Quarterly comment – September 2013
Alphinity Wholesale Socially Responsible Share Fund

Alphinity Socially Responsible Share Fund

Market comment

The Australian share market performed extremely well over the quarter to the end of December, as headwinds felt in the prior quarter receded somewhat. The S&P/ASX 300 Accumulation Index (including dividends) rose in each of the months to return a total of just over 10% in the quarter. We are pleased to report that the Socially Responsible Share Fund did a bit better than that, with a total return of 15%. The fund passed its three year point under Alphinity management at the end of August and we are pleased to report that it was in the top quartile of its comparator set over that period.

Global equities also performed well in the September quarter as the concerns affecting markets in May and June dissipated somewhat. The decision by US authorities not to start easing back on monetary stimulus helped, however such a move is inevitable – the only question is when. Markets in some of the more challenged global economies bounced quite strongly in the quarter, including Spain and Greece which were both ~20% higher in $A terms. Germany, France, the UK and China performed close to our market, the US and Japan however lagged Australia's performance with low-mid single digit returns when expressed in $A.

Domestic news in the quarter was dominated by the Federal Election, although a further cut in the cash rate by the Reserve Bank of Australia also featured. The position in the cash rate cycle is now finely balanced. The established housing market has turned up definitively in most capital cities and, while the RBA is playing down speculation of an emerging price bubble, this prospect is obviously concerning them. However the now-strengthening $A (or more correctly, the weakening $US) is also acting as a drag on the economy and even lower cash rates would help edge the $A lower. With the cash rate now 2.5% – a multi-generation low – it is difficult to make the case that it is holding activity back, and now that the election is over perhaps confidence will improve. Having said that, despite the new Government's very strong position in the lower house its position in the Senate is more tenuous and the new Senate will not sit until mid-2014. Should that new Senate not be as compliant as the Government wishes, further unwelcome political uncertainty may be on the cards.

Commodity prices were generally higher over the September quarter, as confidence in China's economic growth returned. The price of iron ore rose by 13% and base metals about 7%. Gold (+11%) and oil (+7%) were both higher over the quarter with geopolitics – and to an extent the soft $US – largely to blame.

Fund details

Alphinity Wholesale Socially Responsible Share Fund	
APIR code	HOW0121AU
FUM (AUD million)	15.3
Asset allocation	Australian equity: 98.2%, Cash: 1.8%

Fund performance* – as at 30 September 2013

	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	3 years (% p.a.)	Since inception (%)
Alphinity Wholesale Socially Responsible Share Fund	10.3	27.2	22.0	10.6	11.7
S&P/ASX 300 Accumulation Index	10.3	23.6	18.9	8.9	10.3

*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 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 Socially Responsible Share Fund

	Index weight (%)	Active weight (%)
Australia And New Zealand Banking Group	6.5	2.1
Insurance Australia Group Limited	0.9	2.0
Aurizon Holdings Limited	0.7	1.9
Telstra Corporation Limited	4.7	1.9
Westpac Banking Corporation	7.8	1.9

Portfolio comment

The Fund outperformed the market in the September quarter and continues to build on its strong relative returns over longer periods. The strongest contributors over the quarter were global fund manager Henderson Group, global travel company Flight Centre, and electronics retailer JB Hi Fi. On the negative side, the market's return to a degree of risk appetite meant that property companies underperformed. The Fund's positions in GPT and Goodman Group both modestly detracted from returns during the quarter.

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

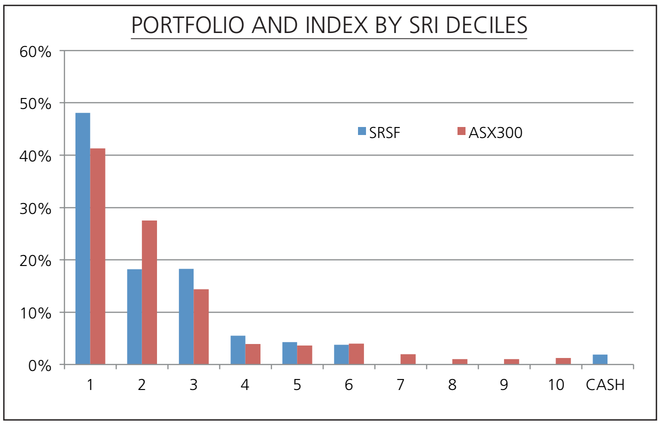
The portfolio remains well diversified and exposed to companies that are exhibiting on average better earnings revisions than the market, which is typically a good indicator of future positive earnings surprises. Having trimmed some of our 'yield' stocks during the year and added to stocks whose ability 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.

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 37% 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 ASX300 of 51%. The chart below shows the portfolio's weighting by sustainability deciles relative to the market. We are pleased that the Fund has been able to achieve comparable returns since inception to our Australian Share Fund, which is unconstrained by ethical considerations and itself has been one of the best-performing equity funds in the market.



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.

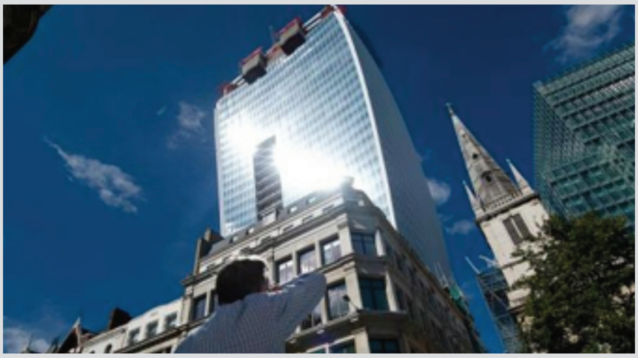
Getting to the day's fourth and final meeting before catching a late afternoon flight to Changsha became the objective, but once more typical alpha-male behaviour was exhibited with more shouting, more assertions that 'all is fine', and an ongoing refusal to ask anyone for directions. 30 minutes into 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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