Monthly Comment – July 2020
Alphinity Concentrated Australian Share Fund

Cold Comfort

Market comment

The market was somewhat becalmed in the chilly winter weather prevailing across much of the country in July. While its upward march did continue, it was very modest with the overall market (ASX300 including dividends) rising by just 0.6% in July. The month was notable for the larger than usual number of company announcements in the month before reporting season. Normally not much happens in July, but with all the unpredictable stuff going on in the domestic economy and around the world, quite a few companies felt they needed to pre-release some details of their upcoming results, either because they were particularly better or worse than expected, or because they were undertaking some sort of capital raising. While the August reporting season might have had some of its surprises already taken away, we do expect a greater-than-usual degree of vagueness in company outlooks. With all that 2020 has brought so far, who knows what else might happen!

Offshore markets were a bit more exciting than ours in July, although for Australian investors some of that was taken away by the strong $A, or more correctly, the weak $US, which depreciated by 3.5% against our currency. Commodity prices were mostly firm, buoyed by an economic resurgence in China as government stimulus kicked in. Brazil, a major resource-producer, was the best market for the month at +9.5% despite the pandemic running rampant in that country.

China's Shanghai market was also up 9% for the month but market returns fell away sharply after that. The US S&P500 was up almost 2% in $A terms in July and is now essentially unchanged since the start of the year; the tech-focused NASDAQ however was 3% higher in July and is now up an incredible 18% year-to-date. Japan, Hong Kong and the UK were all down between 2 and 4%; European bourses varied between +1% (Germany) and -3% (Spain). For the seven turbulent months of 2020 thus far, with the exception of NASDAQ, and Shanghai (+9%, all of which was in July), equity markets are overwhelmingly negative – not surprising considering what we are all going through. The worst has been Brazil at -34%.

Commodity prices were mostly higher with the exception of Coal. Iron Ore was up 7% in $A, largely thanks to China. The price of oil rose modestly but the biggest action was in precious metals: Gold finished the month up 7% to its highest-ever price of $US1975/oz or $A2765/oz, but the real excitement was in Silver, up an incredible 30% for the month (see chart). Base metals too were firm, rising between 2% and 9%. It seems as if the real economy is at least partially looking through the pandemic and assuming that things will be back on track before too long.

Consequently, companies exposed to commodities ended up being the best performers on our market in July. Materials companies were up 6% over the month followed by Information Technology, which was up close to 5%. Energy exposures were the worst performers, down almost 7%, followed by Health Care and Industrials, both down about 4%.

Portfolio comment

The Fund outperformed the market substantially in July. It benefitted primarily from holdings in iron ore miner Fortescue Metals, industrial property developer Goodman Group, copper miner Oz Minerals, global insurer QBE and gold miner Newcrest. Not owning major bank Westpac and being well underweight blood fractionator CSL also contributed nicely. The only detractor of note was Qantas, hurt by renewed Covid restrictions.

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)	2.4	9.3	-7.3	6.9	7.0	8.6	9.5
S&P/ASX 200 Accumulation Index	0.5	7.6	-9.9	5.4	5.1	6.8	7.6

*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. **Source: Fidante Partners Limited, 31 July 2020.**

^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.

Monthly Comment – July 2020

Alphinity Concentrated Australian Share Fund

Market outlook

Have equity markets already found a vaccine? Global equity returns have been less uniform in recent weeks but the direction has still been largely upwards. This has been the case especially in the US, despite continued high infection rates; and in Australia despite the second wave that has taken place in some parts of the country.

While some encouraging news on the progress in developing vaccines against Covid-19, with at least two now in large scale human trials, has certainly helped, markets also seem to have developed a degree of immunity against negative news. The "market vaccine" has come in the form of a double-shot of monetary and fiscal stimulus. Central banks have reiterated their "whatever it takes" policies while most Governments, including our own have extended (albeit at reduced levels) various forms of underemployment benefits. This has given investors continued confidence in the eventual recovery.

So what can undo markets from here? Valuations do look elevated, but that hasn't been an obstacle so far. The answer is probably time. Typically the advice given to investors in equity markets is to take a long-term view and, while we certainly wouldn't suggest any other approach, it's clear that the longer the virus hangs around the more severe the impact on the economy will be. The risk is that hopes of a strong and swift recovery, which some part of the market seem to be locking in, will prove too optimistic. And to continue the medical analogy, perhaps a better description of the stimulus that has been applied thus far is that it has been an effective treatment of the symptoms but not as much a pre-emptive solution to the disease as a vaccine might be.

Markets have reacted favourably to the treatment but the economy eventually needs to wean itself off the various forms of government support: that looks like a challenge currently. After a period of not-as-bad-as-feared economic data and corporate announcements, it is in our view likely that we get at least a pause in the support from rebounding indicators of activity. The upcoming reporting season will shed some light on individual company performance but, in the absence of a real vaccine, which some expect might be in production later this year, the odds are for at least some consolidation in overall share market performance in coming months.

Top five active overweight positions as at 31 Jul 2020	Index weight %	Active weight %
BHP Group Limited	6.7	4.0
Goodman Group	1.7	2.9
Commonwealth Bank Of Australia	7.7	2.6
QBE Insurance Group Limited	0.9	2.5
Wesfarmers Limited	3.2	2.5

Source: Fidante Partners Limited, 31 July 2020.

Portfolio Outlook

With the Australian reporting season upon us, company news rather than macro news should dominate headlines – at least for the next few weeks. While many companies are likely to use the current uncertain environment as a reason not to issue much in the way of earnings guidance, it should none the less give us some insight into how the companies that haven't pre-announced their results have managed the downturn so far, how conservatively (or not) earnings have been stated, what trading has been like in the first 6-8 weeks of FY21 and what balance sheets look like at the beginning of the new financial year.

As we wrote about last month, we believe we are already seeing a more differentiated outcome for companies, both from earnings and share price perspectives, as the market gets a better understanding of which companies and industries face various headwinds and/or tailwinds, which of those are likely to be temporary or longer lasting and, importantly, which management teams have been best at adapting to the new environment.

We have continued to adjust the portfolio according to how we see these factors influence earnings leadership. Additions to the fund in July include medical diagnostics company Sonic Healthcare, auto parts wholesaler Bapcor and domestic holiday-focussed retailer Super Retail Group.

We suspect the market is underestimating the positive earnings impact for Sonic from the global surge in testing for Covid-19, especially in the US, at the same time as volumes for traditional medical tests are showing signs of recovering in several of the company's core markets as GP visitations normalise. Bapcor should benefit from the same surge in the turnover of used cars in Australia which was one of the contributing factors when adding Carsales to the portfolio in June. We funded these new positions largely by continuing to take profits in some of the strongly-performing Resource holdings such as Fortescue Metals and exiting Mirvac, IAG and Orica, all companies for which we have become more concerned about further earnings risk.

Asset allocation	31 Jul 2020 %	Range %
Securities	98.0	90-100
Cash	2.0	0-10

Source: Fidante Partners Limited, 31 July 2020.

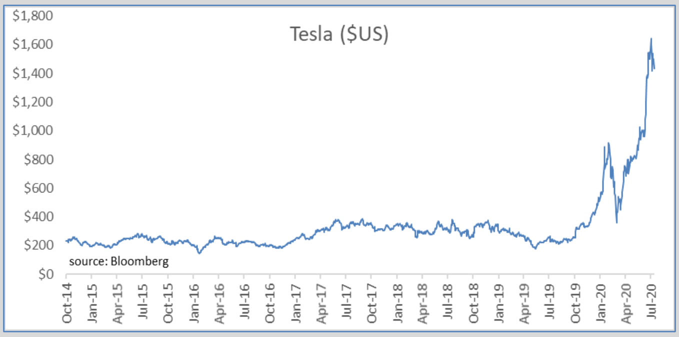
Monthly Comment – July 2020

Alphinity Concentrated Australian Share Fund

BTW

Regular readers of this publication could be forgiven for thinking that we are obsessed with Tesla, or its founder Elon Musk. Musk is undoubtedly a visionary but has some strange personal views and practices, as most visionaries probably do. He founded Tesla after selling payment platform PayPal and has fingers in many other pies as well. Tesla is his most prominent venture, probably because it is a high-value consumer good that is very visible in everyday life. Tesla and Musk are always newsworthy and present interesting case studies in human behaviour and investor psychology.

Why are we writing this time? Mainly because of the share price: it went from $US400 at the start of the year to $960 at the end of June, then in the month of July alone, it went up by a further 50% to close at $1430, having reached $1600 at one point.



Tesla, the car making company, is a bit of an enigma. Building motor vehicles is the ultimate old-economy activity: heavy industry, metal bashing, manual labour and so on – low multiple stuff as evinced by the way its local car-making peers are valued by the share market: General Motors trades at 6 times earnings; Fiat Chrysler is only 5 times. Although you need actual earnings to have a multiple and, for all its many successes, Tesla has still not managed to deliver a profit. It lost $US1 billion in 2019. It should make a profit this year: current broker estimates in Bloomberg project a surplus of between $US200 million and $2.5 billion in the current year ending December 2020. Having said that, Australia was projecting a budget surplus for the year just finished, and we all know what happened there.

But even if Tesla makes the top end of that range, $2.5 billion after tax (and there won't be much tax involved considering the tax losses the company has accumulated thus far), Tesla shares would still be on more than 100x earnings. That's because the market, in its wisdom, has decided that, at the time of writing, the company's worth is not that far off $US300 billion.

That seems like a lot of money, and it is. It is as big as Australia's four biggest companies, (Commonwealth Bank, CSL, BHP and Westpac) put together. It is way cooler than any of those companies though, even though CSL does some incredibly good work making blood products and vaccines to benefit people all around the world. But you can touch and drive a Tesla, they (mostly) look cool and they go fast.

The more interesting comparison however is with their peers in the automotive industry as shown in the table below (using 2019 financial data). You can see that the market is valuing Tesla more highly than any other car company, all of which made actual profits, and not just a bit higher. The only one that comes even close is the highly-productive and very profitable Toyota.

2019 data in $US	**# Cars**	**Sales**	**NPAT**	**Multiple**	**Cap**
Toyota	11m	$272b	$19b	8.8X	$204b
VW	11m	$282b	$15b	5.2X	$87b
Daimler Benz	3m	$193b	$13b	7.9X	$51b
GM	8m	$137b	$7b	5.4X	$38b
BMW	3m	$117b	$6b	7.4X	$47b
Ford	6m	$156b	$4b	5.6X	$27b
Fiat Chrysler	4m	$108b	$4b	3.7X	$17b
Hyundai	5m	$91b	$2b	9.9X	$23b
Tesla	**0.35m**	**$20b**	**-$1b**	**nm**	**$295b**

It will make money at some point. In high fixed cost industries like car-making, once you pass break-even the incremental profit on each car is high, but whether it can make enough to justify $US300b is to be seen.

Tesla is a disruptor, in that it is using new technology to produce a better version of an existing product, but while it portrays itself as a tech company and its shares are priced that way, it isn't really tech. It uses a lot of technology, but so do all other car-makers. The reason for the high multiple might just be the fact that there is a large pool of money out there that doesn't even think about the financial merits of the companies it invests in: if it's in the index, and Tesla is the biggest single component of the popular NYSE FANG index (which should really be called the FANANTATAB* index), they buy it indiscriminately.

*Facebook, Amazon, Netflix, Apple, Nvidia, Tesla, Alphabet, Twitter, Alibaba, Baidu

Monthly Comment – July 2020
Alphinity Concentrated Australian Share Fund

Non-Traveller's Tale

Australia said farewell to its last indigenous Jumbo Jet in July, killed off by the twin forces of time and emissions. Qantas owned a total of 57 747s over the past fifty years and VH-OEJ was the last it took delivery of in 2003. It spent its life trawling the world, finishing up on the Johannesburg route before Covid-19 closed down the whole industry in March. It was mothballed for a few months before being used for some local joy flights and then the final trans-Pacific trip to join its friends in the Mojave Desert (opposite) in the US for salvage – a sad end for such a noble beast.

The plane left our shores on July 23 and in what, depending on your point of view, was either a moving tribute or a massive waste of fuel pointlessly covering thousands of kilometres to make a geeky gesture visible only to those with a flight tracking app, the 747 traced out a flying kangaroo in the air.

Admittedly the 747 was showing its age. Qantas decided fifteen years or so ago that the A380, the two-storey mega-plane made by Airbus, was the future of long-haul travel but, within a decade, Qantas had stopped buying them in favour of the two-engine Boeing 787. The A380 was great flying experience, quiet and spacious, but its four-engine configuration is also considered inefficient.

As (past) fairly frequent flyers this makes us a little sad. The 787 too presents a much better flying experience than the 747 was but we did feel comforted, when traversing vast oceans such as the Pacific, having four engines hanging beneath the wings rather than just two. That option is disappearing fast.

Qantas has had a rough trot this year, being at the pointy end of disruption from the virus. While for a time it played an essential role in repatriating Australian citizens from various parts of the globe, its recurring business has been very challenged and the prospect of international travel returning to normal still appears to be a long way away.

Of course Qantas never made that much from international travel anyway, at a disadvantage to many of its peers who had government ownership, a much lower cost of capital (and this is a very capital-intensive business) and, for some, access to cheap fuel. Qantas' strength has always been in its dominance of the domestic market, and with the new Virgin likely to be a much more rational competitor, Qantas will likely prosper again when the borders open again. One day.

For further information, please contact:
Fidante Partners Investor Services | **p:** 13 51 53 | **e:** info@fidante.com.au | **w:** www.fidante.com.au
Fidante Partners Adviser Services | **p:** 1800 195 853 | **e:** bdm@fidante.com.au | **w:** www.fidante.com.au
Alphinity Investment Management | w: www.alphinity.com.au