Alphinity Global Equity Fund

Monthly Report September 2021

Performance[1]	Quarter %	6 months %	1 year %	3 years % p.a	5 years % p.a	Inception % p.a[2]
Fund return (net)	4.7	18.9	33.8	16.3	18.1	14.6
MSCI World Net Total Return Index (AUD)[3]	3.9	13.6	27.8	13.1	15.1	13.0
Excess return[4]	0.8	5.3	6.0	3.2	3.0	1.6

Fund facts	
Portfolio managers	Jonas Palmqvist, Jeff Thomson, Nikki Thomas, Trent Masters, Mary Manning
APIR code	HOW0164AU
Inception date	21 December 2015
Investment objective	To outperform the MSCI World Net Index (AUD).
Management fee	1.00% p.a.
Performance fee	10% of the excess return of the Fund above the Performance Benchmark (MSCI World Net Return Index (AUD)) and only paid if performance is above the Performance Hurdle (Reserve Bank of Australia cash rate target). Any negative or unpaid performance is carried forward to the next period.[1]
Buy/sell spread	+0.25% / -0.25%
Fund size	$185.9m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
Alphabet Inc	Communication Services	6.7
Apple Inc	Info. Technology	5.3
Bank of America Corp	Financials Ex Prop	4.8
Microsoft Corp	Info. Technology	4.8
Morgan Stanley	Financials Ex Prop	4.4
Danaher Corp	Healthcare	4.4
ASML Holding NV	Info. Technology	3.9
Target Corp	Consumer Disc.	3.8
Keysight Technologies Inc	Info. Technology	3.7
Otis Worldwide Corp	Industrials	3.6
Total		**45.3**

Data Source: Fidante Partners Limited, 31 September 2021

[1] Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

[2] The inception date for the Fund is 21 December 2015

Fund features

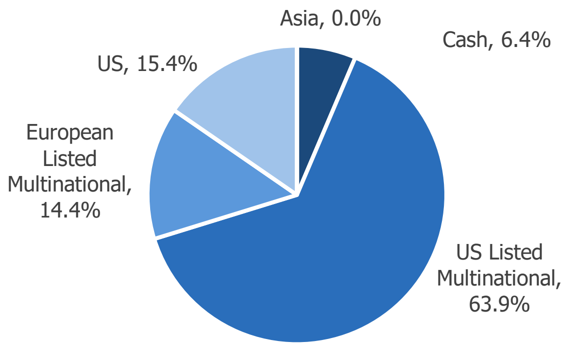
Concentrated: A long only, concentrated portfolio of 25-40 of our best ideas, highly diversified across sectors and regions. A truly global fund consistently exposed to powerful trends reshaping our world.

Discipline: A disciplined process finding quality businesses with strong earnings that are under appreciated by the market. This approach has proven successful across different market cycles.

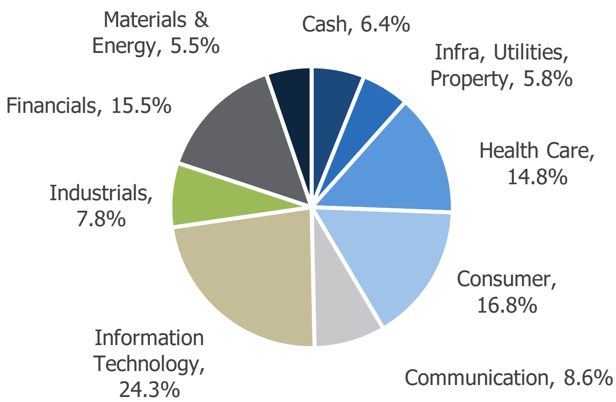
Talent: A united and deeply experienced team of global portfolio managers each with over 20 years in the industry.

Aligned: Alphinity Investment Management is a boutique firm, strongly aligned with its clients' investment objectives and focused solely on growing clients' wealth.

Geographical exposure



Sector exposure



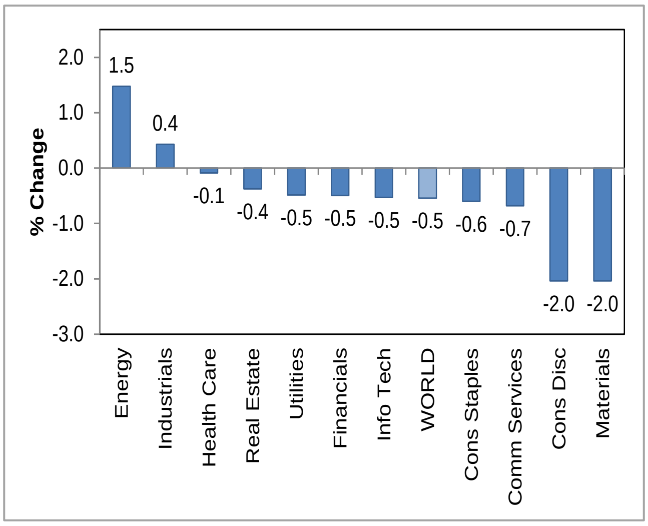
[3] From 21 December 2015 to 31 March 2019, the Benchmark was the MSCI World Equity ex Australia (Net) Index. The current index is effective from 1 April 2019.

[4] Numbers may not add due to rounding

Market comment and outlook

Global equity markets finished the quarter up 3.9% in AUD terms, but fell 3% last month on concern over rising inflation and fading economic growth. A number of issues including energy shortages in Europe and China, supply chain bottlenecks, scandals surrounding the US Federal Reserve and the looming default risk for China property developers all weighed on sentiment. Japan was the strongest performer, with the TOPIX gaining 8.2%, while the U.S. S&P 500 index rose 4.2%. Emerging markets underperformed, particularly Hong Kong (HSI -11.6%) as China imposed regulatory reforms across a number of industries, and Brazil (IBOV -16.6%) on the slump in iron ore. On a sector level, Financials (+5.6%) and Technology (+5.3%) were the best performers while Materials (-2.5%) fared the worst on iron ore and gold weakness.

1FY Four-week Earnings Revisions by GICS Sector

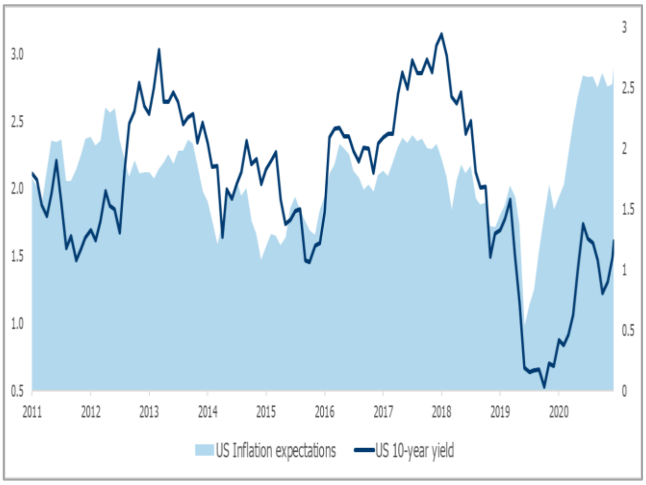


Source: Alphinity, Bloomberg, MSCI, 1 October 2021

Following its' rapid post-Covid recovery in Q2, global economic data generally softened over the September quarter with both manufacturing and services Purchasing Managers Indices (PMIs) coming off their highs. In the US, data was mixed with consumer confidence taking a hit, falling 3 consecutive months from its' high of 129 to close at 109. Disruption within the US Federal Reserve with 2 members retiring following news of a trading scandal undermined confidence, and heightened speculation of Chairman Powell's future. Powell's address at Jackson Hole, adopting his usual dovish stance that calmed markets, was somewhat contradicted in an address just 3 weeks later, with more hawkish commentary at a time of weaker economic data.

Despite U.S. 10-year bond yields only rising 1 bps over the quarter to close at 1.49%, yields rallied 40bps off their lows as the market priced in bond tapering. Most currencies weakened against the U.S. Dollar, with the AUD falling 3.6% to USD0.72, somewhat hedging Australian exporters. Commodities had a mixed quarter, with the CRB All commodities index falling 0.4%, although the aggregate move masked huge dispersion within the group. China's policies aimed at reducing emissions by reducing steel output led to a 43% drop in Iron ore, closing at USD120/t. Energy shortages in Europe and China led to a staggering 60% rise in natural gas prices, and poor management over coal mines and floods in China drove similar gains in coal prices, perversely benefitting from the energy crisis.

US Inflation & Inflation expectations



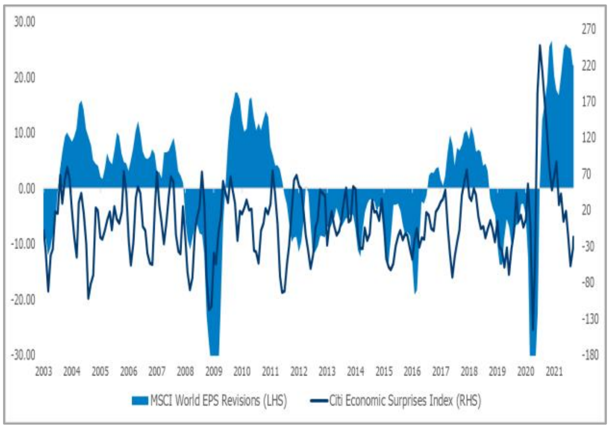
Source: Bloomberg, 10 October 2021

Corporate earnings in both the U.S. and Europe were exceptionally strong in the second quarter, with U.S. earnings growth above 100% y/y and 16% above consensus, with any concern of higher input costs or supply constraints deferred to next quarter. Earnings leadership over the period included Energy, Industrials and Communication Services, while Consumer Staples, Consumer Discretionary and Utilities all lagged. Third quarter earnings will be important to confirm whether this cyclical leadership can be sustained as growth slows and inflationary pressures increase.

Portfolio comment and outlook

Global growth is likely to remain generally above trend as we enter 2022, however momentum appears to have already peaked, and is now slowing in several major economies including the U.S. and China. This is happening at the same time as the duration and scale of the current inflation impulse is proving greater than expected, driven by higher commodity prices, labour shortages and supply disruptions. It remains to be seen how persistent these inflationary factors will prove to be.

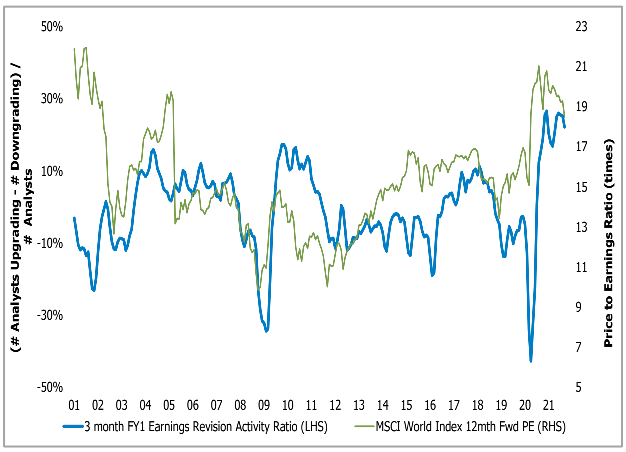
Earnings surprises have rolled over but Global Earnings Revisions still at historic highs



Source: Alphinity, Bloomberg, 10 October 2021

Our current earnings revision data still mostly reflects cyclical leadership however, we will be looking closely for confirmation from the third quarter earnings season. Further positive corporate earnings momentum will also be critical to validate elevated PE multiples and re-assure investors about the outlook for growth and margins.

Global Earnings activity looked to have peaked with multiples derating



Source: Alphinity, Bloomberg, 30 September 2021

During the quarter, we largely maintained our pro-cyclical bias, albeit continuing to shave some positions reflecting the maturing cycle and rising valuations. We exited positions in Nike, Infineon, Vestas Wind Systems, Activision Blizzard, Yum China and NextEra due to weak earnings reports and/or lower conviction on the earnings outlook. We also trimmed positions including Nvidia, Blackstone, Eli Lilly and Morgan Stanley after strong performance. New positions were initiated in several high-quality growth stocks including Zoetis, Apple, American Tower, LVMH, Estee Lauder and Universal Music. We remain relatively less invested in defensives, which are still facing various earnings headwinds.

Some early warning signs are clearly flashing, and we will keep an open mind about the outlook. We have a strong bench of new ideas for different outcomes, including more persistent inflation and/or lower growth. Nevertheless, we will let earnings on a stock by stock basis guide us through the cycle, rather than making brave, top down, macro calls in what remains a fluid situation.

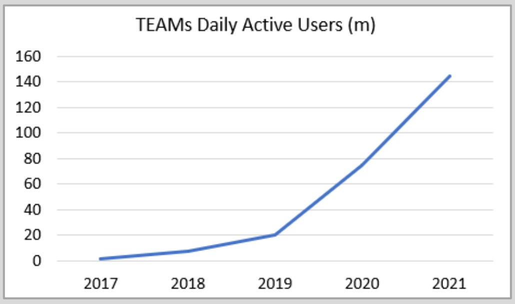
What's on our mind

Microsoft (MSFT US): Same but different

Everybody knows Microsoft. It is a business that has been the bedrock for how we get things done for decades. The Microsoft suite of products and services have been the foundation of our work and study lives for as long as we can remember. But this constancy and longevity of the basic product set masks what has been a remarkable transformation of the Microsoft business in recent years. These business changes place Microsoft at the apex of the 3 key characteristics that all leading software businesses strive for: depth of engagement, leadership in cloud and a recurring revenue model. In this note Trent Masters explores each of these characteristics in more detail and conclude on their combined contribution to the compelling investment case for shareholders.

Deepening engagement: TEAMs as the poster child

The communication platform "Teams" has been an incredible story as when it first entered the market in 2017, Slack was by far the dominant enterprise communication platform. But the launch of Teams under the Microsoft umbrella brought with it a communications platform naturally ingrained with the Microsoft product suite enabling deeper and more natural integration with workflows. This integration with the Microsoft product suite combined with a compelling price point saw TEAMs become the enterprise communication platform of choice within 3 years. The onset of Covid and remote working saw the Teams platform become further embedded as a critical tool for enterprise communication globally.



Source: Businessofapps.com, Company disclosures

Cloud: an industry leader with Azure

The key jewel in the Microsoft crown is the cloud computing business Microsoft Azure. While Amazon's AWS was winning the race for scale in 2019, Microsoft has been closing the gap in recent times with incremental $ additions on par with AWS. The other impressive aspect of the Microsoft cloud business growth has been the maintenance of strong margins of 40-45%. Not only is cloud a compelling space in terms of growth, but the return profile is also exceptional for players such as Microsoft that can

Source: Fandom.com

Recurring Revenue model: the holy grail of software

Overlaying the engagement expansion and strong cloud position has been the fundamental reshaping of the nature of revenue that Microsoft derives. Microsoft is successfully moving the business from a license-based model to a recurring revenue model, with this transformation permeating across all elements of the business.

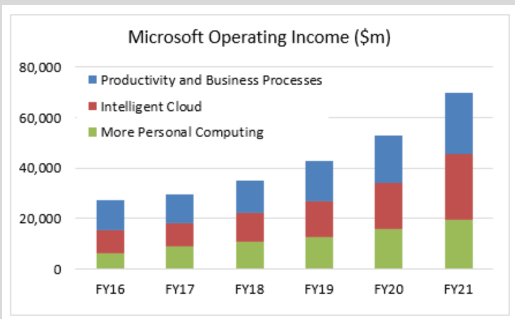
What does this transformation mean for value?

Rolling these three elements together creates an important shift not only in the growth outlook for Microsoft, but in the quality and therefore value ascribed to Microsoft's earnings. Enveloping this growth is the increasingly recurring nature of revenue and the greater stability that such revenue provides. This lower volatility and risk profile increase the multiple that should be ascribed to the Microsoft earnings base.

Conclusion

Microsoft has been compounding revenue at mid-teens and earnings at >20% over the past 5yrs as the forces of product set innovation and workplace dispersion wash their way through what was already a powerful business. Growth of 15-20% in operating income is expected to continue over the medium term as cloud migrations, digital adoption and the general recognition of the value of the Microsoft product offering continue to underpin business momentum in the years to come.

The combination of business positioning, return metrics, earnings leadership and supportive valuation makes Microsoft a compelling long-term structural growth investment in both our Alphinity Global Equity and Alphinity Global Sustainable Equity Funds.



Source: Alphinity, Bloomberg

Traveller's Tale

It's not just Evergrande that's making people nervous about China. Even aside from its expansionist practices in both the South China and East China Seas and its oppression of countries which can't realistically fight back – Australia included – there have been some fascinating things going on in corporate China over the 12 months. The disappearance of Alibaba's Jack Ma after he criticised financial regulators late last year followed by the pulling of the Ant Group IPO; the gutting of Uber-equivalent Didi just days after it listed in New York; the effective nationalisation of companies providing education services in China: it appears that there is a degree of sovereign risk involved for foreign investors there.

Then this month, confirmation that China had been engaging in hostage diplomacy will surely make people from countries China has issues with – which seems to be pretty much everyone apart from Afghanistan under the Taliban regime and North Korea – hesitant about travelling there.

It started in December 2018 when Canadian border officials detained Meng Wanzhou, an executive of telecoms equipment provider Huawei and the daughter of Huawei's founder. Canada did this on behalf of the US which alleged that the company had been dealing with Iran in breach of US sanctions. Meng was detained in her $20m mansion in Vancouver (pictured), with its eight bathrooms and indoor pool, while the three countries traded diplomatic blows. Days later, Chinese authorities arrested two Canadian executives working separately in China, both named Michael, and charged them with espionage. The Michaels spent the time in less salubrious accommodation than Meng, Chinese jails, were tried and convicted (as 99% of cases coming before Chinese courts are – after all, if you weren't guilty you wouldn't have been charged!). China denied that their detention was related to Meng but, within minutes of Meng being released this month, the two Michaels were on a plane back to Canada. That's some coincidence.

Hostage diplomacy has a long history. In the modern era it has mostly been practiced by less reputable regimes like North Korea and Iran but according to that universal source of insight, Wikipedia, it was widely used by some of the ancient Chinese dynasties to keep vassal states in line. Two Australians are currently being held in Chinese jails: academic Yang Hengjun, who was taken in January 2019, shortly after Australia criticised China for taking the Canadians; and news anchor Cheng Lei in August 2020 for supposedly "carrying out criminal activities endangering China's national security". Australia however lacks the diplomatic leverage of having a prominent person such as Meng in custody to trade for their release. Conventional diplomacy is clearly not working.

Unfortunately, the hostage situation did work. It took almost three years but eventually the US varied the most serious charges, Meng claimed vindication and fled back to China to be greeted as a hero. This sort of thing will make people think twice about going to China, and this will not be good for trade, mutual understanding or possibly even world peace.

For further information, please contact:

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