Alphinity Global Equity Fund

Quarterly Report December 2022

Performance[1]	Quarter %	6 months %	1 year %	3 years % p.a	5 years % p.a	Inception % p.a[2]
Fund return (net)	1.1	5.1	-14.5	8.5	11.1	11.1
MSCI World Net Total Return Index (AUD)[3]	4.1	4.4	-12.2	6.2	9.2	9.6
Excess return[4]	-2.9	0.7	-2.2	2.3	1.8	1.5

Fund facts	
Portfolio managers	Jonas Palmqvist, Jeff Thomson, Trent Masters, Mary Manning, Chris Willcocks.
APIR code	HOW0164AU
Inception date	21 December 2015
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	$323m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
LVMH Moet Henne	Consumer Disc	5.8
Danaher	Health Care	5.6
NextEra Energy	Utilities	5.2
Intuitive Surgical	Health Care	4.7
ASML	Info. Technology	4.3
Chubb	Financials	4.3
L'Oreal	Consumer Staples	4.2
McDonalds	Consumer Disc	4.2
Waste Connections	Industrials	4.1
PepsiCo	Consumer Staples	4.0
Total		**46.6**

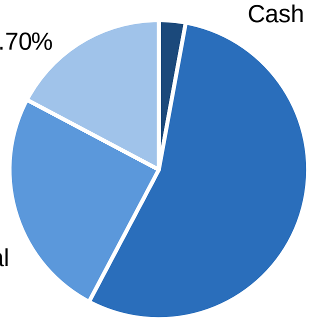
Data Source: Fidante Partners Limited, 31 December 2022

[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.

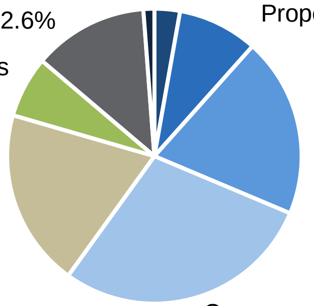
[2] The inception date for the Fund is 21 December 2015

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 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



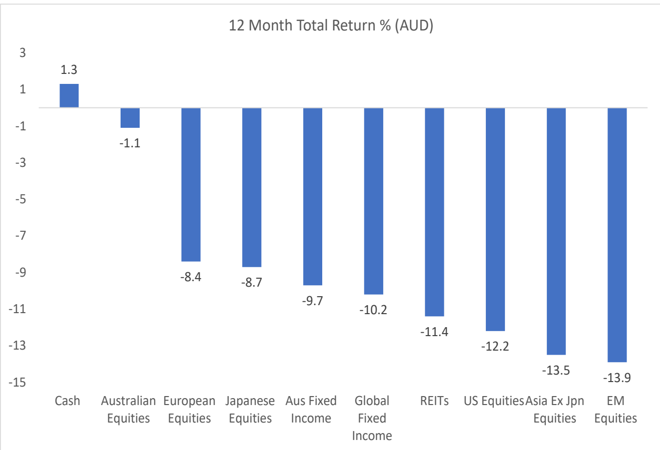
[3] From 21 December 2015 to 30 April 2019, the Benchmark was the MSCI World Equity ex Australia (Net) Index. The current index is effective from 1 April 2019.

[4] Numbers may not add due to rounding

Market comment and outlook

Despite a pull-back in markets in December, the final quarter of 2022 was a positive one for equities as early signs of peaking inflation led to expectations that the pace of rate hikes may also have peaked. The surge in bond yields throughout 2022 also stabilised which supported equities, although even with a less hawkish Fed, the downgrades to global earnings forecasts continued to accelerate. The MSCI World Index gained 3.2% over the quarter in AUD terms, with the US underperforming (S&P 500 +1% in AUD) and technology stocks under pressure (Nasdaq -6.7% in AUD). Europe (Stoxx 600 +13%) was a standout performer, recouping some of the losses worn earlier in the year as energy prices retreated and stocks rebounded following the neighbouring war-led decline.

Asset Class Returns – 12 months to 31 December' 22



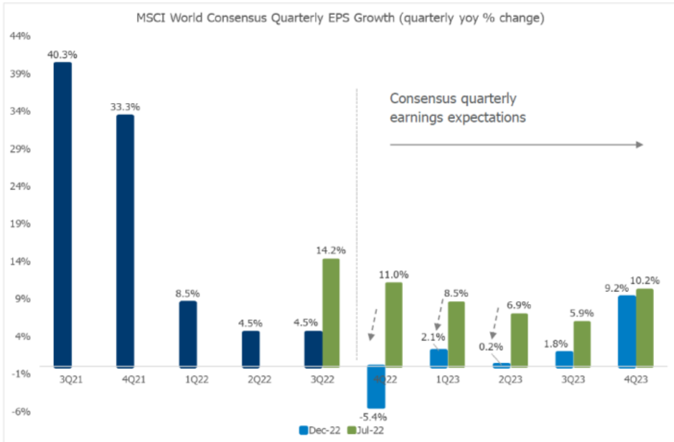
Source: Bloomberg, 31 December 2022

The rapid Chinese policy shift around re-opening post Covid lockdowns led to flows back into Hong Kong / China which, along with an 8% fall in the USD, drove gains in Emerging Markets. China and Hong Kong rose 7% and 21% respectively in November alone when the first signs of response pivoting became clear. China has continued to take measures to ease liquidity to boost a depressed property sector, although weak activity data suggests any easing policy measures are yet to ignite enthusiasm among investors.

The December quarter played out similarly to the rest of the year, with cyclical sectors that usually outperform in a rate hiking environment doing just that; Energy (+12%), Materials (+10%) and Financials (+9%) all outperforming while Consumer Discretionary (-8%), Communication Services (-6%) and Tech (-1%) were among the weakest performers. Large cap tech stocks were particularly weak, including Apple, Amazon and Microsoft where earnings and guidance were weaker than anticipated. Tesla fell 56% on a concern over weaker EV sales and price cuts in China, along with a CEO now distracted from the core business with the purchase of Twitter. Even with the backdrop of recession fears looming, commodities were generally stronger across the board with copper +9% and oil +6.5%.

Economic data continued to give mixed messages, on the one hand lower than expected CPI prints in October and November and an inline number for December was a relief that somewhat dampened rate hike expectations, while on the other hand jobs data was still healthy, with nonfarm payrolls printing above expectations three months in a row. It's difficult to see the US Federal Reserve pivoting too much until we see sustained lower inflation combined with evidence of weaker labour market, both of which are yet to materialise.

Global Earnings Expectations consistently getting downgraded



Source: Bloomberg, 31 December 2022

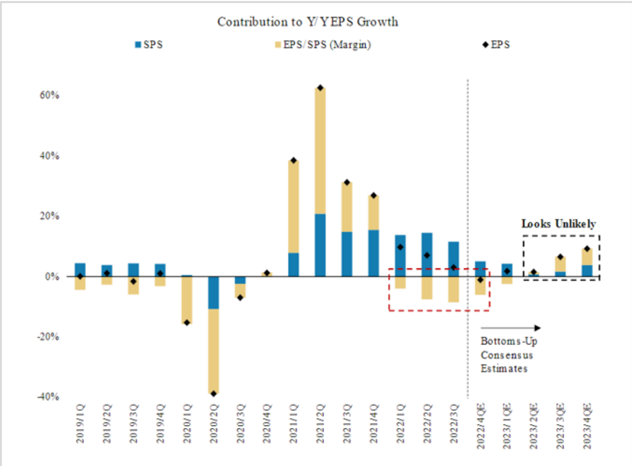
Portfolio comment and outlook

The outlook remains challenging, and after a particularly tumultuous last 18 months, further significant change is likely over the year ahead. Our central scenario is a transition from weaker economic growth and rising inflation, towards an environment where both growth and inflation will likely decline, which should drive further downgrades to earnings expectations, and at least a pause in central bank rate hikes. Financial markets are already beginning to discount this outcome; however, market leadership remains unclear given uncertainties remain around recession risks, downside in corporate earnings, the persistence of wage inflation and the impact of Chinese re-opening.

Our fundamental analysis and company meetings suggest that further earnings downgrades are likely, with margins potentially the biggest negative surprise. Consensus expects positive Earnings Per Share (EPS) growth in 2023 for the MSCI World Index (+2.8% y/y), including margin expansion, which looks unlikely. Our work on earnings cycles indicates that our Global Diffusion Index bottoms 3-6 months before actual earnings revisions, which is usually associated with new cyclical leadership.

Portfolio positioning is largely unchanged with our flagship defensive stocks remaining a key component, in combination with various specific, idiosyncratic growth stocks.

Consensus margin and earnings expectations for 2023 look too optimistic



Source: Morgan Stanley Research

Key changes included an exit from Alphabet after weak third quarter earnings. Cyclical headwinds to advertising suggest earnings are likely to continue to be under pressure. We also sold out of Blackstone and Prologis given growing earnings headwinds from higher rates, lower asset values and weaker investment inflows. We chose to exit Tesla due to governance concerns surrounding Elon Musk's purchase of Twitter. We initiated positions in Fortinet and Intuitive Surgical, both high quality, growth businesses with underappreciated, structural earnings tailwinds. Starbucks was another new inclusion, where we expect earnings upside driven by a recovery in international markets, especially China. We also continued to trim a few stocks which have done very well and are seeing rising market expectations (Keysight, UnitedHealth, Merck, Deutsche Boerse), as well as adding to positions where our investment case conviction is rising (L'Oreal). We intend to continue our focus on bottom-up, fundamental research, and are preparing for a range of potential future paths with a strong bench of new ideas.

Starbucks – China same store sales growth: potential to rebound on reopening

Source: Alphinity, Bloomberg, 31 December 2022

What's on our mind: Did Amazon cancel Christmas?

Christmas fever is running high with beautifully decorated trees and colourful lights cheering us on every corner. The tone was however a lot less cheery when Amazon recently reported their 3Q22 results and downgraded their 4Q22 revenue guidance.

Similar sentiments were reflected across a large range of consumer names noting pricing pressure and a lack of holiday shopping visibility. There is also clear evidence that inventories have been building across US retailers with supply chain constraints lifting and post covid "revenge spending" tapering off

As we head into the new year, we maintain our preference for companies with strong pricing power, exposure to the more resilient high-end consumer and companies with global reach that can also benefit from a China reopening.

LVMH, MercadoLibre and Starbucks are three diverse consumer names that we believe can withstand a less cheery Festive Season.

Why Amazon's revenue downgrade is a concern: Amazon is a behemoth e-commerce platform with tentacles across most consumer channels and verticals. They have access to extensive supporting data that can paint a clear picture of the general consumer outlook.

Historically we have seen Amazon downgrade earnings expectations, but this is the first time in many years that they've downgraded revenue expectations. The fourth quarter outlook is specifically prevalent given that it includes big spending days in the US, such as Black Friday, Cyber Monday, and Christmas. Amazon cited slowing consumer trends particularly in the US and Europe and a lack of holiday season visibility.

Whilst there were several consumer companies that reported relatively good 3Q22 results, outlook statements echoed Amazon's concerns and remained cautious around peak season sales and beyond.

Signs of inventory build are intensifying: Our detailed analysis of inventory levels for a sample of 30 global consumer stocks across retailing, food, and apparel, suggest a sobering level of inventory build across the consumer landscape. We looked at the change in *inventory as a % of sales* and *inventory days* (average number of days a company holds its inventory before selling it) between the latest reported quarterly numbers (3Q22) and the same quarter last year heading into the Festive Season (3Q21). The results showed that there are only 3 stocks with lower inventory days and only 5 stocks with lower inventory as a % of sales in our sample. There is specifically a clear inventory build in sportswear with Adidas, Puma, and Lululemon the worst offenders. For example, Adidas's inventory to sales is now almost 30% up from c17% at 3Q21 and Lululemon's inventory days are up from 126 days to 150 days.

Positioning in companies with strong inventory management and pricing power: Alphinity invests in quality companies that are in an earnings upgrade cycle that trade at a reasonable valuation. In our view, excellent inventory management skills and strong pricing power will be critical in determining the winners vs losers in the 2023 consumer race. Companies that can withstand margin pressures in an environment where business offload excess inventory and consumers hunt for bargains.

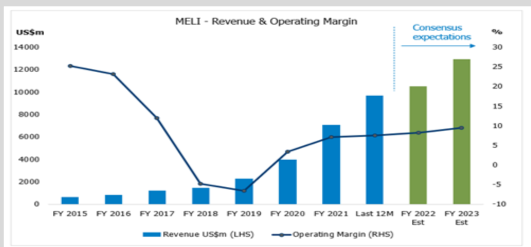
Investing in quality companies at the right time in their earnings cycle

Source: Alphinity, December 2022. Note: Alphinity currently owns LVMH, MELI & SBUX, but not AMZN & TGT

The US consumer is not the global consumer. Certain emerging market countries, such as Brazil, are ahead in the business cycle vs major developed markets, where inflation, interest rates and unemployment are already past peak levels.

MercadoLibre (MELI), is the largest e-commerce and fintech company in Latin America, with over 88 million subscribers and exposure across 15 countries. MELI has a unique eco-system model with their marketplace, payments, credit, logistics and other services all reinforcing each other, driving strong top line growth. MELI's reported very strong 3Q22 results well above their peer group, with accelerating sales growth and margin expansion reflective of their core strengths, including their broad category base, continued logistics improvements and a step change in marketing.

MELI consistently delivering strong Revenue growth and Operating margin expansion



Please visit our website for a copy of the full note here: [Did Amazon cancel Christmas? - Alphinity]

For further information, please contact:

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