Quarterly comment – September 2012
Alphinity Wholesale Socially Responsible Share Fund

Alphinity Socially Responsible Share Fund

Market comment

Markets generally recovered over the course of the September quarter as the risk aversion of the March quarter, largely related to the Greek elections, receded. It was pleasing to once again have an August reporting season in which stocks largely reacted as the fundamentals of their results suggested they should. The ASX300 (including dividends) rose by 8.7% during the quarter. Reporting season provided a few surprises, but unlike the past few years, this time it was industrials which did a little better than expected while resource stocks generally lagged. Stocks providing decent yield were particularly sought, including banks and property companies.

Global markets generally lagged Australia's with the US +6%, UK +3%, although wider European stocks did a little better. Japan however fell 1.5% for the quarter and China's various markets reflected the country's slowing economy.

Commodities important to Australia's balance of trade softened over the quarter as concerns over China's economy became more mainstream. Spot prices of iron ore and coal fell sharply, to levels last seen in 2008, but have stabilised somewhat since the end of September. Oil however rose sharply as Middle East tensions built, and base metals such as copper, nickel and zinc, and precious metals all rose in response to the announcement of another program of quantitative easing by the US Federal Reserve.

The $A strengthened slightly during the quarter, but remained in a fairly narrow band between $US1.02 and $1.05. It is trading roughly in line with its level a year ago, so it is unlikely to be providing too much of an incremental head (or tail) wind to companies over that time.

Portfolio comment

The portfolio performed well in the September quarter with good contributions from a diverse range of companies including insurer IAG, sleep apnea device maker ResMed, automotive advertising platform carsales.com and not owning Fortescue Metals. The biggest detractors were iron ore companies Arrium and Rio Tinto, mining services company Monadelphous and not owning conglomerate Wesfarmers, which is excluded from the Fund's universe by virtue of its ownership and operation of electronic

Fund details

Alphinity Wholesale Socially Responsible Share Fund	
APIR code	HOW0121AU
FUM (AUD million)	15.0
Asset allocation	Australian equity: 98.4%, Cash: 1.6%

Fund performance* – as at 30 September 2012

	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	Since inception (%)
Alphinity Wholesale Socially Responsible Share Fund	9.1	16.9	3.1	4.9
S&P/ASX 300 Accumulation Index	8.7	14.5	2.2	4.4

*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 September 2012

Alphinity Wholesale Socially Responsible Share Fund

	Index weight (%)	Active weight (%)
Westpac Banking Corporation	7.1	2.0
Lend Lease Corporation Limited	0.4	1.9
Insurance Australia Group Limited	0.8	1.9
Goodman Group	0.5	1.6
Telstra Corporation Limited	4.5	1.6

gaming machines. The Fund celebrated two years under the management of Alphinity at the start of September, and has provided above-benchmark returns despite the fairly extreme market volatility at times and its inability to invest in a number of classically 'defensive' stocks due to its ethical mandate.

Market outlook

Over the last quarter, global equity markets' strength has been predominantly driven by monetary easing and reducing fears of a full-blown financial crisis in Europe. These forces have offered welcome relief and should remain in place for some time. Lower interest rates in Australia should further support the Australian equities market from a relative valuation perspective, however global economic conditions continue to weaken and there are few signs of any meaningful improvement here. For the recovery in equity markets to be maintained, a clearer path to stronger earnings will be required. Without this it is reasonable to assume that markets will lose some of their momentum over the next few months despite the support from easier monetary conditions.

For Australian industrials, the August reporting season saw the first signs of industrial earnings stabilising somewhat. While too early to conclude with any certainty, the Reserve Bank of Australia's recent rate cut and subsequent softening of the Australian dollar may provide the trend break that we have been arguing for some time is required for stronger earnings in non-resources Australia. For resources, our last visit to China indicated that underlying demand there remains subdued. The recent bounce in the price of steel and iron ore appear to be more driven by restocking ahead of winter.

The next set of data points is annual general meeting (AGM) season in October and November. In addition to exercising our voting responsibilities for all our holdings, we also use AGM commentary (if not the meeting itself) to get a sense of how the business has been tracking in the first few months of the new financial year. AGM information is not as rich as reporting season, but the trends and degree of confidence expressed during the meeting can be quite informative. In recent years, this AGM season has provided a reality check for companies that the market had started to factor-in turnarounds. We would not expect that this year to be different but rate cuts and a potentially lower dollar may provide a better outcome for some companies later in the financial year.

While an uncertain outlook remains for corporate earnings, the significant valuation gap between equities and bonds and historically low equity allocations by both institutional and retail investors are probably the strongest reasons for further gains in coming months.

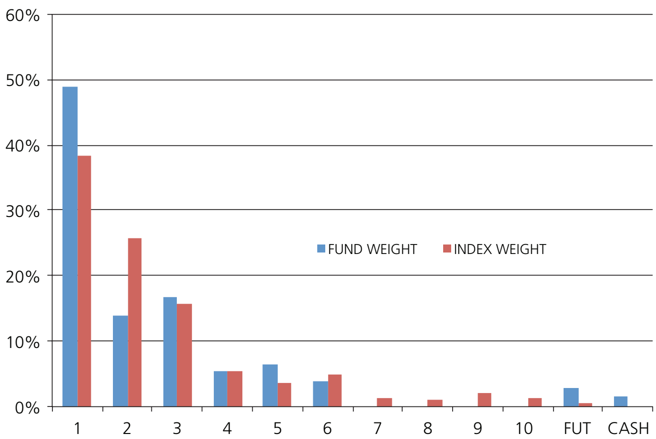
Portfolio outlook

The recent weakness in the resources sector has masked what has been quite an impressive performance in many other parts of the market, especially those which pay high dividends. Banks, for example, have returned close to 30% (including dividends) over the twelve months to the end of September. Lower interest rates may have the potential to revive activity levels in the more cyclical parts of the economy, and we are monitoring developments here closely but feel it is too early to justify a significant shift. Lower interest rates are also likely to further underpin the performance of those stocks that have already benefited from the low bond yields and rate cuts we have seen to date. While we have reduced the exposure to some of these stocks after strong performance, we believe they should remain a substantial part of the portfolio and hence we remain well invested in, for example, the Banks, Telstra, Duet and Australian Infrastructure. Also at the core of the portfolio remain the individual companies with unique earnings drivers that we have identified. Included in this group are companies such as IAG (insurance), Carsales.com (IT), Super Retail Group, (consumer discretionary) and Goodman Group and Lend Lease (REITs). On the flipside we retain our underweight to resource companies following our recent China research trip.

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 September, the Fund had environmental factors 35% better than the market; social factors 38% better than the market; and governance factors 26% better than the market. The Fund's overall sustainability score was 68%, which compares with the ASX300 of 50%. The chart below shows the portfolio's weightings by sustainability deciles relative to the market.

Portfolio and index by SRI deciles



BTW…

Lend Lease has long been recognised as a well-run company and has received many awards, and falls into the top decile of sustainability as calculated by CAER, scoring consistently strongly across each of Environment, Social and Governance. We recently spent a day with Lend Lease in Queensland and, after speaking with managers from many levels of the company it is easy to see why. It has a very strong safety culture, and the care it takes with its employees and contractors is clearly rewarded by dedication to the job at hand. There is an enormous level of executional competence in the company, with decades of experience which lends credibility when bidding for future business, and an enormous amount of pride taken in the jobs it performs.

For example, we went through the new Gold Coast University Hospital (pictured), which is due for completion in December and is already in the process of being fitted out. It will be a teaching hospital, adjacent to the Griffith University campus, serving that growing community with 750 overnight beds and 350 day patient capacity. It replaces an ageing hospital half its size, and comes with its own power generation capability for emergencies, including excess capacity to power to an adjacent private hospital should the grid be knocked out by a disaster. And, using the latest technologies in a number of areas like heating, cooling and lighting, will be as 'green' as a place like this can be. And although it still looks like a building site right now, there is really just a bit of landscaping left to do. The experience of re-building the Royal Children's Hospital in Melbourne and this facility helped them to win another hospital – this time on the Sunshine Coast – which is about to commence, using largely the same workforce. This is very hard for other developers to compete with.

The Fund has a position in Lend Lease which has contributed well in recent months and, we believe, will continue to in the future.

Traveller's tales

One of the challenges of investing in companies which operate in developing economies is keeping track of how these companies are looking after the staff and the environment in those places. To this end, Stephane went to the Philippines in September to investigate the operations of Medusa Mining, a 'junior' gold company, in a remote part of that country. Medusa is aiming to lift its production from its current production of 60,000 ounces per annum to around 400,000 ounces by 2016. It has an existing underground mine and plans to bring in an open pit mine within the next few years. Almost the entire 3300 workforce is local and older than 20 years. The mine employs more people than is really required in order to provide employment for the community, a tacit agreement with the local government. While the pay is quite low by Australian mining industry standards, those wages allow the workers to afford a decent standard of living, as evidenced by the quality of housing around the mine. The unions have negotiated for their monthly bonuses to be paid in food (rice) rather than in money. Medusa also provides its employees and the local community with schools (pictured), scholarship programmes and hospitals. It has also invested in infrastructure in the region including roads, water supplies and non-mining livelihood projects such as plantations, fertiliser production programmes, and micro loans. This investment is seen by the company as part of its 'social contract' to operate in that part of the world: contributing to the local community and ensuring their ability to conduct peaceful operations.

Alphinity Investment Management

Level 15, 255 Pitt Street
Sydney NSW 2000

T 02 9994 7200

F 02 9994 6692
W www.alphinity.com.au

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