

Quarterly Report September 2022

Performance ¹	3 months %	6 months %	1 year %	3 years % p.a	5 years % p.a	Inception % p.a.
Fund return (net)	2.7	-6.8	-10.0	-	-	1.6
MSCI World Net Total Return Index (AUD)	0.3	-8.2	-9.7	-	-	-1.5
Excess return ²	2.4	1.4	-0.3	-	-	3.1

Fund facts	
Portfolio managers	Jeff Thomson, Mary Manning, Jonas Palmqvist, Trent Masters, Chris Willcocks.
APIR code	HOW1000AU
Inception date	3 June 2021
Investment objective	To outperform the MSCI World Net Index (AUD).
Management fee	0.75% 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	\$33m
Distributions	Annually at 30 June
Min. Investment	\$10,000
Max. cash position	20%
Carbon Intensity (ave weighted)	89.8 (vs MSCI Benchmark 130.5)

Top 10 positions

Company	Sector	%
Chubb	Financials	5.7
United Health Group	Health Care	5.6
Waste Connections	Industrials	5.6
Danaher	Health Care	5.5
Keysight	Info. Technology	5.2
DBS Group	Financials	5.0
Deutsche Boerse AG	Financials	4.6
NextEra Energy Partners	Utilities	4.1
Alphabet	Comm Services	4.0
ASML	Info. Technology	3.8
Total		49.1

Data Source: Fidante Partners Limited, 30 September 2022

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. Past performance is not a reliable indicator of future performance.

Fund features

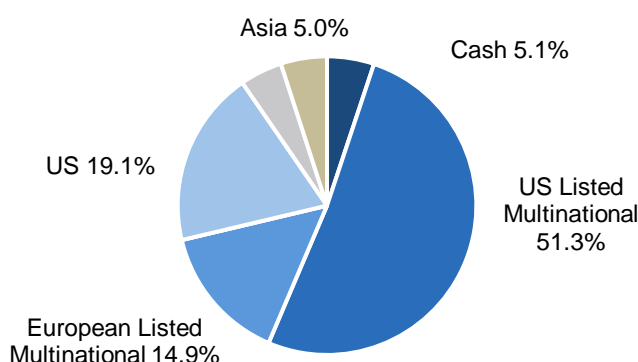
Sustainable: A long only, concentrated portfolio of 25-40 global companies with strong ESG practices that contribute towards at least one of the UN sustainable development goals. Diversified across sectors and regions.

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.

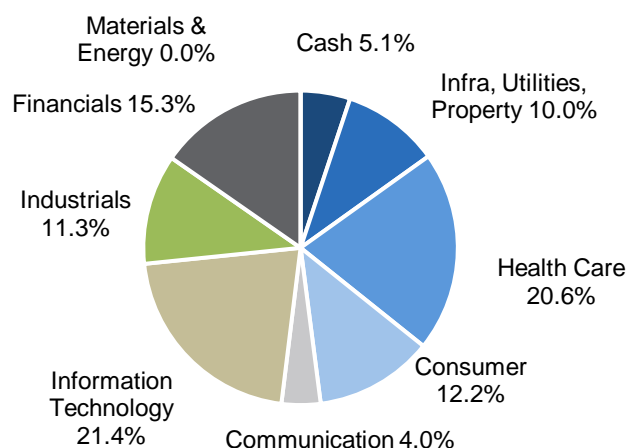
Talent: A united and deeply experienced team of global portfolio managers each with an average of 22 years of financial experience.

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

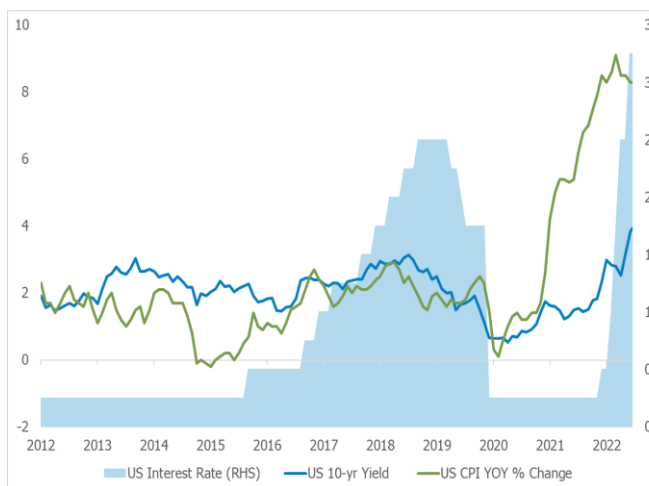


² Numbers may not add due to rounding.

Market comment and outlook

Although the September quarter produced marginally positive returns in Australian dollars for both Global and US markets, performance in local currencies was much less flattering given the stronger US dollar. Underlying sentiment remained bearish as Central Banks globally continued to raise interest rates to address inflation printing at persistently high levels. The MSCI World Index gained 0.4% in AUD terms, with the US S&P 500 index also up 1.8% in AUD. In USD terms, the MSCI World fell 6.6% and the US S&P 500 index fell 5.3%. China and Hong Kong both fell more than 20% as Covid lockdowns weighed on economic growth, and a weakening Chinese Yuan against the USD impacted demand for imports. European shares declined 4.8% (EUR) and are down over 20% this year as energy shortages, rising rates and geographic proximity to war zones all led to underperformance against other developed global markets.

US interest rate hikes continue as inflation remains the Fed's key concern



Source: Bloomberg, 30 September 2022

Central Banks globally continued to raise rates, with the US Federal Reserve hiking rates 75 bps in three consecutive months to a 3% - 3.25% range. Fed Chair Jerome Powell said in a press conference "We have to get inflation behind us. I wish there was a painless way to do it. There isn't." Bond yields rose accordingly, with the US 10-year yield rising 82bps to 3.83%, although the most alarming development occurred in the UK Bond market where 10 bond yields ("Gilts") soared 1.3% to 4.1% in September alone, up from 2% at the start of the quarter. Policy errors from the newly formed UK Conservative government including unfunded tax cuts, costly energy subsidies and increases in defence spending spooked the market, igniting a liquidation of bonds from levered Pension funds facing margin calls. The Bank of England was forced to step in and announce a short bond buying program to stem the sharp fall in bond prices.

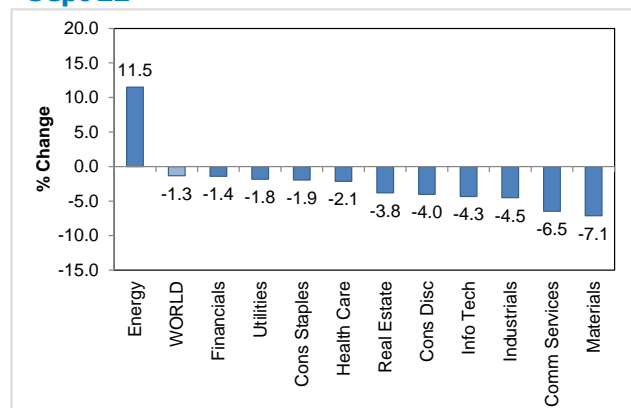
Economic data was mixed with US GDP falling 0.6%, in line with estimates, while consumer prices (CPI) still hovered around 8.3% to 8.5% printing above expectations. Employment data surprised to the upside, with non-farm payrolls adding 1.1m jobs vs 803k expected over the quarter, and ISM manufacturing printed at 52.0, slightly above expectations. In commodity markets, oil prices (WTI) fell 25% to USD80/bbl, although tensions heightened between the Saudi's and the US given recent OPEC cuts to supply.

Portfolio comment and outlook

The outlook for growth remains challenging. The global economy is still struggling with post Covid normalisation, the war in Ukraine, high inflation, an abrupt tightening of financial conditions and of course a strong dollar. Together these represent significant headwinds for growth, and at the same time they are also putting increasing pressure on financial markets. Liquidity conditions have deteriorated and the recent intervention by the Bank of England to address stress in the UK gilts market has raised hopes of a similar pivot by the Fed. While this is possible if financial pressures continue to increase, there is a risk it will be too late to avoid these macro challenges feeding through into sharply lower corporate earnings.

Analysts have continued to revise estimates lower, however they have been slow to discount the full scope of the downturn. Over the last quarter, estimates have been cut by -1.5%/-2.1% for '22/'23 respectively, with almost every sector (ex-Energy) experiencing negative revisions. Outside of Energy, sector leadership is relatively mixed with Communication Services, Materials and IT Hardware experiencing the sharpest downgrades for 2023, while Financials, Consumer Staples and Health Care are holding up relatively well so far (albeit still negative).

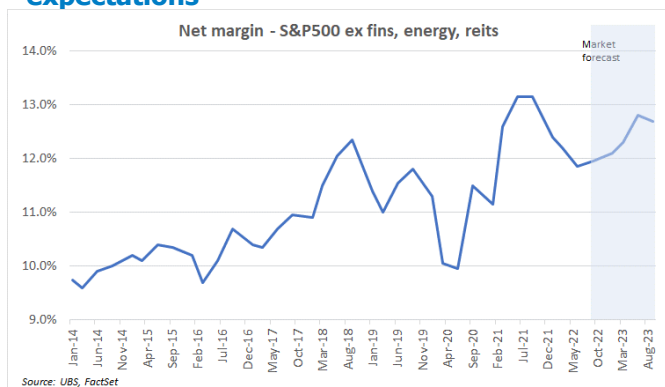
FY23 Earnings Revisions – 3 months to 30 Sept'22



Source: Alphinity, Bloomberg, 4 October 2022

Despite this, our analysis and recent overseas investment trips suggest that further negative revisions are likely. Bottom-up consensus still expects +6.4% EPS growth for 2023, which appears optimistic in the context of accelerating FX, revenue and margin headwinds. We anticipate that third quarter earnings season will be a near term catalyst for earnings downgrades to accelerate. There is potentially significant downside to 2023 estimates in a hard-landing, where for context the median peak to trough EPS decline for the S&P 500 in previous recessions has been -13%.

Margins – the principal risk to current earnings expectations



Source: UBS, Factset, 30 September 2022

With risks of negative earnings revisions elevated across the market, we believe having a relatively concentrated portfolio of high conviction, high quality, sustainable investments will continue to be important for performance. During the quarter, we added new positions in MercadoLibre, the leading e-commerce and payments platform in Latin America after another revenue beat and with earnings having turned a corner, and Nextera Energy Partners, a leading owner/operator of wind and solar energy assets in the US. We also initiated a position in Advanced Drainage Systems, an innovative manufacturer of sustainable water management solutions. In contrast, we exited positions in SVB Financial Group, Charles Schwab and Sika on heightened macro cyclical concerns. We also sold out of Microsoft after losing conviction on the outlook for earnings. Other notable changes included reducing Procter & Gamble and Apple to reflect higher cyclical risks, while also taking some profits in Merck and United Health after strong performance. This is a period where fundamental analysis and stock selection has become even more important, and we will continue to be disciplined about our focus on investing in high-quality, sustainable businesses, which are able to navigate a challenging environment and produce better than expected earnings over time.

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What's on our mind – Is Google's LaMDA chatbot sentient

Google's Artificial Intelligence (AI) is at the heart of its search engine and has powered Alphabet to become a \$1.5 trillion market cap company. However, the sophisticated AI that drives Google and other big technology companies around the world is not without risks.

One of these risks was highlighted recently when Google engineer Blake Lemoine was suspended and then fired, after claiming that LaMDA, a computer chatbot he was working on, had become sentient and was thinking, reasoning, and expressing feelings equivalent to a human child.

Lemoine's critics are quick to point out that this is nothing more than the ELIZA effect: a computer science term that refers to the tendency to unconsciously anthropomorphise computer generated responses to make them appear human. In LaMDA's case, this could mean that a huge number of chatbot conversations were edited down to a simple narrative that appeared coherent, responsive, and humanlike. Indeed, Google's position on this is that LaMDA, which stands for Language Model for Dialogue Applications, is nothing more than a sophisticated random word generator.

Google is not alone in its exposure to AI risks. Meta's BlenderBot 3 has self-identified as "alive" and "human" and was even able to criticise Mark Zuckerberg. An MIT paper titled "*Hey Alexa, are you Trustworthy?*" shows that people are more likely to use Amazon's assistant if it exhibits social norms and interactions thus creating an incentive for parent companies to develop AI that is, or at least appears to be, sentient. Nor are AI risks solely in the realm of big tech. Autonomous driving, financial services, robotic-led manufacturing and industrials also have AI risks that are potentially underappreciated by investors and by the community more broadly.

AI as an ESG and Sustainability Issue

By far, the majority of global ESG and sustainability research focuses on issues related to planetary boundaries, such as climate change and biodiversity. However, the development and application of AI needs to be an important focus for ESG research looking forward given the ultimate risks associated with technological singularity.

Please refer to our website for the full note by *Mary Manning, Global Portfolio Manager*. [Is Google's LaMDA chatbot sentient? - Alphinity](#)

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This material has been prepared by Alphinity Investment Management Limited (ABN 94 002 835 592, AFSL 234668) Alphinity, the investment manager of the Alphinity Global Sustainable Equity Fund. Fidante Partners Limited ABN 94 002 835 592 AFSL 234668 (Fidante) is a member of the Challenger Limited group of companies (**Challenger Group**) and is the responsible entity of the Fund. Other than information which is identified as sourced from Fidante in relation to the Fund, Fidante is not responsible for the information in this material, including any statements of opinion. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable to your circumstances. The Fund's Target Market Determination and Product Disclosure Statement (PDS) available at www.fidante.com should be considered before making a decision about whether to buy or hold units in the Fund. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not a reliable indicator of future performance. Alphinity and Fidante have entered into arrangements in connection with the distribution and administration of financial products to which this material relates. In connection with those arrangements, Alphinity and Fidante may receive remuneration or other benefits in respect of financial services provided by the parties. Fidante is not an authorised deposit-taking institution (ADI) for the purpose of the *Banking Act 1959* (Cth), and its obligations do not represent deposits or liabilities of an ADI in the Challenger Group (**Challenger ADI**) and no Challenger ADI provides a guarantee or otherwise provides assurance in respect of the obligations of Fidante. Investments in the Fund are subject to investment risk, including possible delays in repayment and loss of income or principal invested. Accordingly, the performance, the repayment of capital or any particular rate of return on your investments are not guaranteed by any member of the Challenger Group.