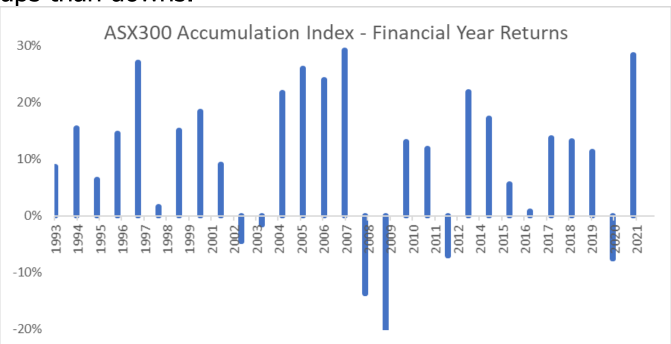
Quarterly Report – June 2021
Alphinity Sustainable Share Fund

Finishing Strongly

Market comment

The final quarter of the 2021 financial year saw the Australian market (ASX300 including dividends) continue its upward march, returning 8.5%. Since the initial Covid panic in March 2020 there has been only one negative month, September 2020. Economic news in Australia continued to be positive with unemployment falling back to pre-Covid lows and job vacancy statistics suggesting further improvement lies ahead. While a Covid flare-up late in the quarter puts some risk around the durability of the recovery, we've been through lockdowns so many times now it appears that the market doesn't fear its impact too much, notwithstanding the greater relative scariness of the Delta strain.

The year to June 2021 will go down as one of the better periods for the share market in recent times. At +28%, it ranks alongside some of the very best since the ASX300 was established three decades ago. The average annual return over that period has been 10.4%, with many more ups than downs.



The $A lost a cent over the June quarter, moving from $US0.76 to $0.75 even though it spent most of that time above $0.77. Global markets were mixed as usual and Australia performed in the middle of the pack, similar to China but better than the UK, Germany, Italy, Singapore, and New Zealand. Some markets however delivered returns greater than 10%, including the US, France, and Canada. Japan had a zero return for the quarter as that market contemplates imminently hosting the Olympics at the same time as battling virus breakouts.

Commodity prices remained generally well supported across the June quarter, reflecting a building economic recovery in many parts of the world. Bulk commodities were the clear winners: Iron Ore was up 39% in $A terms; Thermal Coal, used in power generation, was up 41% and Metallurgical Coal, used in the making of steel, rose 48%. Energy prices were also strong: Brent and Tapis Oil up 20% and light crude from the US up 25% while Gas prices in the US rose by +40%. Some base metals also showed strength: Lead up 18%, Aluminium and Nickel up 15% and Copper up 8%.

Despite the very strong energy prices mentioned above, however, companies in the Energy and Utilities sectors on the Australian market performed quite poorly across the quarter, falling 2% and 5% respectively. This is a little perplexing one would normally expect the oil price and share prices of energy producers to be quite closely related but actually worked in the Fund's favour this quarter as it does not invest in fossil fuel producers. Much better outcomes were achieved from Consumer Discretionary and IT companies (both +12%) and Consumer Services (+11%). Materials companies, which include resources, building materials and chemical producers, and Financials also did well, rising close to 10% overall. Real Estate and Healthcare companies were essentially market-performers.

Portfolio comment

The Fund outperformed the market nicely over the June quarter. It benefitted most from tech exposure Megaport, mineral sands producer Iluka, waste management company Cleanaway, iron ore miner Fortescue Metals, industrial property developer Goodman Group. Not owning gas producer Woodside Petroleum also helped. The largest detractors from performance were light-weight car parts maker Carbon Revolution, horticulture company Costa Group, airline Qantas, held back by more lockdowns, and hospital operator Ramsay Healthcare. Not owning gaming machine maker Aristocrat Leisure also detracted from 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)	2.2	9.4	32.6	12.8	14.6	11.1	11.1
S&P/ASX 300 Accumulation Index	2.3	8.5	28.5	9.8	11.3	9.2	9.3

*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 June 2021.
^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.

Market outlook

So was that it? Have bond yields already peaked? While many commentators – ourselves included – expected the yield of longer-dated bonds to rise as the reduction of monetary stimulus through the bond market (a.k.a. tapering) approached, the exact opposite has happened in the last month or so. When Jerome Powell, Chair of the US Federal Reserve Bank (Fed), said it is now "talking about talking about" tapering market participants sent bond yields lower, and "growth" stocks, which tend to benefit from less abundant earnings growth and lower interest rates, higher. The market's view now is that the Fed will rein in economic growth and inflation before more drastic action is required down the track.

We suspect the last word might not yet have been said about inflation, as there are now more companies talking about having pricing power (i.e. being able to pass higher input costs on to the selling price of their product) than at any time in the last decade or so. An increase in the supply of bonds as the US Government looks to fund its ever-increasing budget deficit and roll over existing debts might be another reason for bond yields to reverse course.

Not much has changed from a domestic corporate earnings perspective. Earnings growth expectations have been further revised upwards for both the financial year just finished (FY21) and the one just started (FY22). FY21 earnings growth, which will be confirmed in the upcoming August reporting season, is likely to come in at well over 20%, a very strong outcome even when compared to the weak FY20. However, the bulk of the earnings growth can be explained by a rebound in Bank earnings, following overly pessimistic bad debt assumptions in the past, and strong commodity prices. More recent positive earnings growth revisions have been even more concentrated in the Resource and Energy sectors. And while many Resource stocks are trading at low earnings multiples, sell-side analysts' commodity price assumptions are starting to catch up to spot prices which limits the potential for further upgrades – at least for the remainder of the year.

In summary, while we cannot rule out a return to some sort of Goldilocks scenario, in which economic growth is solid but not so high as to trigger interest rate increases, it is increasingly difficult to find areas of the market for which earnings are either not already looking close to as good as they can get or, for companies whose earnings are yet to recover, share prices that are not already factoring in a lot of positive future earnings news.

Portfolio Outlook

With most of the positive earnings growth surprise potential still concentrated in Resource companies, we retain a solid exposure to the sector. Within that however, we have further skewed the positions towards diversified miners as we see in them the greatest potential for further earnings upgrades in addition to healthy dividend payments in coming months. Copper miner Oz Minerals has been a favourite company of ours and management has hardly put a foot wrong over the last several years. However, with consensus copper price expectations now close to the spot price (which is up 60% over the last 12 months) and the company's growth projects largely reflected in the share price, which has doubled in the same period, we have reduced our position somewhat.

While we are skeptical about bond yields staying at current levels, and as a result continue to be underweight Technology, which is the most expensive sector in the market, we have continued to diversify the portfolio by adding more structural growth companies in the past few months. Recently we added ResMed, which has been in the portfolio before but a lack of earnings upgrades kept us out until recently. ResMed has had some challenges with the lagged impact on demand for its sleep apnea products due to a decline in sleep diagnostics during Covid. Testing is now recovering and a significant global product recall by its major global competitor, coinciding with ResMed's launch of its new S11 airflow generator, is also providing the company with an opportunity for a step-change in market share globally.

The upcoming August reporting season will, as always, be an important test of the investment theses for many portfolio holdings. The portfolio achieved a strong score card in the February interim reporting season and, while share prices, earnings expectations and the economic environment have continued to evolve since then, we believe – supported by recent management commentary – that most of the companies that did well in February will also report solid numbers in August.

Top five active overweight positions as at 30 June 2021	Index weight %	Active weight %
Fortescue Metals Group Ltd	1.8	2.9
Goodman Group	1.7	2.2
Lifestyle Communities Ltd	0.1	2.1
Wesfarmers Limited	3.2	2.1
Iluka Resources Limited	0.2	2.0

Asset allocation	30 Jun 2021 %	Range %
Securities	98.0	90-100
Cash	2.0	0-10

Source: Fidante Partners Limited.

The EU Taxonomy: A pathway to consistently measure the sustainability of financial products

For years the finance sector has been grumbling that there is no consistent way to assess the overall 'sustainability' of financial products in the market.

There are of course a number of ESG data providers which purport to measure sustainability but the results vary greatly from one provider to the next. There are also the SDGs, which we believe are the best measure of overall sustainability available right now, but the Goals require a degree of interpretation in order to be used by investors.

So when we heard that the European Commission was releasing a classification system that could help define which investment activities are sustainable and which are not, we were understandably excited.

The EU Taxonomy aims to increase the amount of investment in sustainable activities and assist the EU achieve the goals of the EU Green Deal. The Taxonomy was released in July 2020 and, for now, focusses on *environmental* sustainability aspects. It's likely the system will be expanded to also cover *social* aspects over time.

The system establishes six environmental objectives and four overarching conditions that an economic activity has to meet in order to qualify as environmentally sustainable:

Environmental objectives	Overarching conditions
1. Climate change mitigation 2. Climate change adaptation 3. The sustainable use and protection of water resources 4. The transition to a circular economy 5. Pollution prevention 6. The protection and restoration ecosystems	1. Contribute substantially to one or more objectives 2. Not significantly harm any objective 3. Comply with minimum safeguards 4. Comply with technical screening criteria

The technical screening criteria will be published in papers known as Delegated Acts and will be adopted for each of the six environmental objectives, fleshing out in detail what it means for an economic activity to substantially contribute to an environmental objective. The first Act, for climate change objectives, was published in April; the remainder are expected to be released by the end of this year for adoption at the beginning of 2023.

Although Alphinity will not be obliged to report against the Taxonomy, as we do not operate or report into the EU, we can see how this could be something our clients would like to see. We can also see that over time, once the social elements are also added, the taxonomy could supplement or even replace the SDGs as a tool to measure the overall sustainability of our portfolio.

Once further Acts have been published we will review our degree of alignment and consider the implications further.

Emissions

The estimated carbon intensity of the portfolio, using emissions data supplied by MSCI, is shown in the table below. It is well below that of the ASX300 benchmark. Almost any economic activity involves the emissions of CO_2 but the fact that our negative screens exclude eight of the ten largest emitters in the benchmark, which between them make up around half of the benchmark's total emissions, makes us confident that the fund is minimising carbon dioxide emissions while still supporting companies which promote the Sustainable Development Goals.

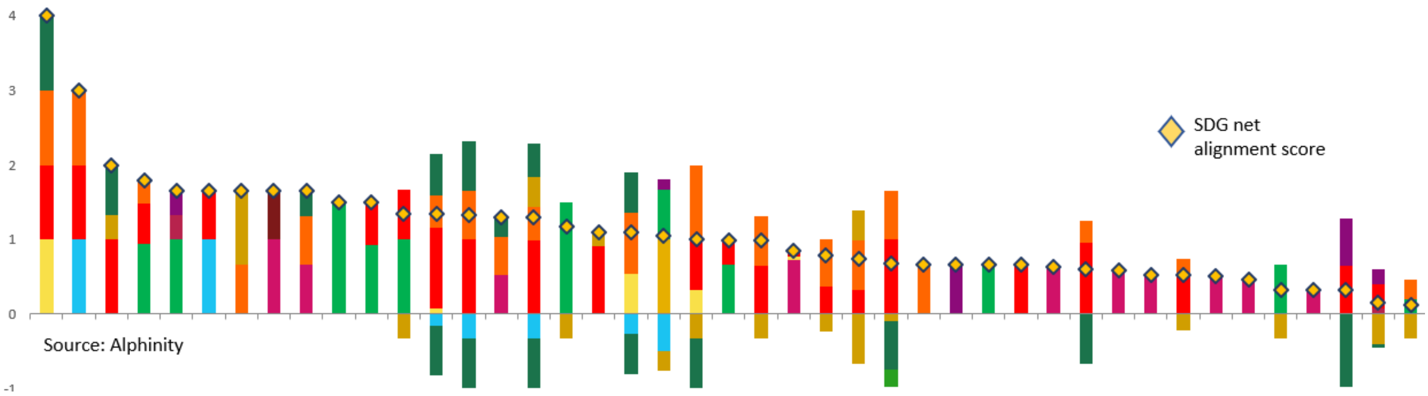
Carbon Exposure Metrics

Scope 1 & 2	SSF	ASX300
Carbon Intensity*	121.4	220.5

* Weighted average tonnes of CO_2 equivalent emissions per $USm revenue
Source: Alphinity, MSCI. Data as at 30 June 2021.

SDGs

The chart below shows the SDGs positively and negatively addressed by companies in the portfolio as at 30 June 2021 to show the proportion of revenues of each company that helps to support sustainable development. It has since been evolved by Alphinity to also include an assessment of the companies' operational alignment to the SDGs.



BTW

"Early to bed, early to rise, makes a [person] healthy, wealthy, and wise". So says the proverb, although the causal link has never been definitively established. We all must be sleeping really well then: we are wealthy and we are healthy (see BTW2 on p4). Are we wise? Might be best to leave that topic for another day…

The fact you are reading this suggests you care about your wealth, and Alphinity is pleased to be able to provide products to assist you in building that. We are always interested to see the annual Credit Suisse global wealth survey, the 2021 version of which was released this month. It examines the state of peoples' wealth around the world and it's always intriguing to see how well Australia fares in this respect. While the strength or otherwise of the $A can have an impact from time to time (all countries' metrics are expressed in $US), in recent years we have tended to end up close to the very top. Credit Suisse's home market of Switzerland generally ends up #1.

This year Australia came in at #4, with average wealth (total assets net of debt) of $US483,760 per adult. Switzerland topped the list with a $US673,960 and was followed by the USA at $US505,420 and Hong Kong at $US503,340. Our friends across the Tasman were not far behind in 8th place with $348,200. Between us and New Zealand were the Netherlands, Denmark, and Belgium.

More pleasing however is that Australia is the highest-ranking country in the world when it comes to median wealth, with $US238,070 per adult. Median wealth is the point at which there are just as many adults with higher wealth as lower wealth. This means our wealth is shared more equally than most wealthy places: the rich here are not as super-rich and the poor are not as super-poor as in some countries. The US for instance is often perceived as a place where there is great inequality and the Credit Suisse report supports that: average wealth is half a million dollars but that is distorted by a relatively small number of people with obscene amounts of wealth – Musk, Gates, Buffet, Bezos, Zuckerberg et al – which increases its average a lot. Median wealth in the USA is $US79,000, just a third of ours. New Zealand also scores highly in the equality stakes, coming in at #4. Switzerland, with the highest average of wealth, has the 6th highest median wealth with $146,730.

	mean ($US)	Δ 20 to 21	% Δ		median ($US)	Δ 20 to 21	% Δ
1 Switzerland	673,960	70,730	10.5%	1 Australia	238,070	32,280	13.6%
2 United States	505,420	41,870	8.3%	2 Belgium	230,550	35,330	15.3%
3 Hong Kong	503,340	-26,420	-5.2%	3 Hong Kong	173,770	-10,550	-6.1%
4 Australia	483,760	65,700	13.6%	4 New Zealand	171,620	7,180	4.2%
5 Netherlands	377,090	46,030	12.2%	5 Denmark	165,620	16,980	10.3%
6 Denmark	376,070	38,750	10.3%	6 Switzerland	146,730	14,090	9.6%
7 Belgium	351,330	54,030	15.4%	7 Netherlands	136,110	16,880	12.4%
8 New Zealand	348,200	15,150	4.4%	8 France	133,560	7,090	5.3%
9 Sweden	336,170	55,460	16.5%	9 United Kingdom	131,520	8,100	6.2%
10 Singapore	332,990	25,460	7.6%	10 Canada	125,690	11,330	9.0%

source: Credit Suisse

Why is Australia so well off? A number of factors contribute but compulsory superannuation, which has forced most workers to save a meaningful proportion of their income for the last 30 years, is a big factor. This has grown into an enormous pool of assets, a bit over $A3 trillion, which is bigger than the country's annual economic output, around $A2 trillion). Thank you Mr Keating!

Covid has turned out to be pretty good for wealthy people. Almost all countries showed hefty increases in average and median wealth, largely thanks to huge amounts of economic stimulus around the world, and zero interest rates which sparked booming share and housing markets almost everywhere. In Australia, for instance, wealth in $US rose by 13% on the prior year and in many other countries it was up double digits too.

Wealth fell by about 5% in Hong Kong, although one can probably attribute this to other factors being in play there, such as the pro-democracy crackdown and exit of expats which has hit property values. Still Hong Kong's average and median wealth remain very high at $US503,340 (average, #3) and $US173,370 (median, also #3): much wealthier and more equal than across the border in China (average $US67,771; median $US24,067). It is intriguing that China would rather impose its own system onto Hong Kong than replicate Hong Kong's clearly successful economic model.

The number of millionaires per country is also measured in the survey. Credit Suisse found that there were 1.8 million $US millionaires (adults with a new worth of about $A1.3m) in Australia at the end of 2020 – up from 1.4 million the year before. Of course, this used to be quite an impressive claim; these days it just means you have a decent wedge of equity in a house in one of our major capital cities. There are 56 million millionaires around the world, 22 million of which are in the US. But our relative equality is again shown by the proportions: with 9.4% of the adult population we are second only to Switzerland, 15% of whose population is a millionaire. The US comes in a close #3 with 8.7%.

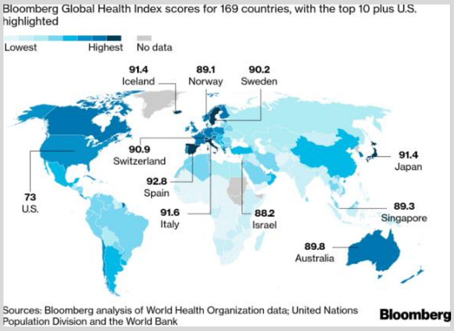
What does the future hold? No one really knows but for what it's worth Credit Suisse forecasts a continuation of the upward trend, projecting a further 39% increase in overall global wealth by 2025. It expects the robust recovery from the Covid recession (which was mercifully brief in Australia) to continue, and our number of millionaires to increase by 50% – to 84 million – by then. Our own number is supposed to rise by 70% to a bit over 3 million. China's number is expected to almost double, from 5.3 million to 10.2 million, although will remain well short of the 28 million they say will be in the US at that time.

BTW2

Being rich doesn't necessarily mean being happy but it does seem to correlate somewhat with being healthy. Bloomberg, which seems to have stats on pretty much everything, measures relative health in its Healthiest Countries Index. The most recent report we could locate was from pre-Covid 2019: there were some purporting to be from 2021 and 2021 but they generally referred back to the 2019 Bloomberg report. A bit has happened on the health front since then which might make the assessment a bit different now but at that point the healthiest country in the world was Spain. It was followed by Italy, Iceland, Japan, Switzerland, Sweden and, at number seven, Australia. Singapore, Norway and Israel rounded out the top ten.

One could make up some common themes out of this. The Mediterranean diet (Spain, Italy, Israel); primarily fish-based diets (Iceland, Japan, Sweden, Norway); and wealth as per the previous article (Switzerland, Australia, Singapore). Wealth of course is not completely positive for health. It does enable some good health outcomes (for instance good housing, access to drugs and medical care), but equally predisposes people to the negative aspects of prosperity: hypertension, alcohol consumption, obesity, and sedentary lifestyles. Wealth didn't help the US however which ended up in 35th spot: inequality was enough to offset that. China was not that far behind, 52nd, and is rising quickly.

Would Covid have changed the situation much if Bloomberg re-ran its data today? Probably it would: the fact that hundreds of thousands of people died in rich western countries with supposedly good health systems, like the USA and UK, while deaths in China were suppressed (according to official numbers at least) means that China might now rank ahead of its rival. Bloomberg used data to arrive at its conclusions. The starting point was mortality from communicable diseases, life expectancy and the probability of surviving various life stages, followed by risks of adverse outcomes from the abovementioned lifestyle factors and measures such as availability of fresh air, clean water and good sanitation. There were 169 countries assessed by Bloomberg – a further 30 had insufficient information available so were not scored – but sadly at the lower end of the scale were the long-suffering Sub-Saharan African countries which made up 27 of the 30 bottom countries. The very last spot was held by Sierra Leone.



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