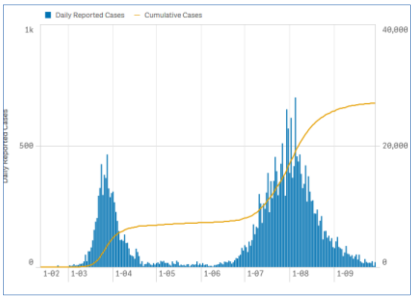
Quarterly Comment – September 2020
Alphinity Australian Share Fund

Spring Forward

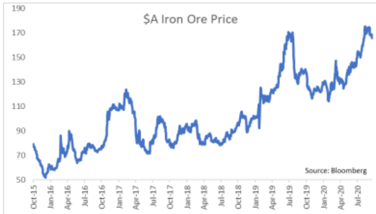
Market comment

Normally at this time of year we think of springing forward but the market (ASX300 including dividends) failed to do that, essentially being flat for the September Quarter. But there was an increasing sense of optimism in the air as we progressed through September. Not only was Spring springing, growing signs of Covid coming under control everywhere in the country also brought hopes of an imminent end to the worst of Melbourne's restrictions, and an increasing prospect of some of the more absurd state border restrictions being lifted; even a NZ travel bubble might soon be back on the table. With daily infection numbers dwindling to single digits in Victoria and negligible levels in all other states, it was only news from overseas that provided cause for alarm. And alarming it was: US deaths passed 200,000 with little sign of the infection rate improving; another severe wave hit the UK and continental Europe, and with lockdowns being reimposed in some countries. Infection remains at high levels in much of the world, and the quarter was topped off by the US President and much of his entourage catching the bug.



There was a wide range of equity market performances around the world: Sweden was best in the September Quarter in $A terms with 10%, followed by the quickly-recovering China (Shanghai) at 9%. The most-developed markets did the best with US, Germany all rising between 4 and 7%. On the negative side, Turkey fell 16%, Brazil, Hong Kong, Singapore and the more troubled European economies all fell by between -4 and -7%. The lead-in to the December quarter though is even more uncertain than usual, with the US Presidential election only weeks away, and the incumbent's health inserting even greater uncertainty.

Commodity prices kept doing different things during the September quarter. The price of bulk commodities was surprisingly strong, as China's resurgence from the virus continued, and largely as a consequence the $A rose 4% against the $US. Iron Ore was the star, starting the quarter at $A142/tonne before shooting up to $175 in August before settling back to $A165 at quarter's end; Coal was higher too. Energy prices however were not, with Oil falling between 4% (Brent) and 9% (Tapis) – great for consumers but less so for energy-producing companies. In precious metals, Gold was a modest 2% higher but Silver had a much wilder ride, finishing the quarter 26% ahead of where it started.



Base metals were mostly stronger, also buoyed by the economic stimulus in China. Copper is generally seen as a precursor of global economic activity, so its rise of 7% was good news for the near future. Zinc and Nickel were even stronger, both up around 10% for the quarter.

The best-performing sectors over the Quarter were Technology and Consumer Discretionary, followed by Property. The worst was Energy, not surprisingly considering the move in the oil price, with Utilities and Banks coming in close behind. Resource companies were steady overall but within that sector there was quite a disparity of returns, with Iron Ore companies doing better than anything else.

Portfolio comment

The Fund outperformed over the September quarter. The best contribution to returns came from industrial property play Goodman Group, copper miner Oz Minerals, iron ore miner Fortescue Metals, safety app Life 360, building materials maker James Hardie and not owning either gas producer Woodside Petroleum or infant formula maker A2 Milk. The only detraction of note was from not owning consumer credit provider Afterpay Touch.

Performance*	1 Month %	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Fund return (net)	-3.8	0.4	-7.9	5.6	7.7	7.7	8.1
S&P/ASX 300 Accumulation Index	-3.6	-0.1	-10.0	4.9	7.4	6.9	7.3

*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. **Source: Fidante Partners Limited, 30 September 2020.**

^The Fund changed investment manager and investment methodology on 12 August 2010, at which time Alphinity Investment management commenced managing the Fund and started the transitioning of the portfolio to a structure consistent with Alphinity's investment views. The transition was completed on 31 August 2010. Therefore, the inception date for the return 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

Despite the highly unusual circumstances surrounding the global economic recession of 2020 and a pandemic which – other than in a few fortunate countries including our own – looks a long way from being under control, the economic recovery has so far been surprisingly similar to the way previous economic cycles have played out. While the extent of the re-rating of equites doesn't leave much room for error, and the continued strength of the highly-valued tech sector looks like an important anomaly, overall what we've seen so far is reasonably close to text book in terms of what typically happens in equity markets ahead of an expected earnings rebound.

Importantly, most economic lead indicators have continued to strengthen and suggest that the earnings recovery should broaden, both here in Australia and globally. Of course, there remains a high degree of uncertainty, especially around the economy's ability to rebound should physical restrictions remain in place or get tightened again. After all, it doesn't matter how much we would like to enjoy a restaurant meal or a flight and can afford to do so if we are not allowed to.

We also know that some negative impacts take time to come through. Companies and individuals have a tendency to hold on as long as they can, in many cases supported by various forms of Government subsidies. However, this is no different to previous cycles during which the same leading indicators have been reliable indicators of an improved future earnings picture. So while very high valuations in some pockets of the market look unsustainable and pose a degree of risk, there is in our view enough indications of the economic recovery becoming more broad-based for overall market returns to hold up.

Positive vaccine news could further accelerate the recovery, although we take more confidence from the fact that many countries appear to becoming better at living with the virus. As one company we spoke to recently in Europe put it: "After three months of relatively normal summer months we're experiencing increased restrictions again but it's more impacting our social lives. From a work perspective it's pretty close to business as usual." This was obviously not a restaurant or office owner speaking, but with fiscal stimulus being largely maintained and interest rates remaining very low there should be enough parts of the economy getting back onto a more solid footing to enable us to look forward to the next 12 months with increasing confidence.

Asset allocation	30 Sept 2020 %	Range %
Securities	98.7	90-100
Cash	1.3	0-10

Source: Fidante Partners Limited, 30 September 2020.

Portfolio Outlook

The portfolio continues to be exposed to companies exhibiting earnings leadership across a number of thematics including a broadening of the economic growth recovery, structural growth, and stocks benefiting in some way from Covid. We think a well-diversified portfolio is always a good strategy but this is especially the case in the current environment.

Companies in the broadening growth category include Resources stocks such as Oz Minerals and BHP as well as hospital operator Ramsay Healthcare, which will benefit from normalising – or possibly even larger than normal volumes – of elective surgery as economies open up. We also expect that even a partial return of domestic flights would result in earnings for Qantas that are ahead of beaten-down market expectations.

Furthermore we have reduced our underweight to the Bank sector as the extensive Government stimulus should at least delay large scale credit losses. More structural growth stocks continue to trade quite expensively but we are maintaining some positions for which we see further earnings upside including industrial property developer Goodman Group and respiratory product maker Fischer & Paykel Healthcare.

The duration of the current Covid-impacted environment, and as a consequence the current consumer trends, remains to be seen but we suspect the earnings impact for some stocks will be both greater and more enduring than current consensus earnings reflect. Companies such as auto parts wholesaler Bapcor, Super Retail Group, Reliance Worldwide, Wesfarmers and James Hardie are in strong positions to capture the upside from consumer spending in segments such as DIY, domestic holidaying, second-hand car sales and housing repair and construction.

A more difficult call is what to do with so-called yield stocks. While the dividend yields of some companies of around 4% look attractive compared to bond yields which are currently close to zero we suspect improving earnings upside in other areas of the market might detract from that appeal. There is also some risk that the large scale stimulus we are seeing will result in higher inflation expectations and, as a consequence, cause an uptick in bond yields which would prove a challenging environment for these stocks. We have as a consequence reduced or exited some of these positions.

Top five active overweight positions as at 30 Sept 2020	Index weight %	Active weight %
Goodman Group	1.8	2.3
BHP Group Limited	6.3	1.9
Macquarie Group Ltd	2.4	1.7
QBE Insurance Group Limited	0.8	1.6
Woolworths Group Ltd	2.7	1.5

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BTW

This year has been a fascinating case study into the way the different political systems cope with crises such as Covid-19. One has to admit that for all its faults, the way in which authoritarian regimes are able to exercise control over their people proved to be very effective in managing the spread of the virus. We hasten to also say that those faults are manifest, and that regardless of the public health benefit we do not wish to live under such a system!

In China, the drastic lockdown techniques used in Wuhan included welding up the doors of apartment buildings so that residents were unable to get out – this is even more extreme than the curfew that was imposed on Melbourne. But it worked to the extent that life in China is now pretty much back to normal in most parts, at the same time that some of the more freedom-loving, individualistic people in the US and Europe are denying that the virus even exists and protesting against masks, while the virus still runs amuck.

The lessons of SARS and MERS a decade or so ago were well-learned not just by China but also by many non-authoritarian countries in Asia, and they were often very early to implement stringent public health measures. High public compliance with laws around mask-wearing – which was already part of many of those cultures even when there weren't global pandemics – helped many of them to avoid the worst of the depredations of the disease. Thailand, for instance, should have been at great risk. It has a population of 69 million, many of whom live in close quarters. It is also in close proximity to China, which usually sends it 13 million visitors a year. Despite these risks it managed to get away with only 3500 infections and 59 deaths. Well done Thailand!

So how did we do? It is too early to make definitive conclusions – this virus has not yet fully played out but thus far Australia is coming in the middle of the pack, in between the free and easy US and high-touch China. We're not doing as well as Thailand admittedly, but our natural advantage of geographic isolation and a fairly early decision to restrict our borders has worked in our favour. The world passed a million deaths attributed to Covid in September, although the real number is probably far higher. On a per-capita basis we have had 36 deaths per million population as at September; the worst country according to data compilation website Statista, was Peru with a massive 1023. Our favourite European country, Belgium with a population of 13 million, has had more than 10,000 deaths making it second worst, with 882 deaths per million.

Our favourite Scandinavian country is doing unusually poorly. Sweden is often held up as an example of how a successful progressive society should operate but its decision early in the pandemic to avoid a lockdown has resulted in the 13th highest per capita death rate, 579 per million, with the bulk of the impact felt by people living in residential aged care facilities, an area in which Swedish authorities now admit they should have imposed tougher restrictions. Neighbouring Denmark has had fewer than a fifth of Sweden's deaths.

Any statistics such as these are subject to reporting error – for instance Belgium and Peru might have been extremely scrupulous about attributing deaths to Covid, whereas other countries might have been less stringent. There are reasons for this, it could be a lack of testing capacity or even just making themselves look better. There is an interesting regional bias to the table however with South and Central American countries taking out nine of the 'top' 15 spots, totalling almost 350,000 deaths between them. Number 9 is the USA and 10 is the UK with 210,000 and 40,000 deaths respectively.

		Confirmed deaths	Population (m)	Deaths per million
1	Peru	32,742	32.0	1,023.5
2	Belgium	10,078	11.4	882.3
3	Bolivia	8,129	11.4	716.0
4	Brazil	146,675	209.5	700.2
5	Chile	13,037	18.7	696.1
6	Spain	32,225	46.7	689.7
7	Ecuador	11,681	17.1	683.7
8	Mexico	81,877	126.2	648.8
9	USA	209,424	327.2	640.1
10	UK	42,279	66.5	635.9
11	Italy	36,002	60.4	595.8
12	Panama	2,430	4.2	581.8
13	Sweden	5,895	10.2	578.9
14	Colombia	26,844	49.7	540.7
15	Argentina	21,468	44.5	482.5
84	Australia	895	25.0	35.8
136	Malaysia	137	31.5	4.4
137	Benin	41	11.5	3.6
138	China	4,739	1,392.7	3.4
139	Congo	274	84.1	3.3
140	Niger	69	22.4	3.1
141	Burkina Faso	59	19.8	3.0
142	Rwanda	29	12.3	2.4
143	Mozambique	66	29.5	2.2
144	Uganda	82	42.7	1.9
145	Thailand	59	69.4	0.9
146	PNG	7	8.6	0.8
147	Sri Lanka	13	21.7	0.6
148	Tanzania	21	56.3	0.4
149	Vietnam	35	95.5	0.4
150	Burundi	1	11.2	0.1

At the other end of the scale, Thailand had fewer than 1 death per million people; Vietnam did even better with just 0.37, with only 35 deaths attributed to Covid from its massive 95 million population. It might be reasonable to conclude that some of the 'better' countries have attribution issues rather than world-class health and infection tracing systems.

So surely there must have been a massive spike in deaths around the world as a result of this pandemic, right? Well, bad as it has been, the World Health Organisation reports that instances of regular influenza infections around the world have fallen to almost zero since the pandemic took hold. On some estimates the flu can cause as many as 2 million deaths in a bad year. A much higher rate of flu vaccination this year combined with the massive public health effort, including hygiene and social distancing precautions, has been very effective.

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Travelling Tales

We've written volumes about Tesla in these pages in the past but it's a company that never stops giving us material to work with. Like the fact that according to the US share market Tesla is now the single most valuable car maker in the world, worth $US400 billion – that's more than twice that of powerhouse Toyota. Or the activities of its visionary genius billionaire founder, Elon Musk, a man with any number of foibles but also with the drive, vision and resources to run several very different organisations at once, each of which has the potential to change humanity for the better (mostly!).

This time it's about Tesla's cars. They generally contain many innovations which put them ahead of most makers of conventional vehicles, but it does often get criticism about build quality for what are quite expensive cars. Traditional buyers of vehicles in that price bracket are used to German quality standards which the Californians often struggle to achieve.

Tesla now has three models available in Australia – the imaginatively-named Model S, Model X and Model 3. Essentially a slightly taller version of the Model 3, the Model Y is not yet available in Australia. More models are being developed, including the rather beautiful Roadster sports car and the rather ludicrous Cybertruck. But it is the Model Y which now has the car company in trouble.

One of the features of the Model Y (pictured here), is a fixed panoramic glass roof which gives it an incredibly open and airy feel. A glass roof in itself is not all that unusual, other car makers have been using these for years, but in the case of one owner it accidentally became a convertible. A driver in California was surprised recently when, driving it on the freeway less than two hours after picking up his new Model Y from the dealer, its glass roof suddenly flew off.

This was a bit shocking initially – and the story didn't say what happened to any cars behind when faced with a great sheet of glass flying towards them – but the owner at least displayed a sense of humour. He tweeted Elon Musk: Hey @elonmusk why didn't you tell us that Tesla sells convertibles now? Because the roof of our brand new model Y fell off on the highway. This brought accusations of fake news and doctored pics from Tesla fans, as well as comments about optional ejector seats but also a bit of sympathy from fellow travellers, like: See I was sitting here feeling sorry for myself, as my model Y only leaks when it rains. Who knew it was a pop top convertible.
Anyway, it was probably nothing a new piece of glass and some judiciously applied glue couldn't fix. And maybe a memo to the right section of the production line to double-check that bit. After all, you probably can't change the world without having a few stuff-ups along the way!

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