Monthly Comment – October 2020
Alphinity Australian Share Fund

Judgement Day

Market comment

October brought building tension as the US election grew nearer. This was when voters were supposedly going to deliver the blue wave to Washington, a crushing repudiation of the last tumultuous four years of Trump – but they didn't. In fact, several million more people voted for him this time than in 2016, even though his share of the vote was about the same. The result ended up being on a knife's edge for several days with lawyers at ten paces shaping up in some of the more marginal states.

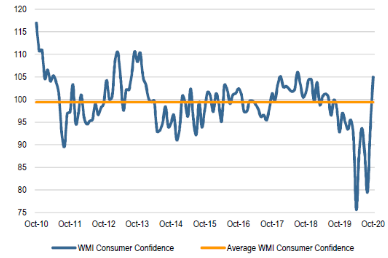
Notwithstanding all that hype the Australian market (ASX300 including dividends) managed to finish about 2% higher in October. It was actually doing much better than that for much of the month before peeling off in the final few days. Ours was actually one of the better performing markets in the world despite the $A falling by 2%. US shares themselves were down a little, even tech shares, held back somewhat by politics and another wave of Covid-19 cases in that country. European shares were worse, falling between 2% (Spain) and 8% (Germany) as a new series of population lockdowns were imposed across much of Western Europe.

It was a month in which corporate activity seemed to kick into gear. There were many of rumours of bids and a number of companies were actually bid for, including some which could be considered household names, with varying degrees of enthusiasm. The more prominent were soft drink bottler Coca Cola Amatil, registry manager Link Administration, financial services company AMP and movie/theme park operator Village Roadshow. Considering the almost zero interest rate environment it would not be surprising to see more takeover bids emerge over time.

The best performing sectors in October were Technology, Banks and Consumer; the worst were Industrials and Utilities although these negative moves were generally quite small. Resource companies declined slightly in aggregate, although as usual there was a lot of variance between the best and worst depending on the commodities they were exposed to.

Any company with leverage to the oil price suffered in October as prices fell sharply, between -5% and -9% depending on the grade. This was due partly to an increase in supply as Libya's main oil exporting port re-opened to exports after the lifting of a blockade but was not helped by the impact of the aforementioned Covid lockdowns in Europe. Bulk commodities were mostly fairly steady with the exception of Metallurgical Coal, the price of which was down 10% after shipping was affected by escalating trade tensions with China. Base metals however were mostly fairly firm, rising between 2% (Lead) and 7% (Zinc), assisted by the strength evident in the Chinese economy.

Domestic economic news was mixed during the month. The Federal Budget was delivered, five months later than normal, revealing eye-watering deficit numbers for the next few years with government income being reduced and expenditure increasing sharply in response to the pandemic. But all that government largesse has made the people reasonably happy: Consumer Sentiment (chart), as measured in the Westpac Melbourne Institute survey, has now bounced back to pre-pandemic levels.



Source: J.P. Morgan calculations, Bloomberg

Portfolio comment

The Fund performed roughly in line with the market in October and there were a surprisingly small number of contributors and detractors. It benefitted primarily from holdings in insurance broker Steadfast and auto parts wholesaler Bapcor. Not owning Brambles also helped. On the negative side was exposure to diversified resource company BHP, gold miner Newcrest and tech company Megaport; not owning ANZ Bank or consumer credit provider Afterpay Touch also held back returns.

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)	1.9	0.5	-6.5	4.9	7.2	7.6	8.2
S&P/ASX 300 Accumulation Index	1.9	1.2	-7.9	4.2	6.9	6.9	7.4

*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. **Source: Fidante Partners Limited, 31 October 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.

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Market outlook

Domestic macro factors have continued to be largely supportive for the Australian equity market. An expansionary budget, further cash interest rate cuts and more importantly an expansion of the Reserve Bank of Australia's quantitative easing program to lower interest rates across the yield curve, together with a continued fall in Covid infections and an end to lockdowns in Melbourne, should all assist economic growth and asset prices.

Recent overseas data, and therefore equity market performance, has been more mixed, especially with escalating Covid infection rates in both the US and Europe which has led to renewed restrictions being implemented in a number of countries. Authorities are loath to fully shut down their economies again so the restrictions this time are likely to be less severe than last time, at least initially. This should mean less economic impact as well, but of course the risk is that it also means greater restrictions might have to be implemented later if the current measures are not enough to get the virus under control. Even so, we expect the impact on equity markets should also be less severe as market particpants now understand better the temporary nature of lockdowns and the way in which Governments, central banks and consumers are all likely to respond during and after restrictions.

The US election lived up to all expectations when it comes to drama and hype, but in the end it looks like the only significant change is to the Presidency itself, with a Republican Senate and Democrat House remaining in place. While the change of President might result in improved geopolitical relations and a less fractious political debate, the status quo of the US Congress has probably reduced the prospect of large fiscal stimulus, with more monetary stimulus potentially being considered instead.

Together with the Covid infection upswing, the election looks initially to have shifted the market back to favour structural growth stocks over cyclical beneficiaries. With the election out of the way the remaining known event that could change the outlook significantly again is any forthcoming vaccine. Positive news would likely give the cyclical trade renewed momentum, while delays or negative results would reinforce the initial market reaction to the US election. Either way, equity markets look reasonably well supported.

Top five active overweight positions as at 31 Oct 2020	Index weight %	Active weight %
Goodman Group	1.8	2.2
BHP Group Limited	5.8	2.0
Macquarie Group Ltd	2.5	1.9
Woolworths Group Ltd	2.8	1.6
Steadfast Group Ltd	0.2	1.6

Portfolio Outlook

Large swings in macro sentiment related to the US election, potential positive or negative vaccine news and geopolitical tension are likely to continue to pose some challenges for a bottom-up stock selection process like ours. However, we are encouraged by a solid couple of months of earnings upgrades, driven by a diverse range of factors, for a number of our positions. For example, cyclical stocks such as OzMinerals, Fortescue Metals and BlueScope Steel are benefitting from the global recovery, and especially from China being largely back to its normal level of economic growth.

Some positions exhibiting strong upgrades have an element of Covid tailwinds behind them, and we need to be mindful of how long these will last, but we remain comfortable owning well-managed businesses with an underlying growth thematic such as James Hardie, Reliance Worldwide, Burson Group, Woolworths and Goodman Group. These are just a few of the portfolio holdings in this category that have seen recent positive earnings changes.

Our largest sector overweight at present is Healthcare. The Australian Healthcare sector is typically a defensive sector with stable but above GDP earnings growth. However, in this highly atypical year the sector has seen companies such Sonic Healthcare and Fisher & Paykel Health strongly benefit from Covid, while others like Ramsay Healthcare, Cochlear and CSL have been negatively impacted due to a combination of lockdown restrictions and fear of infections.

We still see a number of opportunities in the sector. We think the market is still underestimating the size and durability of earnings for Sonic and Fisher & Paykel. We are also more positive than the market about the speed of the earnings recovery for Cochlear and CSL. CSL is benefiting not only from a gradual normalisation in US plasma collection volumes but also from significant price increases for its plasma derived IG products – these price rises should be sticky even as supply and demand normalises over time.

Ramsay's recovery should be well underway in Australia ex-Victoria (soon there too), although its European hospitals are having a setback to their recovery from the second wave of Covid infections in the region. However, that demand is delayed rather than destroyed, as we can see from building elective surgery waiting times. While some patience therefore might be required the earnings recovery should be strong, making the wait worthwhile.

Asset allocation	31 Oct 2020 %	Range %
Securities	98.8	90-100
Cash	1.2	0-10

Source: Fidante Partners Limited, 31 October 2020.

Traveller's Tale

After a travel drought since the very start of the year, Stephane was required to experience the new reality of international travel when a family event required his presence in Belgium. He received permission from the Australian authorities to make the trip surprisingly easily but had to pay figuratively through the nose (and almost literally considering the number of Covid tests he was subjected to!) for the flights, stumping up also for the mandatory two weeks in a hotel when he returned.

Getting his return flight locked in was the main logistical challenge, considering only around 350 people a day could come back into Sydney at the time. Fortunately, with a combination of luck and tenacity, he managed to secure a flight that, unlike most options, didn't require him to use multiple airlines through multiples cities and take 40 or 60 hours.

Once all this was settled, the journey began. The port of the mask became mandatory from the moment he stepped into the plane and was confronted with the flight attendants attired in their new-normal outfits →.

Arriving in Brussels, the situation was getting alarming with 2500 cases being reported a day in a country of fewer than 12 million people. By the time he boarded his flight back to Sydney less than two weeks later the number of new daily infections was 25,000, Intensive Care Units were 60% full, and a full lock down was being put in place. Very few people did not wear a mask, a very different scene from here. All his flights back were almost empty.

Arriving back in Sydney he was required to spend two weeks in quarantine before he could be released into the more normal life. So how was the quarantine experience? At Sydney Airport he and his fellow passengers were welcomed by a large committee: border control handed him to the police who handed him on to the army who directed him to a bus.

Each of the buses went to a different hotel but he had no idea which one. You just get into the first bus; you can't pick and choose. His luck (or otherwise) was the Park Royal Darling Harbour. While maybe it could have been worse, his hotel review is that the Park Royal does not have a Park, nor is it very Royal! His room was a 30m^2 area with a sealed window offering a view of cars accelerating onto the Anzac Bridge access ramp.

He did not need to be worried about losing the hotel room keys – they were not given to him as you are not allowed to leave your room. There you are, stuck for two weeks. The only physical contact you have with humans is if you manage to see them walking away in the corridor after they have knocked on your door to alert you of the food delivery. The other two contacts were on days 2 and 10 for swab tests. Nurses phoned him daily to check whether or not he was suffering from any Covid symptoms – if he was, he would have been sent to a hospital. Thankfully Stephane was able to stay in his room.

All thing considered, he felt that everyone he came into contact with throughout the whole out-of-a-bad-movie process were incredibly friendly and supportive in typical Australian style. He did feel however that it would be quite easy to fall into a panic from being confined to such a claustrophobic space if one took too much time to think about the situation, especially those sharing the room with family. His strategy was to focus on staying fit by practicing an hour of gym a day (delivery of gear is allowed) and focusing on the markets which as we know always have plenty of ammunition to keep one busy 24/7. He also used it as an opportunity to handle unexciting but important matters like completing his tax return.

So apart from the constant roar of cars and his German neighbour in the next room, Johannes, whom he heard every night calling his family and colleagues, speaking loudly and clearly into the phone so that despite the 20,000km distance they could still hear him, his room was a place of calm and solitude. This is luxury compared to so many people who face much harder conditions, so it would be wrong to complain about having to stay in a 4½ star hotel for 14 days. 'Take it as an experience', he says. And it's also necessary, especially when coming back from a red zone, to protect our country from any new cases.

What did he miss most during the two weeks? Besides the obvious partner/friends, he says it was fresh air! Air conditioning for 14 days can be daunting. Anything he would change? "Besides the room, if quarantine were to become the norm up until a vaccine is available, I hope we will develop faster ways to assess whether one is infected, maybe through more frequent tests over a shorter period, but I'm sure the government and medical world will address that in time. For now, I feel fortunate to have been able to go where I needed to be, and then to be able to return here and enjoy what is an almost normal way of life".

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BTW

Asbestos was one of the wonder products of the 20th century – a lightweight material which was almost impervious to heat – and ended up being used in all sorts of products, including building materials and car brake pads. Vast swathes of asbestos-laced Fibro were used building houses in the post-WWII building boom. It is a naturally-occurring mineral which is mined in the same way as iron ore or coal – dug up out of the ground and shipped off for processing into Useful Stuff.

Then they discovered a nasty side effect – if you breathed in fragments of it you had a high chance of developing a debilitating and incurable carcinogenic lung disease. Undisturbed Fibro is quite safe, the risk arises when you cut or break it and the fragments are breathed in. The product was phased out in Australia in the 1980s although the sale of product containing asbestos itself was not officially banned here until 2003. There were some huge lawsuits in the 1970s and 80s and some of the companies that once used asbestos in their products are still paying out compensation to sufferers.

Asbestos really should be banned everywhere but it is still legal in a number of countries, including large countries like the USA. Surprisingly it is still being produced in a number of countries, primarily Russia, Kazakhstan, China and Brazil, and is mostly used in China, India and Indonesia. It was mined in Canada until relatively recently, the last mine closing in 2012.

These thoughts about asbestos were sparked by an article we saw in the New York Times about a town called Asbestos in Quebec, Canada. It was thus named because it was adjacent to a large asbestos mine, and obviously the name was given prior to the mineral becoming a pariah. Anyway recently its citizens determined in a referendum that Asbestos was such an embarrassing name that it should be changed to something a bit more relatable, like Val-des-Sources (valley of springs).

300km from Asbestos/Val-des-Sources, across the border in upstate New York, is the tiny town of Swastika – named in 1913 long before the Nazis appropriated that ancient Sanskrit symbol for their nefarious purposes. Residents of Swastika voted as recently as September to keep the name.

Other odd placenames around the world include Boring, in Oregon USA (we've been there and can report that it lives up to its name). Also Bland Shire in western NSW; the villages of Ugley and Nasty in Hertfordshire UK; Hells, both in Norway and Michigan USA; and Middlefart in Denmark. The list is very long, and that's before you get to the rude ones.

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