As goes January…

Market comment

…so goes the year. It's one of those market sayings that works every time, except for when it doesn't. It was first proposed by the US publication Stock Trader's Almanac in 1972 and seems work pretty well: in 86% of the last 72 years, since 1950, a positive January has seen the US market higher at the end of the year. US stock market returns have also been positive in 83% of the Years of the Rabbit since 1950, as is 2023. Will it be the case in 2023? We'll let you know in December.

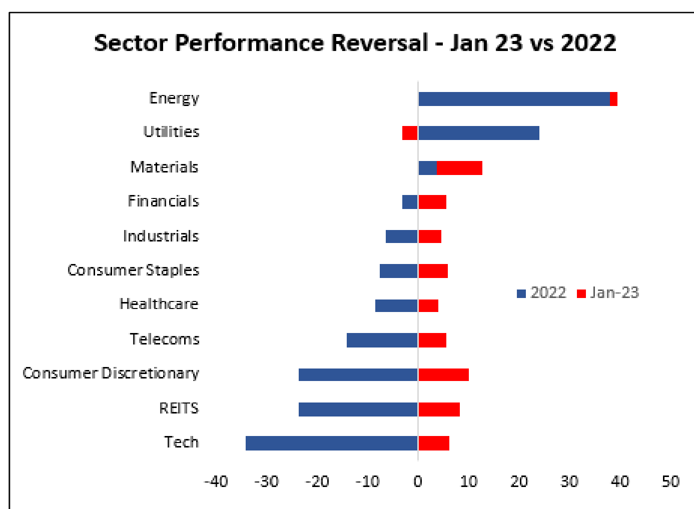
With inflation showing early signs of coming down in the US without significant job losses, hopes of a soft landing in developed markets drove equities higher in January. Further measures to re-open China, picking up any slack in growth elsewhere, also continued to be supportive and got 2023 off to a good start. Many of last year's beaten-up names, those with valuations more sensitive to rising rates, were bought in January as FOMO (or panic) kicked in from investors sitting on high cash balances.

Time will tell if the January rally was purely positioning, given that earnings downgrades are still coming through, but so far the market is running on dovish talk out of the US Federal Reserve Bank and, unbelievably, the market has been even pricing in US rate cuts as soon as the second half of this year. In our view, this is at odds with labour market still remaining relatively tight. Our market (ASX300 including dividends) rose 6.3%, outperforming both global shares (MSCI World +3.5% in $A) and the US (S&P500 +2.7%). Softness in the $US, which began last quarter, continued in January. It has now fallen 9% from its most recent peak in September 2022.

The adjacent chart → shows the extent of the reversal in January, with the sectors under the most pressure last year, such as Tech and Consumer Discretionary, being the stronger performers this month. Only Materials and Energy gained both last year and in January, although Energy was only marginally positive.

The degree to which the market has looked through weakness in the Chinese economy and focused on what it will look like once re-opened was a major theme last quarter, and this momentum continued in January, with iron ore prices rising a further 6% to $US118/tonne. As there is as yet still no evidence of recovery in the Chinese property market, the China-trade thus far has been one of hope. It could come to fruition, but markets are always a quick way to express a forward-looking view. Other commodities were mixed, with oil prices coming off a little, but the weaker $US also lead to inflows back into gold, which has risen 17% off its November lows. Lithium stocks rebounded strongly in January, reversing December's move, as prices of Spodumene and Lithium Carbonate showed no signs of easing.

Domestic economic data continues to paint a mixed picture with local business confidence indicators falling, and softer retail sales in December after the solid lead-in Christmas. The weaker data is still yet to hit the labour market, and although 14,600 jobs were lost in December, the unemployment rate of 3.5% was still in line with expectations. Despite all the noise around monthly indicators and surveys, it still feels as though the inflation prints are all the matters for the market, and if the market perceives that Central Banks have done their job to rein in inflation, the soft landing narrative may hold.



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)	6.0	8.4	9.8	6.4	8.9	9.1	9.4
S&P/ASX 300 Acc. Index	6.3	9.5	11.6	6.0	8.5	8.7	8.8

*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 January 2023.

^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.

Portfolio comment

The Fund essentially kept pace with the rampant market in January. The best returns came from rare earths producer Lynas, industrial property developer Goodman Group and not owning registry operator Computershare. On the other side, however, health insurer Medibank Private, pallet pool operator Brambles Industries and insurance broker Steadfast all lagged the very strong market. Not owning lithium producer Pilbara Minerals also hurt a little.

Market outlook

Global equity markets have had a strong start to the year, with investors being encouraged by both a further moderation in the US inflation rate and the end of Covid lockdowns in China. Lower inflation has allowed the US Federal Reserve to moderate its pace of rate hikes and China's Government is likely to be targeting a rebound in economic growth in 2023 to at least 5%.

While Australia's own annual rate of inflation set a new high for this cycle of 7.8% in December, it's likely that we are now also near, or even past, the peak. In addition, Australia stands to benefit disproportionally from the stimulus measures already announced in China and any new programs that are likely required in order for the Chinese government's growth objectives to be achieved, and this has been reflected recently in surging commodity prices.

This is clearly supportive news for prospective equity returns; however, several challenges remain. Firstly, while well down from peak levels, inflation remains high in most economies and the path to sustainably lower inflation rates consistent with central bank objectives remains uncertain, especially as the strength in employment data has continued to surprise to the upside. Secondly, despite the lags involved in the way monetary policy impacts the economy, central banks in general, and the US Federal Reserve in particular, appear to be concerned about repeating mistakes of the past by lowering interest rates prematurely, which could result in a resurgence in inflation. Thirdly, the pace of rate increases, albeit from extremely low levels, stand out in a historical context. This makes predicting the timing and severity of the coming economic slowdown, and any impact on corporate earnings, unusually difficult.

So while equity investors may overall be able to look forward to a 2023 that is less challenging than 2022 was, we suspect that the combination of these factors could hold back returns.

Asset allocation	31 Jan 2023 %	Range %
Securities	98.8	90-100
Cash	1.2	0-10

Portfolio Outlook

With the equity market so far focusing on macro factors in the first few weeks of 2023, stock-specific drivers have largely taken a back seat. As the debate about the macro challenges discussed above continues to wax and wane, we expect that company-specific earnings outcomes and outlooks will start to play a more important role. The February reporting season will be an important test of the latest market optimism, especially for sectors other than Resources and Energy, where commodity prices will continue to dictate earnings trajectories.

Pre-announcements and results to date suggest a solid Christmas trading period for most consumer companies, although outlook commentary has been more mixed. The Fund's portfolio enters the reporting season dominated by stocks that have experienced solid earnings upgrades compared to the overall market over the last few months and we believe this will support portfolio returns.

Companies such as oil refiner Viva Energy, retailer Super Retail Group, The Lottery Corporation, logistics company Qube, Qantas and Treasury Wine Estates have all been performing well in recent months and are expected to deliver solid results in February. A number of other holdings are also well positioned, in our view, to deliver earnings ahead of market expectations but might need to confirm this again in February in order to gain broader investor confidence.

While Commonwealth is the only major bank to report, we continue to see upside from better margins and low credit losses. We also remain overweight the Insurance sector, one in which stock selection has been important over the last couple of years. We continue to see upside resulting from strong premium growth for insurance broker Steadfast in particular, but also underwriters QBE and Suncorp.

The correction in energy prices has increased the short-term earnings risk for Woodside Energy and Santos so we have trimmed these further. The opposite is case for the bulk producers and, while the economic recovery in China will take some time to gain momentum and is likely to be more consumer led than in the past, we have added iron ore producer Fortescue Metals to the portfolio. The company is not without concerns: while its allocation of capital to Fortescue Future Industries is admirable, from a financial point of view the returns are uncertain. Nonetheless, stronger iron ore prices have the potential to trump this in 2023.

Top five active overweight positions as at 31 Jan 2023	Index weight%	Active weight %
BHP Group Limited	11.0	2.6
QBE Insurance Group Limited	0.9	2.0
National Australia Bank Limited	4.4	1.9
carsales.com Ltd	0.4	1.7
Treasury Wine Estates Ltd	0.5	1.5

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BTW

Back in Economics 101, we were taught that one of the building blocks of measuring economic growth is to calculate productivity, which is defined by inputs such as labour and capital. Productivity can be increased by either having more workers (increasing the *amount* of labour) or by technological change and innovation (increasing the *efficiency* of labour).

One of the greatest challenges facing some parts of the global economy is a decline in the size of the workforce, brought about mainly by an ageing population but exacerbated, in the short-term, by Covid. We've known about this for some time in countries like Japan, where its ageing demographic has been a large driver of stalled economic growth. World Bank stats show that Japan's fertility rate of 1.34 children per female is well below the replacement rate of 2.1. More than a quarter of Japan's population is now older than 65, and more nappies are sold in Japan for adults than for babies. This caused Prime Minister Fumio Kishida to issue an alarming warning this month: "Japan is standing on the verge of whether we can continue to function as a society. Focusing attention on policies regarding children and child-rearing is an issue that cannot wait and cannot be postponed". Despite announcing numerous financial incentives, government policy has thus far been ineffective.

This demographic shift is not just happening in Japan. Recently China (1.28) saw its population actually fall for the first time in more than 60 years, while in the US (1.6) fertility has been running below replacement level for more than a decade where. Even in Scandi countries, with their generous welfare and leave policies, and where women have traditionally had high rates of work participation and high fertility rates, fertility is also going down. Fertility in Finland (1.37) and Norway (1.48) is below even the rate of the US. The idea that making it easier for women to combine work with having a family would keep fertility rates elevated appears disproved.

There are plenty of places with high birth rates but they tend to be concentrated in certain regions. The "Arab World" is running at 3.19. Countries categorised as HIPC (heavily indebted and poor) are 4.69. Central and Western Africa is a huge 5.05. The absolute highest country is Niger, with 6.89 children per female; the lowest is South Korea's 0.84. Australia has 1.58. Logically, one solution would be a transfer of people from countries with too-high birth rates to those with too-low; that's what has been keeping Australia's population from ageing as rapidly as the stats suggest it should; immigration is a very challenging discussion in some cultures though.

An example of one of the challenges of an ageing population can be found among the vast muddy fields and grassy paddocks in Ohio, where chip company Intel is spending $US20 billion to build a semiconductor plant. According to US President Biden, producing technology on home soil is the future of the American economy, driven by the recently passed Chips Act. But is the workforce available to realise these ambitions? Ohio is in the rust belt and its demographics are challenging. Bechtel, the company building these plants, needs 7,000 construction workers in the building phase, with a further 3,000 required to operate it after completion. Securing them all will be a huge task.

There are potentially other solutions. Maybe technologies will be able to help bridge the labour gap in the long term? This is where we segue into the world of artificial intelligence (AI). Unless you had your head buried in the sand (or in the snow) over the holidays, you wouldn't have missed the hype around ChatGPT. Although this type of technology has been around in a similar format for many years, it is 'generative AI' that has taken off recently: the bots that can take your feedback and use it to re-generate smarter and more tailored responses. The recent $10bn investment by Microsoft in OpenAI, the company behind ChatGPT, has pushed it further into the spotlight.

Naturally, this type of technology evokes many emotional reactions: fear of losing jobs, plagiarism and the inevitable mis-use of its powers are at the top of most concerns. Will schools and universities resist, or embrace the technology and find ways to work with it? Interestingly, OpenAI itself has now launched a tool so that recipients of documents can see whether what they're reading has been written by ChatGPT or a human. With ChatGPT being free, it would not be surprising to find a charge to access the detector at some point…

But a computer algorithm doesn't naturally think or behave ethically. OpenAI tried to address this by giving its model the mathematical equivalent of penalties or rewards in response to whether the responses it generated were harmful or not. This month, Time magazine reported that OpenAI had used low-paid Kenyans to view obscene and even illegal content, so they could code the system so as not to reproduce it. The possibly unethical treatment of workers in order to generate more ethical content is an uncomfortable and disturbing conundrum that seems quite difficult to resolve.

AI is here to stay, and it will keep improving. It may help to improve the overall productivity equation and take up some of the slack of a declining labour force as our population ages, but whether or not it will improve humanity will not be known for some time yet. Will it ever replace Actual Intelligence? Perhaps we'll have time to answer that when we all become replaced by bots. We let ChatGPT have a go at writing a few parts of this report, and it was incredible to put a request into the bot and see an instantly-generated response, sometimes with spooky nuance, but much of the detail was not accurate enough to use. So we think our job is safe for the moment, but who knows for how long?

Traveller's Tale

While January is typically a month during which we think about beach holidays, one of our global PMs, Mary, decided instead to undertake a research trip to Canada, in the middle of its winter. She had a full schedule which included visiting a commercial waste hauling facility of Waste Connections Inc, one of the holdings in our Global Equity and Global Sustainable Funds. Oh, the glamour of international funds management!

"What was she thinking?" many might say, but it turned out to be one of the more interesting parts of her trip. What is the one thing Waste could be more exciting than? Canadian banks, of course. Mary met with some of the largest Canadian banks and concluded that loan growth is decelerating, net interest margin expansion has plateaued, the housing market is in decline and credit costs and expenses are going up: not a great combination of factors. Australian banks have been performing well recently and we remain more positive on their short term outlook for the Fund, but it is always worthwhile keeping an eye on how their peers in other regions are seeing things, as trends like this can sometimes spread.

Back to Waste Connections. Mary had to get there early in the morning as the first shift for waste collectors starts at 3am! Good thing there was lots of Tim Horton's coffee on hand while she met with management, including the President of the Canadian business and the Head of IR. She was then kitted out in the obligatory high-viz PPE before having a tour around the facility.

Mary learned about how the company uses technology to get significant safety, environmental and productivity improvements which, in an industry with a high workforce injury rate, this has made a tangible difference to many peoples' lives. She was also able to sit in a truck and see how the cameras and controls work, inside and out. She didn't actually drive the truck, as that definitely would have been against the company's Occupational Health & Safety policies!

After Toronto, Mary went to a technology conference in San Francisco. While the weather was definitely better than in Canada, the mood was noticeably sombre given all the lay-offs in the tech sector. While the conference was on, Google announced staff cuts of 12,000, which followed closely on the heels of Amazon and Microsoft reducing headcount by 10,000 and 18,000, respectively. While the outlook for tech workers at the former FANGMANs was dire, there was considerable buzz at the conference around Generative AI and ChatGPT. This seemed to lift the mood somewhat and has become a major driver of AI-related stock prices in the 1Q23.

Mary's final observation from her travels was about Starbucks, a core position in Alphinity's Global Fund: the line to get a Grande Latte at the airport was so long she almost missed her flight home. Yes, waiting in line for Starbucks might seem sacrilegious to Aussie coffee afficionados, but it was valid – if anecdotal – evidence of demand, and SBUX subsequently reported better-than-expected US comp sales exceeding 10%.

From waste to AI to coffee, and everything in between, it was a very insightful research trip!

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