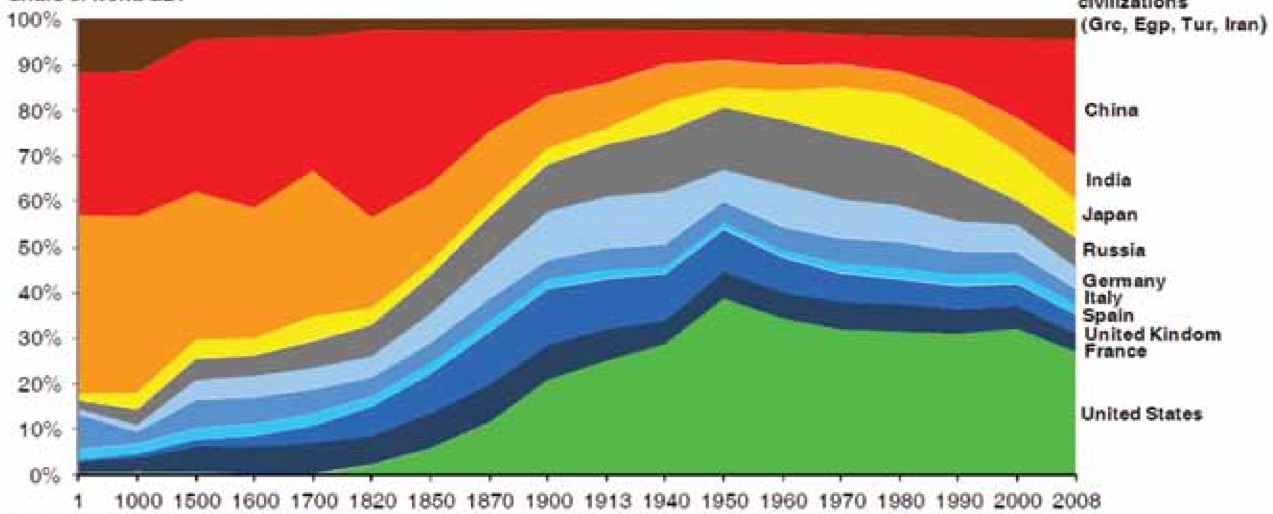
As is often the case in uncertain times, cyclical companies with earnings risk are getting increasingly cheap, and companies with more stable earnings (and in many cases those with higher yields) are getting increasingly expensive.

Our portfolio is positioned for an overall cautious earnings outlook with exposure to stable cash generators such as Transurban, Australian Infrastructure, Duet and Telstra while also maintaining some exposure to the more cyclical parts of the market especially in companies where we see company specific drivers, such as Oilsearch and Woodside which have leverage to a resilient oil price and growth from gas projects coming on-stream. However, the core of the portfolio – and where most of the relative outperformance has been generated over the last year – is built around companies which have generated solid earnings growth ahead of market expectations. Companies like Goodman Group, Carsales.com, and Super Retail Group are all in different sectors but each have unique market positions and/or strong operational execution in common. We will continue, through our research and stock selection, to pursue these opportunities.

BTW

JP Morgan recently came up with an interesting chart which we thought we would share, with their permission. It looks at the contribution to global economic output of various counties or regions since the time of Christ. Note that the X-axis is not a linear scale, so the most recent decades are given much more prominence than they probably should be. And obviously data collection must have been an issue going back that far so a fair bit of latitude must be given for the earlier years but the trend is probably fairly accurate. It shows that the 'Chindia' growth story is not a new phenomenon: what has been happening for the past couple of decades is really just re-asserting previous trends. Up until the industrial revolution, China's and India's economies relative to the rest of the world were much larger than they are now: about 70% of global GDP was produced by them at one stage. India alone has been much larger in the past – it was at one point as much as a third of the world's production – but has a long way to go to make that position up. Europe has largely maintained its position over the two millennia, and although the 'cradle of civilization' countries were much larger years ago, given Greece's issues since 2008 the chances of them regaining their previous position any time soon seem slim, notwithstanding some chunky oil reserves lying under some of the others. The largest emergence is of course the USA, which didn't have much of an economy 2000 years ago but now accounts for about a quarter of world GDP. What are the chances of USA going back to zero? Zero: although they still face a few serious issues, the US remains a large and creative economy which will bounce back.

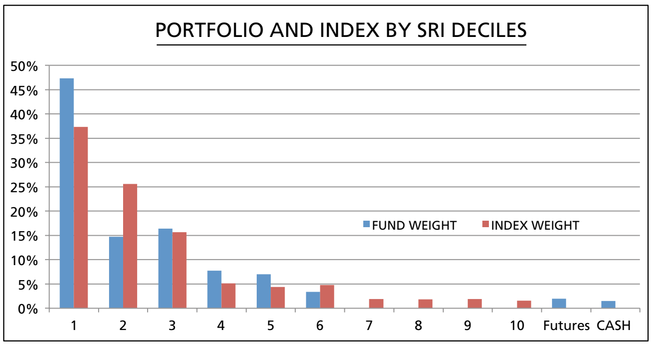
Economic history of China and other major powers
Share of world GDP



Source: *"Statistics on World Population, GDP and Per Capita GDP, 1-2008 AD"*, Angus Maddison, University of Groningen.

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. We are pleased to report that as at the end of June the Fund had Environmental factors 39% better than the market; Social factors 33% better than the market; and Governance factors 26% better than the market. The Fund's overall Sustainability Score was 70%, which compares with the ASX300 of 50%.



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