Alphinity Global Equity Fund (Managed Fund)

Quarterly Report March 2023

Performance[1]	Quarter %	1 year %	3 years % p.a	5 years % p.a	7 years % p.a	Inception % p.a[2]
Fund return (net)	9.4	6.3	13.6	12.9	13.7	12.1
MSCI World Net Total Return Index (AUD)[3]	9.1	4.3	13.0	11.0	12.0	10.6
Excess return[4]	0.4	2.1	0.6	1.9	1.8	1.5

Fund facts	
Portfolio managers	Jonas Palmqvist, Jeff Thomson, Trent Masters, Mary Manning, Chris Willcocks.
APIR code	HOW0164AU
ASX code	XALG
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	$379m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
Fortinet	Info. Technology	5.2
LVMH Moet Henne	Consumer Disc	5.1
ASML	Info. Technology	4.9
Danaher	Health Care	4.6
NextEra Energy	Utilities	4.6
Mercado Libre	Consumer Disc	4.5
Waste Connections	Industrials	4.3
L'Oreal	Consumer Staples	4.2
On Semiconductor	Info. Technology	4.0
Accenture	Info. Technology	3.8
Total		**45.3**

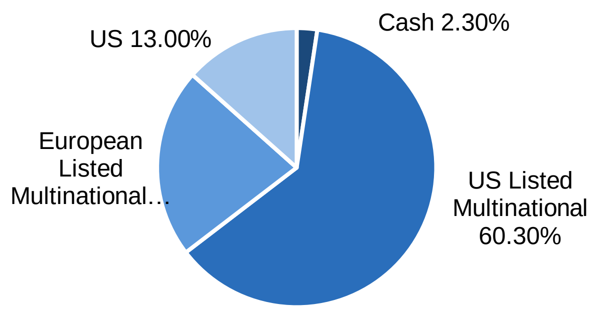
Data Source: Fidante Partners Limited, 31 March 2023

[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.

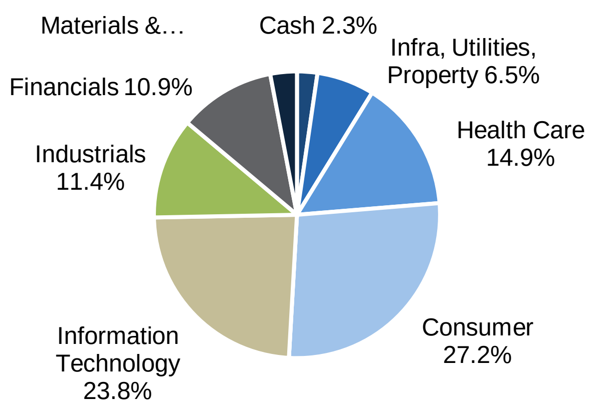
[2] The inception date for the Fund is 21 December 2015

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



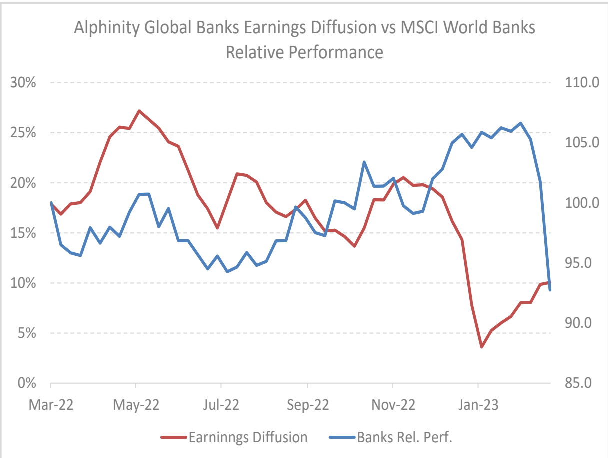
[3] From 21 December 2015 to 30 April 2019, the Benchmark was the MSCI World Equity ex Australia (Net) Index. The current index is effective from 1 April 2019.

[4] Numbers may not add due to rounding

Market comment and outlook

The fall-out from the fastest rate hiking cycle in US history came to a head in March with the second and third largest ever US bank collapses, sending shockwaves through markets. Despite initial fears of a systemic collapse across global financials, the damage was largely isolated to US regional banks; broader markets strengthened as monetary authorities acted swiftly to protect deposit-holders and restore calm, injecting a considerable amount of liquidity into the system. The sharp move lower in yields resulted in most major markets ending the first quarter of 2023 with positive returns. The move higher in stocks continued to be at odds with expectations for earnings, with the pace of downgrades continuing to accelerate.

MSCI World Banks collapsed vs MSCI World Index, Earnings yet to be adjusted



Source: Alphinity /Bloomberg, 31 March 2023

The MSCI World Index gained 9.2% in the March quarter in AUD terms, with the US S&P 500 index up 9% and US tech stocks, as measured by the Nasdaq, closing up 19% (AUD). Emerging markets gained 5.4% in AUD terms, with a rebound in China and Hong Kong as investors warmed to the split up of Ali Baba and the hopes of more corporate friendly behaviour ahead. Europe also outperformed, the Stoxx 600 Index gaining 11.3% (AUD), driven by a strong rebound in retail, technology and travel stocks. These sector moves also played out at the aggregate global level, with consumer and tech stocks the clear winners, while underperformance was limited to energy and banks. Oil prices fell 5.7% which led energy stocks lower, while the US bank failures drove outflows in financials on concern of liquidity risk, despite being swiftly dealt with and contained within the US regional banks.

Economic data continued to be supportive of rate hikes, with the number of jobs being added in the US continuing to print above expectations, although the pace of jobs growth declined each month.

The non-farm payrolls added just over 1 million jobs last quarter versus expectations of 644k, with the huge spike in January which sent bond yields higher and expectations for the end of the rate hiking cycle to be pushed further out. This move in yields quickly reversed in March following the SVB and Signature Bank failures, with US 10-year bonds falling 40 basis points to 3.47%. Global Purchasing Managers' Indexes (PMIs) also expanded and beat expectations, with the JPM Global composite PMI increasing from 50.1 to 54.4 over the quarter, driven by larger beats in Services PMIs than Manufacturing PMIs, which were in line with expectations. Consumer confidence was also surprisingly resilient, and US inflation at 5.1% YoY versus 5.0% expectations shows the Fed still has some work to do with rates, notwithstanding further unforeseen shocks.

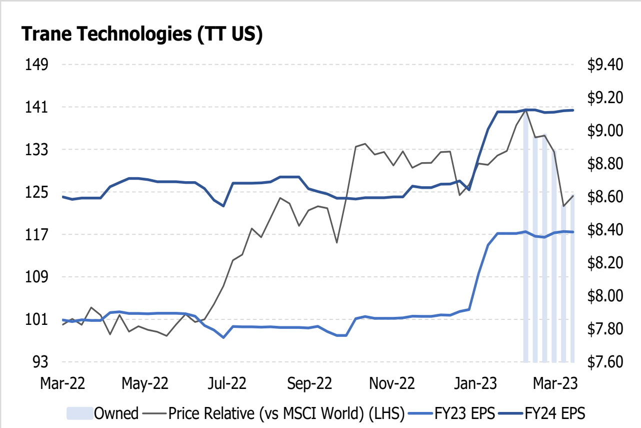
Portfolio comment and outlook

The recent banking turbulence in the US and Europe has added to market volatility and further clouded the outlook. While we currently view systemic risks within the banking sector as relatively limited, the ultimate implications for growth, monetary policy and financial markets are still unclear. Our central scenario remains a period of weaker economic growth and modestly declining inflation, which should drive further downgrades to earnings expectations, and at least a pause in central bank rate hikes. However, we acknowledge that there are significant tail risks around this outlook, ranging from stickier inflation and a higher-than-expected peak in rates, to a sharp pivot in monetary policy and an eventual cyclical recovery.

Reported Earnings Per Share (EPS) in the US fourth quarter reporting season was broadly in-line with lowered expectations, however concerns around the outlook for margins, and generally cautious forward guidance has prompted analysts to continue lowering estimates for 2023. Global earnings consensus has fallen by -1.1% over the last month and -2.9% over the last three months, with most sectors seeing negative revisions. Defensive sectors continue to mostly outperform, with Energy, Real Estate and IT Hardware experiencing the sharpest downgrades over the last three months, while Utilities, IT Software and Financials have held up relatively well. Consensus expectations for EPS growth in 2023 for the MSCI World Index have now fallen to +0.2% y/y, however analysts continue to expect +11% growth in 2024.

The upcoming first quarter reporting season will be another test for earnings expectations, especially post recent banking turmoil. While it's likely too soon to see any definitive trends in actual results given that stresses occurred late in the quarter, updated forward guidance will be closely watched as downside risks appear to have increased. Nonetheless, it's worth noting that we are now more than 18 months past the earnings cycle peak and have entered a phase of broad analyst downgrades (diffusion). Historical analysis shows that our Alphinity Global Diffusion Index typically bottoms 3-6 months before actual earnings revisions, and this is usually associated with new, cyclical leadership.

Trane Technologies – Leading high quality commercial HVAC business with upgrades



Source: Alphinity, Bloomberg, 4 April 2023

Overall portfolio positioning is largely unchanged, with our defensive flagship stocks remaining a key component, in combination with various specific growth stocks and relatively modest cyclical exposure. During the quarter we chose to exit long-held positions in Merck, Nestle and Mercedes, with all three having performed relatively well in a difficult market environment, but where we view the risk-reward as increasingly unfavourable in the context of rising valuations and expectations. We trimmed positions in American Tower, Wells Fargo and Danaher to reflect various emerging risks to earnings and also took some profit in LVMH and McDonald's after strong performance.

This capital was mostly deployed into new positions in Freeport McMoran, Trane Technologies and Sandvik, all supported by somewhat idiosyncratic cyclical earnings drivers. A new position was also initiated in Airbnb, which is a leading, scalable, asset-light growth business trading at an attractive valuation. A full reset in the outlook for earnings continues to be one of the outstanding factors necessary to resolve new market leadership and consequently we continue to prepare a strong bench of new ideas for a range of different potential outcomes.

What's on our mind – SVB's long shadow - The implications of SVB's collapse for financial markets and the outlook for growth

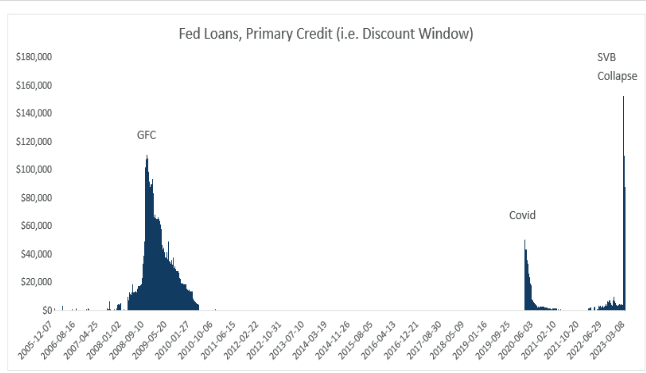
The rapid and unexpected collapse of SVB Financial Group three weeks ago has shocked markets and led to systemic concerns across financial markets. While this isn't Lehman Brothers, and we don't expect persistent systemic stress across the banking system like we saw in the 2007/8 financial crisis, the collapse is nevertheless significant and likely to cast a long shadow. If nothing else, we expect these events to not only drive up the cost of funding for banks, but also very likely an extension and tightening of US bank regulatory standards and capital requirements. It remains to be seen how significant the associated growth shock will be and whether this will ultimately prompt the Fed to pause or even cut rates.

In this brief note we explain what happened and discuss the potential implications for the sector and the broader outlook for growth and rates. We also review current positioning at Alphinity Global.

<u>What are the implications for Banks and the outlook for growth?</u>

- Short term contagion risks appear manageable
- Higher funding costs for banks
- More regulatory tightening is inevitable
- Higher credit risks, especially in Commercial Real Estate

The Federal Reserve as Lender of Last Resort



Source: US Federal Reserve (www.federalreserve.gov), 31 March 2023

<u>Alphinity portfolio positioning</u>

In this context, Alphinity Global is conservatively positioned within Financials across all strategies. We currently have a significant underweight to the Financials sector, and to Banks in particular. Banking stocks have already corrected significantly, and valuations are not demanding, however until earnings expectations have been adequately reset to reflect these new headwinds, and a new upgrade cycle is in play, we expect to remain defensively positioned.

Please refer to the Alphinity website for a copy of the full note [SVB's long shadow - Alphinity]

Author: Jeff Thomson – Global Portfolio Manager & Financials Analyst

Traveller’s Tale

After being tied to the desk in February for reporting season, March brought with it the opportunity to get out there, see the world, see companies, check on investment theses and generate new insights and investing ideas. Members of the domestic equity and ESG teams ended up in North America, South America, Europe and Asia in March – every continent except Africa and Antarctica in the space of a few weeks. In addition, we went to pretty much each state of Australia. We will eke some of these stories out over coming months

Moana had the most exotic trip, to Bangladesh and Vietnam where she mostly saw apparel-making companies who work for large Australian and global companies, including Kmart, Big W, Premier Group, H&M and Uniqlo. It has been quite some time since China was the main country from which to source clothing, as its peoples’ technical skills have increasingly increased and the price of labour has escalated. Apparel moved to other countries in Asia but the working conditions in some has been called into question.

In 2013, a fire in a factory complex in Dhaka resulted in the deaths of more than 1100 workers – an astounding human toll that was a catalyst for significant change in Bangladesh. In addition, there were accusations of exploitation of the mainly female workers who were being forced to work very long hours with unpaid overtime in order to meet customer orders. It wasn’t just labour conditions that was problematic: a great deal of pollution was being created through the garment-making processes, like the dying of fabric.

In the succeeding decade, a lot has changed a lot but some things not so much. The working conditions of the factories she visited were still confronting, but even so far better than existed in 2013. Industry standard hours have been brought down to 48, with workers being paid an hourly rate, with access to sick leave. Child labour was nowhere to be seen there were signs in the factories prohibiting the practice: having said that, the fact the sign was also in English suggests its intended target was not only aspiring child workers! Moana was told child labour was no longer an issue, at least in tier-1 factories. The labour issues are now more about working hours, conditions, unpaid overtime, and gender inequality.

Of course Moana was only being shown a curated selection of factories, and those she saw were quite acceptable, but there is a seemingly irresolvable tension between the factories and their customers, the apparel brands. The brands want the cheapest possible product, but the factories also need to charge enough to pay their workers a living wage but also live up to ever-increasing compliance demands of their customers. Those customers are often not willing to pay up however, in fact she was told that the unit prices of clothing have actually fallen each year for the past five. And customers are generally unwilling to give factories long-term contracts, so they often need to make capital investments without any guarantee of getting any payback. While there was probably a message they wanted to be conveyed back to the brands from investors, it does appear that small increments in the cost of a garment, or for that matter one of these Paddington Bears from Vietnam destined for UK chain Marks & Spencer, wouldn’t make much of an impact on its retail price.

Moana was also given a glimpse into the life of a typical garment worker, being invited to the into home of one in Dhaka. It was quite confronting from a western viewpoint, but the worker was very proud of her one-bedroom flat with electricity but no running water and shared facilities; these living conditions however were superior to many of her peers. The typical wage is around $US110 a month – about $A160 – for their 48-hour working week; any overtime. In fact, garment workers in Bangladesh get paid more than teachers and nurses.

Vietnam was significantly more developed than Bangladesh. Factories were more spacious, more automated, and generally air conditioned. A typical garment industry worker in Vietnam earns close to double those in Bangladesh, but even that still falls well short of a living wage according to most human rights organisations. It appears that the higher labour cost in Vietnam has driven more automation which enables more complex manufacturing processes and higher-value products. This is the cycle Bangladesh needs to get onto, but in doing so they face the risk that a meaningful wage break-out could result in manufacturing shifting to yet another low-wage jurisdiction.

For further information, please contact:

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