alphinity
INVESTMENT MANAGEMENT

Monthly Comment – April 2019
Alphinity Australian Share Fund

Election Fever

Market comment

After three strong months in the share market it would have been reasonable to expect something of a pull-back in April, yet the market carried on with its bullish trend. The ASX300 (including dividends) rose by a little over 2% for the month, taking year-to-date returns to well over 13%. An election was called during the month but this did nothing to dampen the market's rally. A lot of the credit for the Australian market's good performance can be attributed to global factors, particularly US President Trump who has firmly tied himself to the stock market as a barometer of his personal success, and the US S&P500 finished the month at a new all-time high, having now recovered all of its December quarter falls and a bit more. With "only" a year and a half remaining until the 2020 US Presidential election, it would be courageous to bet too much against the equity market: we suspect all stops might be pulled out to keep it pumping as hard as it can at least until November next year, and possibly longer.

International markets also had good returns. European markets were mostly up between 3 and 7% in $A terms, and the UK managed to rise 2% despite the ongoing unresolved saga of Brexit. US markets were up 3 to 5%. Asian stocks were a little more mixed: Chinese shares fell about 2% but Japan and Singapore traded quite strongly, up around 5%. Overall, equity holders were mostly happy in April. There is an old saying in the market "sell in May and go away, come back on St Legers Day" (September): we will see if that applies this year. With so many markets up even more than our 13% for the year to date, a degree of pull-back would not surprise us too much.

May may also see a mayday from Theresa May who, in a very Easter-like gesture, effectively offered her position as UK Prime Minister as a sacrifice to get some sort of Brexit deal through. It will be interesting to see if she sees out the month but we can sympathise: the fact she has survived despite being in such an unsustainable position for so long is testament to her British tenacity, if not her common sense or sanity. It will also be interesting to see who replaces her.

It will be even more interesting – and relevant – to see who our own Prime Minister will be at the end of the month. The Federal Election will finally be held in May and the contest of ideas is now well and truly under way, with lots of heat being generated but not a great deal of light. The polls are tight but, considering the minority starting point of the present Government and the fine margin of some of its seats, it is difficult to see it surviving. Having said that, there are not many examples of a party winning government with a major policy of increasing taxation, so maybe it is too soon to write the government off. All will be revealed very soon.

In the economy, inflation figures were released during the month which revealed that prices in aggregate were hardly going up at all. This is in contrast to opinion in the community, pushed by opposition politicians and the unions, that prices are going up a lot while wages are not. The federal budget was also released during the month and the government's projected surplus for next financial year – if achieved – would represent quite an achievement after more than a decade of deficits.

The Reserve Bank of Australia left monetary policy unchanged in April but hinted that a cut in rates is now more likely than an increase. While this sent the $A to the lower end of the $US0.70-72 range it has been trading in all year, there has as yet been no sign of it helping the residential property market. While lower rates wouldn't hurt, issues in that area involve the availability of credit as well as the price.

Portfolio comment

The Fund lagged the market fractionally in April, with few really significant moves either way. Companies which contributed to performance were global wine producer Treasury Wine Estates and mining services company Seven Group. Not owning a couple of under-performers, mining company South 32 and shopping centre owner Scentre Group, also helped. There were no detractors of any significance.

Performance*	1 Month %	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	7 years % p.a.	Since inception^ % p.a.
Fund return (net)	2.2	10.2	8.7	11.6	7.3	10.8	9.6
S&P/ASX 300 Accumulation Index	2.5	9.4	10.3	11.1	7.6	10.0	8.9

*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 Fund and started the transitioning of the portfolios to a structure consistent with Alphinity's investment views. The transition was completed on 31 August 2010. The inception date for the returns for the Fund 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

Following a strong four months for the Australian equity market, the question is: where to from here? The rally we have experienced, of course, needs to be seen in the context of the slump in the final quarter of 2018 but do we note that a new record high for the market (including dividends) was set during the month of April. As we have written about in earlier reports, the strong market performance has been driven primarily by central banks around the world, particularly the US Federal Reserve, signaling a more cautious approach to further rate hikes as economic growth has slowed and inflation expectations materially pared back. Our own Reserve Bank is even warming up the market for a rate cut. Long gone are the days of guidance from the Reserve Bank that "the next move in rates up is up".

ASX300 Accumulation Index

Source: Bloomberg

Would this change earnings leadership in the market and start a new broad based "upgrade cycle"? We're not so sure. To us it looks more like some of the downside scenarios will likely be avoided and the current cycle extended, rather than being the beginning of a new one. This is important, because very different stocks perform the best in a new cycle than those that do well in a "more of the same" scenario. Of course everything has its price but it's hard to see, for example, Banks outperforming for some time unless credit growth picks up meaningfully and the market can see the end of remediation payments for historical wrongdoings. Neither look likely at this point.

Equally, the Resource sector has outperformed the broader market for more than two years, driven by capital discipline and strong commodity prices. With current commodity prices foreshadowing further earnings upgrades for the sector, especially the iron ore-exposed companies, Resource companies should continue to be well supported, in our view. With the overall market now trading a bit ahead of long term valuation metrics, additional upside will require a further expansion of multiples.

Asset allocation	30 Apr 2019 %	Range %
Securities	96.4	90-100
Cash	3.6	0-10

Portfolio Outlook

While global macro settings continue to evolve and the US-China trade negotiations are currently creating some uncertainty, it looks as if 2019 might end up being a less dramatic year than 2018, at least from a top down perspective. US interest rates appear to be on hold and, even though Australia may get an interest rate cut once the federal election is out of the way, we don't see too many significant changes to current trends. From this perspective we are broadly comfortable with current portfolio settings which have worked well so far in 2019.

We remain overweight the bulk commodity stocks (BHP, Rio Tinto and Fortescue Metals) which will all benefit from the strong iron price. While news flow around potential restarts of Brazilian mines might cause some volatility, we believe that supply will remain tight and the iron price supported for some time, most likely well into 2020. This view is supported by our recent meetings with key players in China and our analysis of the situation in Brazil.

The Bank reporting season did nothing to suggest that the challenges from a slowing credit growth environment or remediation payments following the Royal Commission findings are about to reduce. Recent company news also suggests that the housing construction downturn is increasingly starting to impact stocks exposed to this part of the economy. Apart from our position in property company Mirvac, which is enjoying robust conditions for its office portfolio, we have limited exposure to this part of the market as we presently have no holdings in the building materials sector.

We remain overweight the insurance sector with QBE now our largest exposure. We were encouraged by the recent Annual General Meeting update which suggested that global insurance prices are now firming after several years of little change, and we also expect further process improvements to assist the company's earnings outlook.

The result of the federal election will soon be known. Some stocks, such as Medibank Private, will be impacted by some opposition policies should there be a change in Government, as is suggested by the polls. However we believe management has had plenty of time to prepare for a period of lower premium rate increases, and that investors should also be well aware of the announced policies. Overall, we believe the portfolio remains well positioned for further outperformance, with an unexpected increase in global risk aversion the main threat.

Top five active overweight positions as at 30 Apr 2019	Index weight %	Active weight
Macquarie Group	2.5	2.2
Computershare	0.5	1.6
CSL	5.2	1.6
Goodman Group	1.2	1.5
QBE Insurance Group Limited	1.0	1.5

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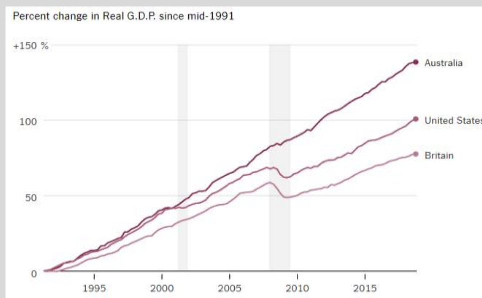
BTW

Australians' level of national insecurity is legendary: nothing pleases us more than being told we're good by someone else. That happened in spades this month, by the New York Times (NYT) no less, in an article titled *What the Rest of the World Can Learn From the Australian Economic Miracle.*

We all know that Australia's economy is about to hit its 28th year without a recession. A recession, generally accepted as two consecutive quarters of negative economic growth, last happened here in 1991. This is a world record for a developed economy. The Netherlands had the longest winning streak prior to ours, 96 quarters, between 1982 and 2008. We've now had 106 and, despite regular complaints about how tough things are, growth looks like continuing for at least a little while longer.

What's so great about not having a recession? This chart from the NYT article sums it up: it takes so much from your potential. Australia's economy has managed to incrcease by almost 150% in real terms since 1991, while the US has only doubled, and the UK has grown only about half of our rate. The shaded areas represent US recessions. Yes we've had a lot of population increase through immigration, which helps, but so has the US. What we have also had is the largest mass of people in history moving from abject poverty into the middle class right on our doorstep, and their demand for the things we produce – initially iron ore and coal but subsequently more sophisticated products like food, education and property – have bolstered us no end. This has helped to keep our unemployment rate low.



Most workers however have no idea what it would be like: 28 years represents a career for some! A portion of our readers might nor even have been born in 1991. To have been in the workforce then you would need to have been born prior to the early 1970s, and most workers who were over 40 in 1991 would be retired by now. So there are plenty of people in the workforce (and especially the markets) who have never experienced a falling economy.

The 1991 recession was a nasty one, and then-Treasurer Paul Keating described it as "the recession we had to have". It wasn't a lot of fun though, as those who lived through the business closures and mass redundancies that took place will attest. Most of our banks almost failed, saved only by forced mergers, massively dilutive capital raisings and government support. The economy has gone through a few cycles since then but, due to some good fiscal and monetary management and a reasonable dose of good luck we've managed to avoid another, despite some significant external events.

The Asian debt crisis of 1997 was one, when some of our major trading partners suffered vicious currency devaluation and collapsing economies. Another was after the Tech Wreck in 2000, and the imposition of the Goods and Services Tax about the same time didn't help. The September 2011 attacks on New York caused severe ructions in the global economies but we got through that just with another slowdown. The big one we dodged however was the Global Financial Crisis when we fought back with some targetted fiscal stimulus, explicit government support for the banks and sharp cuts to interest rates. Our banks in any case hadn't done some of the silly things that had been going on in many countries, and thankfully China's demand for our resources persisted so Australia snuck through without the black mark of recession against its name, despite coming pretty close.

So if things have been so good for so long, why has it felt so tough here? The answer might be in that GDP chart: without a significant slump it is difficult to get a significant bounce-back, so while say the US economy was coming back strongly after the Global Financial Crisis, ours didn't have anything to bounce back from. We just kept trundling along at a similar pace, with variations only at the margin. A good pace but not a rapid pace.

Maybe this is a good thing; the NYT certainly thinks so. It said: "An entire generation of young adults has grown up without experiencing a protracted downturn. But in Australia, as I came to learn, nobody really *acts* as if they're the stars of an unprecedented three-decade success story. They're aware the good times could end. The mood is more practicality than pessimism."

Will Australia ever have another recession or have we managed to completely overcome the business cycle? It is inevitable that at some point we will, it's just maths really. Nothing can keep going up forever, but we should embrace it while it lasts. But the conclusion of the NYT article is that others can learn from Australia's success: "The best way to keep [negative economic events] from causing the mass pain that accompanies a recession is to combine sound policy, a flexible and dynamic economy and – perhaps most important – just the right amount of fear."

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Traveller's Tale

Johan went to the US in April to take the pulse of the US economy and catch up with Australian companies that have significant operations there. He found an economy that is generally moving along quite nicely, perhaps growing a little slower than it was last year, but there was nothing that caused him any major concern. Manufacturing has weakened a bit but the consumer, buoyed by higher wages and low unemployment, seems to be picking up most of the slack. The number of "help wanted" signs in shop windows and on the back of various commercial vehicles was noticeable in many places.

Not surprisingly, supply chain logistics was a common discussion with a number of companies, including United Parcel Services (UPS) and Home Depot who are investing heavily to keep up with the continued shift to online retailing. Amazon has had it pretty much its own way for many years but companies like Home Depot are fighting back with a multi-billion dollar investment program to facilitate "click and collect" and home delivery. Our Home Depot equavlent, Bunnings, is talking about the same thing but has some work to do if the Australian hardware consumer follows the US trend.

A more surprising observation he made was that environmental awareness is becoming increasingly important for most companies' strategies and investment decisions. US recycling efforts have lagged most other developed countries, including most of Europe, Japan and Australia. It seems that public sentiment there has shifted in the last year or two, despite voting in a President who seems intent on turning back the clock in environmental regulation.

But when a company like Dunkin' Donuts, which goes through more than a billion cups a year, decides to switch from styrofoam to recyclable paper cups for its hot and cold drinks, it shows that big business is taking notice. No wonder a company like Amcor, which has long been focused solely on plastics packaging and is now the world's largest consumer packaging company following its recent merger with US peer Bemis, has committed to making all its packaging products recyclable by 2025. It's the right thing to do, and it's what consmers want.

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