Monthly Report – July 2021
Alphinity Concentrated Australian Share Fund

Delta Blues

Market comment

With vaccine penetration running at high levels in some countries, much of the Western world thought that Covid was almost done with and life was on its way back to normal. Then came the highly infectious Delta variant and a resurgence in case rates across Europe, the US and the UK. Although the numbers remain relatively low in Australia, our relatively lower vaccination rate meant another round of lock-downs in July, including in some of our biggest cities. The local market however (ASX300 including dividends) seemed relatively unperturbed, rising a further 1% and finishing the month at another all-time high. The month was bookended by corporate activity: a bid for Sydney Airport started the month and a bid for Oilsearch finished it.

We did lag some of the major offshore markets in July however, whose returns were boosted by the $A which fell 1.5% against the $US and Euro, 2.3% against the UK Pound and almost 3% relative to the Japanese Yen. In $A terms our share market did better than some of the bigger Asian markets: Hong Kong and China (Shanghai) fell 8% and 3% respectively; Korea and Japan both fell a bit over 2%, but Australia's 1% lagged pretty much everywhere else. Most European markets were up between 2% and 5%, and Sweden was a stand-out at 6.4%. The broad S&P500 index in the US rose 4.5% but tech-focused Nasdaq was up by less, about 3%. We know it's not a race but our market is now up 14% for 2021 to date, placing us in the middle of a pack that stretched from -10% (Turkey) to +27% (Sweden).

Commodity prices remain a driver of our market. Some mixed messages coming out of China about the future of its economy caused some uncertainty in the iron ore market, sending its $A price down 6.5% from the recent highs which had been seen by many, ourselves included, as being unsustainable. Demand for coal however remains intense, driving the price of thermal coal for electricity generation up 13% and metallurgical coal for steel-making 20%. Energy prices were largely unchanged but base metals continued their upward trajectory, especially copper (+7%) and Nickel (+10%).

Materials and Resource companies were the best performers on our market during July rising about 7% overall, followed by Industrials with a 4% rise. Technology stocks were the poorest performers for the month, falling 7%, and Energy stocks fell about 2.5%. August will see the FY21 Reporting Season kick off and provide a deluge of information and insight about current trading conditions and the near-term outlook for most of the companies in the portfolio.

July also saw the start of the 2020 Olympics in Tokyo, running a tad late thanks to Covid. It has been a little surreal seeing all of those beautiful facilities largely devoid of spectators, and hard to reconcile running a major global event of that nature, involving thousands of people travelling from and then back to countries all around the world, at a time Japan had declared a state of emergency and was recording thousands of Covid infections per day. But still, the show must go on and so it did, providing much-appreciated opiate for the masses who were locked in.

Portfolio comment

The Fund outperformed the market nicely in July. Not owning Afterpay helped, as did our holdings in miners BHP and Lynas Rare Earths and industrial property group Goodman. Being underweight major bank Westpac was also positive. On the other side of the ledger the biggest detractor was not owning Sydney Airport, which attracted a takeover bid at the start of the month. Aside from that, our holding of Santos and not owning Fortescue Metals both cost a small amount in July.

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)	2.0	6.2	27.0	8.8	11.2	11.4	11.0
S&P/ASX 200 Accumulation Index	1.1	5.8	28.6	9.5	10.0	9.8	9.4

*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 July 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.

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Market outlook

Another month, another positive share market return. Global equity markets continued to rise and pre-Covid peaks are now well in the rear-view mirror. As we have written about before, the combination of massive monetary and fiscal stimulus has created a heady cocktail of low interest rates, an abundance of liquidity and strong corporate earnings growth.

What could end the party? In the short term, it appears not much. Central banks show little appetite for drastically changing policy settings. The Delta variant of Covid perhaps? Maybe, but global economic indicators remain strong, although arguably stabilising at high levels rather than accelerating further. And while longer term valuation metrics look quite full, these tend to matter less when earnings growth is this strong.

The June quarter reporting season in the US has been very solid with optimistic outlook statements also featuring heavily. While Covid-related people movement restrictions in the US and most of Europe are quite different to Australia, the earnings drivers appear largely the same: cashed up consumers, strong commodity prices (and even more so in Australia) and pricing power allowing companies facing input costs pressures to recoup those high raw material prices.

The upcoming back-to-school period in the US will be an important test of some these dynamics. Not only will the opening up of the economy be tested with increased risk of Covid infections as students return but it also appears that some of the budding wage pressure can be explained by many parents faced with home schooling who are yet to return to the workforce. More widespread wage pressure would have significant implications for the ongoing inflation debate – or at least put company profit margins at risk.

Back in Australia, renewed and extended lockdowns could take some gloss off the August reporting season, especially in relation to outlook statements. However, even though the Federal Government has so far been reluctant to re-introduce JobKeeper, at least under that name, with the next Federal election swiftly approaching it is likely that more stimulus will be forthcoming.

Which brings us back to interest rates and bond yields. While Delta variant outbreaks around the world will likely further delay any significant tightening, bond yields still look too low considering the current economic strength and inflation risks. These remain the key risk to equity markets, in our view.

Portfolio Outlook

With Reporting Season about to hit us, the next few weeks will be a busy period for the Alphinity team with much information to analyse and many discussions to be held with management of companies we own and don't own. Leading into the Season, consensus earnings upgrades have continued to be skewed towards Resources companies and this has benefitted the fund. While indications that growth in China is slowing, after a strong recovery, supply and demand balances still look healthy for the bulk commodities (iron ore and metallurgical coal), and we anticipate strong dividends and, potentially, capital management from highly cash-generative companies such as BHP and Bluescope Steel.

A slew of domestic lockdowns, particularly the extended one in Sydney, has added some complexity to the outlook for domestically-exposed companies. We have in previous lockdowns seen a quick shift online by consumers and a sharp rebound in activity as the lockdown ends. Although we expect some of this behaviour to repeat, especially for the supermarkets and other staples, we are not so sure that online buying will compensate for reduced in store buying to the same extent this time in the more discretionary categories.

We can be more certain however that the earnings recovery in stocks most negatively impacted by Covid last year has been pushed out again. The Fund's exposure to these stocks has been limited over the last 12 months and was further reduced in recent months by trimming our holdings in Qantas and Transurban and exiting Ramsay Healthcare. On the other hand, we suspect that the market continues to underestimate the longevity of the earnings tailwinds for a number of so-called Covid winners. As such we remain comfortable with our holdings in companies such as Bapcor, Sonic Healthcare and Medibank Private.

Top five active overweight positions as at 31 Jul 2021	Index weight %	Active weight %
BHP Group Limited	7.6	5.0
Commonwealth Bank of Australia	8.5	3.1
National Australia Bank Limited	4.1	2.5
QBE Insurance Group Limited	0.8	2.4
Macquarie Group Ltd	2.6	2.3

Asset allocation	30 Jun 2021 %	Range %
Securities	98.2	90-100
Cash	1.8	0-10

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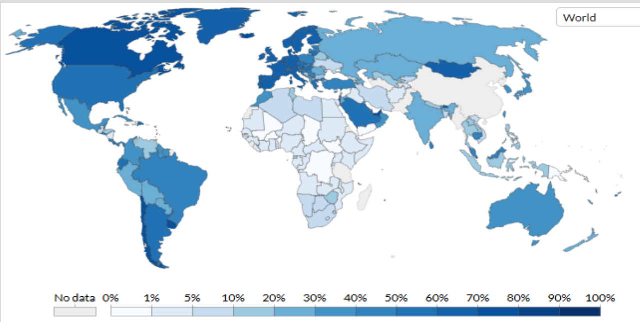
BTW

The head of the US Centre for Disease Control said this month that the Delta variant of Covid-19 is "one of the most infectious respiratory viruses we know of". It is now the dominant strain in the US, accounting for 90% of infections there, wreaking havoc in communities with low vaccination rates. There seems to be a political divide, with states that had most strongly supported ousted President Trump making up many of the vaccine-resistant regions. This seems a little odd considering one of the things of which Trump should be most proud is the way his administration drove the effort to develop the vaccines in 2020: one would think his supporters would also support the vaccines that were developed, but it seems not.

This time last year there were overflowing emergency wards in countries like the USA, UK and Italy, shortages of ventilation equipment and essential gasses, thousands of deaths daily – including of many health professionals caring for the infected – and so on, it is clear just how far the world has come. A year ago there was no vaccine and many experts were pointing out that no one had ever developed a successful vaccine for a coronavirus.

Equally, no one had ever thrown such immense resources at developing a vaccine for a coronavirus and, in an incredible triumph of medical science, by November last year several had been developed and proven. Approval was fast-tracked in some countries. The first was administered in the UK in December and by the end of July, only eight months later, 4.1 billion doses have been given worldwide; more than a billion people, almost 15% of the world's population, have been fully vaccinated and many more are only a jab away from being the same.

The vaccines however have not been evenly distributed. Those who developed the vaccines and had the biggest emergencies – especially US and Europe – have achieved very good coverage but less-developed countries are lagging. The chart below from ourworldindata.org shows first doses, which provide some coverage and indicate an intent of full vaccination, and the African continent has had very little. China apparently has a good level of coverage but is loath to disclose its numbers. It is also suffering Delta outbreaks in some cities. Countries that didn't suffer the worst impacts of the disease – ourselves and New Zealand, Taiwan, Vietnam and Thailand for instance – ended up scrambling for allocations.



There are glimmers of hope, however. The first piece of good news is that, despite a resurgence of infections in many other places, Covid hospitalisation and deaths in highly-vaccinated populations are substantially lower than was the case before the vaccines were available. This suggests that the vaccines currently being used in most places are working, even against Delta. The second piece is that vaccination supply is ramping up rapidly. Until quite recently some sections of our population has been reluctant to be vaccinated and, for those who were willing, not enough supply of the "right" sort of vaccine after a misguided but highly-effective campaign against the AstraZeneca vaccine in the media and even by some health professionals.

This is particularly unfortunate because of all the vaccines the Anglo-Swedish AstraZeneca seems to have the best ethical framework. It was developed by the company with Oxford University but, unlike all the US vaccines, AZ took the moral stand at the start of the pandemic that it would not seek to profit from it. AZ is selling it to governments all around the world at cost and even donating some to poor countries. It is also allowing various parties around the world to make it, and since March it has been produced in vast quantities in Australia by portfolio holding CSL. It is therefore a "cheap" vaccine, selling for between $2 and $4 per dose in different parts of the world.

By contrast, Pfizer has charged what the market will bear, meaning $20-50 per dose according to some sources (actual prices are top secret). This is what you might expect a commercial operation to do, especially one which developed a whole new way of making vaccines, but it's not as noble as AZ has been. When you multiply those high prices by the ~15 billion doses that will be required to vaccinate the world, before you start factoring in the inevitable booster shots, the difference is stark. In the latest US earning season Pfizer reported record earnings and its share price jumped sharply. Same with Moderna.

Back home, as larger quantities become available in coming weeks we can look forward to the supply issue disappearing; and the reality of an easily-spread but preventable illness and the suffering and death it can cause, not to mention the great inconvenience, mental stress and financial loss resulting from lockdowns, seems to be solving the demand issue. All of a sudden people are clamouring for their jabs so the confluence of adequate supply and intense demand should result in a much higher vaccination rate within months. Our shading on the map should become a darker blue reasonably quickly.

Will it be enough to ease up on the draconian international travel restrictions we are living under? We can only hope. While not being able to go anywhere was quite pleasant for a while, we are all starting to develop itchy feet and keen to get back out there. If we can achieve strong take-up rates who knows, we might be back winging our ways around the world again in 2022.

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Traveller's Tales

Thank goodness for the Olympics. It was postponed last year due to the pandemic and even as recently as last month there was ongoing debate and dissent in Japan as to whether it should go ahead at all considering the state of emergency in force there. The rest of us are glad that it did as it provided a welcome distraction for those in lock down and trying to avoid catching/spreading the disease. It has been a bit confusing sometimes though, considering the games are still officially called Tokyo 2020 even though it is now only a few months until the 2022 Winter Olympics in Beijing, China. The cost of all the disruptions to the organisers must be immense, but our reward for Japan's pain has been a lot of entertainment and a slew of medals for Australia in many different sports. And when the Olympics is done we have the Paralympics to look forward to.

A fact little known to many of our investors is that Alphinity has its own Olympian. Portfolio Manager and health care/ transport/building materials guru Stuart Welch competed and won medals rowing in the Men's Eights at both the Sydney Olympics in 2000 and the Athens Olympics in 2004. A keen rower at school and throughout university, he is still involved in the sport at a high level as a director of Rowing NSW and Vice President of the UTS Rowing Club.

There aren't many people who join this industry and end up travelling less but Stuart is one. Over 14 years of competitive rowing he raced in countries across Europe, North America, South America, Asia, Australia, and NZ. While with the Australian Institute of Sport he would spend two months each year training on Lago Di Varese in northern Italy. Sounds glamorous, and it is, although he says the best rowing course in the world is actually at Lake Barrington in Tasmania.

He has lots of stories about the places he's been and races he's been in. Motivational talks from America's Cup skipper John Bertrand before the Olympic final in 2000 and mentoring from Wallabies captain John Eales in 2004. Being invited to race in Valdivia, Chile, where his team was provided with a rickety old boat that was held together with duct tape; the hosts were in an Italian carbon fibre job and, of course, won the race. A similar thing happened at an invitational in Jilin, China.

His most memorable trip though was coming home with all of the athletes from Athens in a dedicated Qantas 747 the morning after the closing ceremony. Gold medal winners were placed in first class, Stu was in Business with the other Silvers and Bronzes; all the non-medallists were way down the back. A lot of fun was had on the plane and on arrival they reunited with family and friends in a hangar at Mascot. Sadly this year's athletes are facing a more subdued return to Oz, straight into two weeks quarantine.

For further information, please contact:

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