Monthly Report – October 2021
Alphinity Concentrated Australian Share Fund

RBA Steps Away

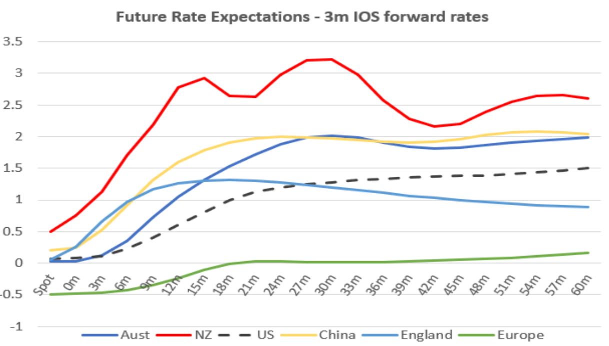
Market comment

October 2021 marked a return to freedom for many Australians, with Covid lockdowns easing in the two most populous states. Some sense of normality is returning, the return to school allowing parents to re-gain some sanity. Minor day-to-day activities, unremarkable in normal times, like eating out and getting haircuts, feel like small luxuries. The Australian market (ASX300 including dividends) limped over the finish line only just in positive territory, +0.1% for the month. Our market has risen in 17 of the 19 months since the initial Covid sell off in March 2020. Are we set for another roaring 20s, like in the 1920s after the last major pandemic, or will inflation and rate hikes spoil the party?

The strong $A took the shine off offshore returns. The US and Canada were both up about 3% but most European markets returned between 0 to -2%. Japan was a notable underperformer, losing 8%, and other Asian markets like Korea (-6%) and China (-4%) fell. Brazil was the worst at -13%. It was hit by a combination of sluggish growth, higher rates and fears that President Jair Bolsonaro may be about to blow up the country's finances. In Australia, tech stocks (+2%) and healthcare (+1%) were the best performers, while industrials (-3%) and consumer staples (-2%) fared the worst.

While the debate continues on what the future path of inflation will resemble, an imminent bond taper in the US and rising producer prices globally put upward pressure on bond yields. October saw an extraordinary move in the Australian 3 year bonds, which rose 90 bps to 1.2% in October alone. The Reserve Bank of Australia (RBA) declined to buy April 2024 bonds on market, stepping away from yield curve control: this led to a further sell-off in bonds. While not as dramatic as the move in the 3 years, 10 year yields still shot up 60bps to close at 2.1%. 10 year bond yields were much more subdued in the US, rising only 6 bps to 1.55%.

Despite the RBA having said it will not raise rates until 2024 at the earliest, after the spike in inflation markets are pricing in a much shorter timeframe. At the end of October the market was pricing in over 180bps of rate hikes in the next two years – albeit rotations like these usually overshoot. To put this move into context, in mid-October the market was pricing in only 10bps of rate rises. There has been a sharp sentiment shift which, if sustained, could have longer-term significance for the equity market. The below chart looks at the current rate expectations here and the rest of the world.



In commodity markets, pressure is being felt at the petrol pumps with oil rising as the world re-opens. Crude oil jumped 7% in $A but iron ore continued to slide as China continued cutting steel production. A series of unfortunate events, such as droughts limiting hydro power and floods in China affecting coal production, has led to energy shortages across Europe and China. This in turn has led to massive spikes in gas and thermal coal prices this year, although prices settled in October. But winter is coming in the Northern Hemisphere, and with risks remaining over energy supply, can Europe rest easy knowing their Russian friends will be ready to lend them a gas bottle or two?

Portfolio comment

The Fund outperformed the market a little in October but there were few big movers. The most material positive contributors were global investment bank and asset manager Macquarie Group, and plumbing products manufacturer Reliance Worldwide; not owning Rio Tinto also helped. The only detractor of note was health insurer Medibank Private.

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)	0.1	0.0	27.2	11.7	11.7	11.7	10.7
S&P/ASX 200 Accumulation Index	-0.1	0.5	28.0	11.9	10.9	10.0	9.2

*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 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

With the equity market fretting over big picture issues like inflation and the trajectory of global economic growth, it's been refreshing to get some operational updates from companies following the conclusion of the September quarter and as we enter Annual General Meeting (AGM) season in Australia. Of course, lockdowns have complicated the local picture and made extrapolating any trends more hazardous.

After a year of broadly positive earnings revisions, changes to aggregate forward earnings expectations started to turn negative in August. This trend has largely continued, although more recently it has largely been through negative earnings revisions to bulk commodity producers in the Resource sector resulting from the sharp contraction in the iron ore price.

The much-publicised global supply constraints are also having some impacts on Australia but thus far not to the same extent as overseas. This can at least partly be explained by the different composition of our market. We have fewer manufacturing companies, which have had the most conspicuous challenges; instead we have a decent weighting towards companies further up the value chain, many of which are benefitting from high prices of everything from energy to metals to agricultural products. Encouragingly, while consumer spending appears to have been more subdued in this round of lockdowns, the rebound in activity as NSW and Victoria have reopened has been strong.

Globally, the US third quarter reporting season has been positive too overall, with margin pressure from higher input costs not materialising to the extent feared by many. Of course, this is primarily due to companies being able to pass on the cost increases as a result of the strong demand environment – which will potentially only exacerbate general inflation concerns.

With many central banks getting ready to start reducing (or tapering, as market parlance has become) the extent of their monetary stimulus, our own included, higher bond yields remain a key risk to equity markets in coming months. The risk from more broad-based earnings disappointment looks more like something to revisit in the new year.

Portfolio Outlook

Quarterly releases and AGM updates for companies in the portfolio have thus far been quite positive with Macquarie Group, Reliance Worldwide, industrial property developer Goodman Group and gaming machine company Aristocrat Leisure some of the highlights. More domestically-focused companies such as Super Retail Group, Bapcor and Viva Energy will likely require good Christmases and second halves however to make up for the negative impact of the east coast lockdowns. With the opening up so far on track or even ahead of expectations we believe that each of these are well positioned to do so, especially as they were all trading well in the months prior to the lockdowns.

We sold the last of our holding in Domino's Pizza Enterprises in October. It had only been in the portfolio since March this year, an unusually short holding period for the fund. However, it performed exceptionally well, almost doubling since our initial investment only seven months ago, and in our assessment its valuation had become quite stretched. Coupled with increasing inflation pressure from both wages and the cost of some pizza ingredients, Domino's as an investment proposition had become less compelling despite the company's excellent long term growth potential. We may end up revisiting Domino's should the investment case improve one way or another.

Top five active overweight positions as at 31 Oct 2021	Index weight %	Active weight %
Macquarie Group Ltd	3.3	3.9
BHP Group Limited	5.2	3.8
National Australia Bank Limited	4.6	3.6
Santos Limited	0.6	2.8
Commonwealth Bank of Australia	8.6	2.7

Asset allocation	31 Oct 2021 %	Range %
Securities	98.6	90-100
Cash	1.4	0-10

BTW

There seems to be no holding back Elon Musk. Not only has he saved the environment through decarbonising transport, he is making big impacts on a bunch of diverse industries such as Artificial Intelligence, Space Exploration, Data, Tunnelling, Neuroscience and Energy – this month he could possibly single-handedly solve world hunger!

Thanks to the wild appreciation of Tesla shares in October Musk's personal net worth soared to about $US300 billion and he became the world's wealthiest person by quite a margin. Tesla shares started the month trading at $US767; with a billion shares on issue this valued the whole company at $US767 billion – a value exceeding the combined value of all other car making companies. It held its Annual General Meeting on October 8th, which contained positive news and the shares moved a little higher, to $800. As we have mentioned in these pages before, Tesla's chair is Australian, the impressive former Telstra CFO Robyn Denholm. It is fair to say that Robyn needs to be a special person to deal with the challenge of controlling the rather unpredictable Elon and we can imagine she has some tough conversations from time to time. On the 21st Tesla released a quarterly result which was also taken well by the market, with the shares moving up to $900. A few days after that came the Hertz announcement.

Hertz is the world's biggest car rental company but it went bankrupt last year and re-listed under a new corporate entity in July. On the 25th Hertz announced that it would buy 100,000 Tesla cars for a bit over $US4 billion. The market responded by marking Tesla shares up by a further $120 taking the total value of the company to a bit over $US1 trillion. That's right, a $4 billion (as yet unsigned) one-off sale increased the value of the company by $120 billion. Car rental companies are frenemies for car makers: they buy a lot of vehicles but they tend to demand steep discounts. Interestingly, Musk said that he would be selling the cars to Hertz on the same terms as he does to any buyer – no discount was involved.

Tesla shares closed out the month at $1135, up an incredible 48% in October alone! This meant Musk had surpassed Amazon founder Jeff Bezos by quite a margin to be "worth" about $US300 billion. With great wealth comes great responsibility and he and his fellow billionaires drew the attention of people wanting to relieve him of some of it. One of these was the head of the UN-sponsored World Food Program which said $6 billion, a tiny portion of the net worth of a few people in Musk's echelon, could solve world hunger. This seemed to us like a very small amount of money for such a big problem.

Musk must have come to the same conclusion. He responded by saying that if the WFP could prove how $6 billion would solve world hunger he would sell some of his Tesla shares and do it. The WFP quickly revised its claim to say it wouldn't solve world hunger but would relieve the suffering of as many as 42 million people – which is great but not quite the same. We suspect Musk will be hanging onto his shares.

But you don't become the world's richest man without taking a few others along with you for the ride. We saw a Bloomberg article during the month about a man in Singapore who has amassed a $US7 billion stake in Tesla. He did this by ignoring the conventional wisdom generally offered by financial advisors – diversify your assets – and going all in with Elon.

Like most very wealthy people, 66 year-old Leo KoGuan started out with quite a lot, having owned property and technology companies in Asia and the US for a number of years, but he discovered Tesla shares a few years ago and just kept buying them whenever he had some spare cash – even borrowing money to buy them. He had $US1.5 billion worth at the start of Covid but the Tesla share price the proceeded to halve, to below $100 a share, early in 2020 and he almost lost the lot as a result of margin calls. But he managed to hold on and, using more borrowing and call options, doubled down on Tesla again and again. It's not a strategy we'd recommend but it certainly worked for Leo who parlayed his small fortune into a big one.

What's his end game? According to the interview he is aiming to accumulate $US100 billon at which point he will use some of the funds to "build a better system for society", one which will "help society provide free health care and material comfort for all people". We're not sure where or how but it is certainly a worthy ambition. He said: "I look at it like a squirrel. You collect acorns and you eat some. But most you are trying to keep for the winter and you don't eat until later".

![alphinity INVESTMENT MANAGEMENT]

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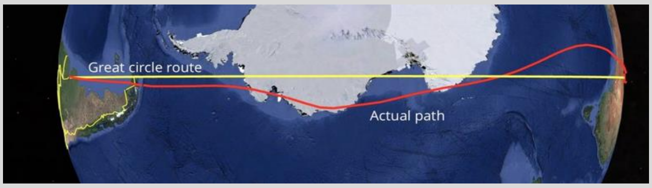
Traveller's Tale

The opening up of Australia to travellers is welcome news for many Alphinites, considering the wide range of countries from which we come and the number of family members we have in other countries including Sweden, Belgium, Canada, the UK, South Africa, and Russia. With flights out of Sydney now on sale and home quarantine permitted on return, a number of trips have already been booked for the upcoming Christmas break. In these troubled times of course you can never completely rely on actually getting out should things go awry at the last moment, and getting back in might also turn out to be a bit of a lottery. But it's a start.

Repatriation flights are still taking place though, and a notable one took place in October when Qantas flew one of its 787 Dreamliners non-stop from Buenos Aires in Argentina to Darwin carrying 107 passengers headed for the Howard Springs holiday camp, plus 21 crew. It was the longest commercial flight ever undertaken by the airline, a total of 15,037 km in 17½ hours as shown in the map (courtesy of Flightradar24.com) below.

Why did it take such an odd route, essentially a big U-turn? Surely they know that the shortest distance between two points is a straight line? Well, despite appearances it was almost a straight line, it is just the distorting projection of the map that makes it look so odd. On a sphere, as shown below, the route looks more sensible. It is almost straight, with only a few deviations required to avoid bad weather and to ameliorate some of the risks involved in flying over that part of the world in a two-engine aircraft.



The flight took off from Buenos Aires with 126,000 litres of fuel and reached an altitude of 40,000 feet (~12km) at its peak. According to a tweet from the cockpit half way into the trip, the outside air temperature was -75 degrees Celsius.

Prior to this month, Qantas' longest commercial flight was London-Perth at 14,499 km. It has done a few longer legs but they were not for paying passengers. One was in 2019 when it was testing non-stop flights New York to Sydney for "Project Sunrise": 16,013km in 19½ hours. London to Sydney will be an even more challenging 17,800km! The thought of sitting in a seat – even a comfortable one – for that long isn't all that appealing although we can see that saving a few hours on the way will be compelling for some frequent fliers.

For further information, please contact:
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