Alphinity Global Equity Fund (Managed Fund)

MONTHLY REPORT – MAY 2023

Performance*	1 Month %	Quarter %	1 Year %	3 Years % p.a.	5 Years % p.a.	7 Years % p.a.	Since Inception^ % p.a.
Fund return (net)	1.0	7.1	14.4	12.6	12.5	13.0	12.1
MSCI World Net Total Return Index (AUD)3	1.1	8.2	13.1	11.9	11.2	11.3	11.0

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	$407m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
Microsoft	Info. Technology	6.5
Alphabet	Info. Technology	5.7
NextEra Energy	Utilities	4.5
Mercado Libre	Consumer Disc	4.4
PepsiCo	Consumer Staples	4.0
ASML	Info. Technology	4.0
Zoetis	Health Care	3.7
Waste Connections	Industrials	3.7
Accenture	Info. Technology	3.6
Keysight	Info. Technology	3.5
Total		**43.6**

Fund features

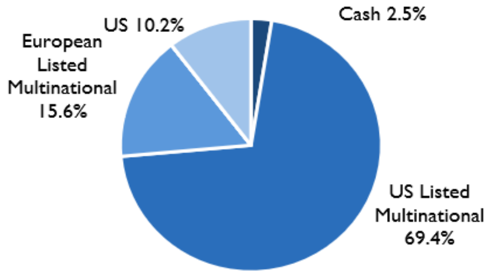
Concentrated: A long only, concentrated portfolio of 25-40 of our best ideas, highly diversified across sectors and regions. A truly global fund consistently exposed to powerful trends reshaping our world.

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.

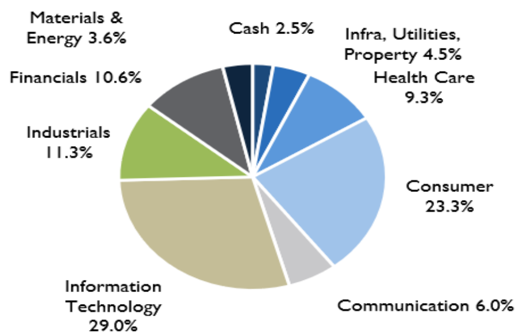
Talent: A united and deeply experienced team of global portfolio managers each with an average of 22 years of financial experience.

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



Data Source: Fidante Partners Limited, 31 May 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
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

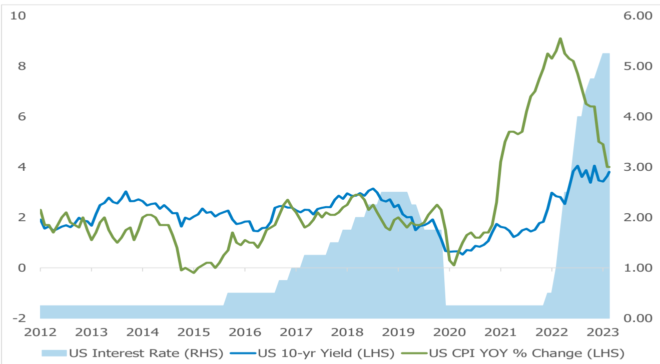
Market comment and outlook

Equity market strength in May was largely attributable to the Technology sector, driven by a narrow breadth of US mega cap stocks tied to the AI growth thematic. Outside of this specific area of strength in semiconductors and some parts of communication services, most sectors closed the month lower, with the slower recovery in China putting further pressure on commodity prices and raising doubts around the demand outlook for oil and other raw materials.

The MSCI World Index gained 1.1% in AUD, although fell 1.3% in USD terms due to a weaker Australian dollar. US markets outperformed other regions, helped by its larger relative contribution of Technology and Communication stocks with the US S&P 500 index +2.6% and the Nasdaq +8.3% in AUD terms. Japan continued to strengthen, with the Nikkei index up 19% this year, driven by its Government's push for improved cash allocation and greater focus on profitability, while European shares (Stoxx 600 Index -4.4%) underperformed, reversing strong gains made the prior month. China weakness persisted, the Shanghai Composite Index down 4.1% as softer economic data including weaker than expected trade and manufacturing PMI's did little to assure investors of its post-Covid growth prospects. While a stimulus response might be a catalyst for renewed interest, any measures thus far have been subtle and specific.

Economic data in the US was surprisingly positive and company earnings have generally beaten lowered consensus expectations, which have helped to ameliorate recession concerns. Jobs data showed a strong labour market, with non-farm payrolls at 339k vs 195k expected, while headline inflation printed below expectations, CPI at 4.0% versus 4.1% expected and down from 4.9% in April. US bond yields rose in May, the US 10 year bond rising 22 basis points to 3.64%, although yields have traded in a narrow 40bp range for most of this year as the market prices in a nearing of the end to the rate hiking cycle.

US – Fed Funds Rate vs Inflation vs 10-year Yield – Getting closer to a Fed pause?

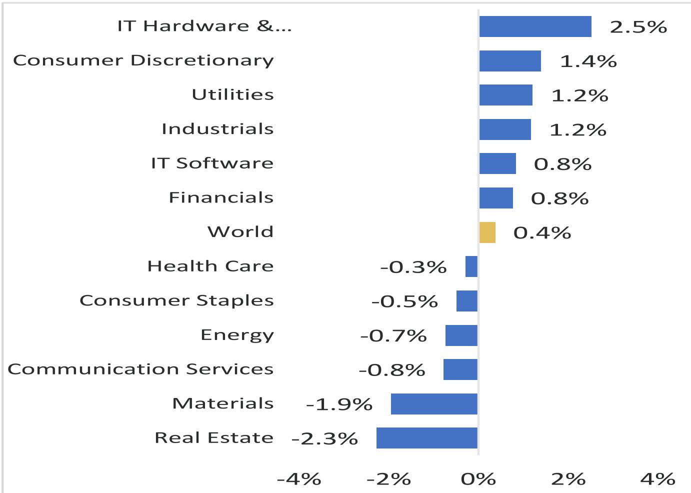


Source: Bloomberg, 31 May 2023

Portfolio comment and outlook

Surprisingly good economic data, combined with better than expected first quarter earnings, saw recessionary concerns take a backseat in May; however, we continue to believe that near-term growth risks are skewed to the downside amid the lagged impact from Fed rate hikes, tightening credit conditions after the U.S. regional banking crisis and a challenging outlook for corporate earnings. Labour markets have also remained surprisingly resilient so far, however there are some early signs of weakening and we expect inflation will carry on moderating as the impact of lower energy and commodity prices flow through, which could drive some further downgrades to earnings expectations. Consequently, we continue to believe we are close to at least a pause in Fed rate hikes, although 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.

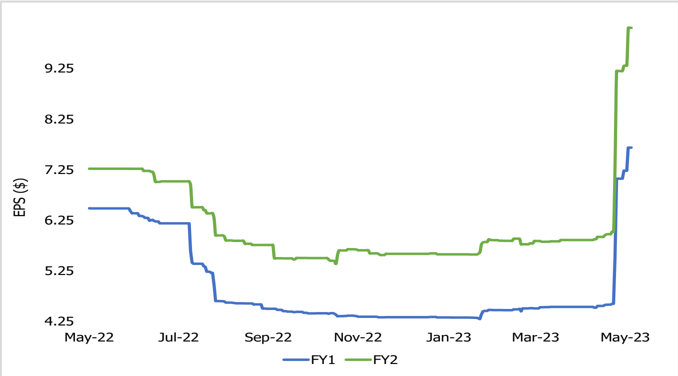
2023 One-month Earnings Revisions by GICS Sector – MSCI World Index seen EPS upgrades over last month with big divergence between sectors



Source: Factset, 31 May 2023

While first quarter earnings growth for the S&P 500 was negative (-3% y/y), most companies beat recently lowered expectations and forward guidance was also not as bad as some had feared. Consequently, earnings revisions for the MSCI World have been broadly flat over the last three months (-0.1% y/y), albeit with a wide dispersion by sector. Weaker commodity prices have driven sharply negative revisions for Energy and Materials, while Consumer Discretionary, I.T. Software and Industrials are all positive. Blow-out results from Nvidia have driven exceptional post-report earnings upgrades of close to 70% for the company, with analysts also beginning to assess potential profit boosts from AI in other large technology companies. Nevertheless, we continue to be wary of near-term risks to corporate earnings from lower growth and higher rates, as well as a potential margin squeeze from stickier cost inflation, however we are now more than 20 months past the peak of the earnings-cycle, and we recognise the potential for a more constructive outlook for both growth and earnings if inflation continues to moderate and rates can indeed be cut.

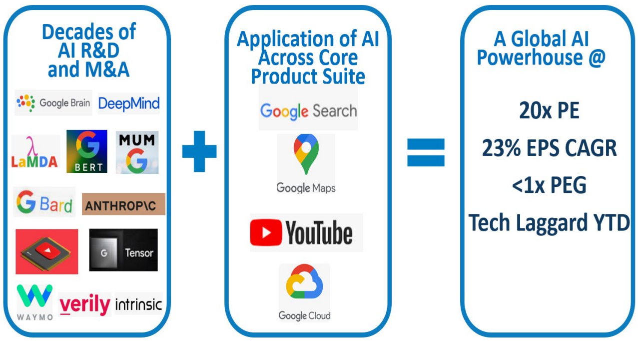
Nvidia – 1Q results and 2Q/FY23 guidance driving massive EPS upgrades



Source: Alphinity, Bloomberg, 31 May 2023

During the month we added new positions in Alphabet and Nvidia following strong earnings reports. We believe both companies are set to benefit from faster than expected adoption of AI across a wide range of industries over the next few years. We also invested in Linde, a global leader in industrial gases with a resilient outlook for growth underpinned by a diversified set of cyclical and structural earnings drivers. These new positions were financed by exiting long-held positions in Apple and American Tower, where earnings momentum has weakened. We also took some profits in LVMH, Keysight, Accenture and Fortinet after recent strength. Overall, the portfolio continues to be positioned in strong growth stories combined with some flagship defensives and remains less invested in cyclical stocks.

Alphabet – A global AI Powerhouse with a renewed focus on Profitability



Source: Alphinity, Bloomberg, 31 May 2023

The AI revolution is no segway

Every year in technology there are advances and breakthroughs that are lauded as having the potential to fundamentally transform how we live and work

Sometimes they are truly revolutionary and the economic gains to be made are enormous - think of the transformative impacts of the internet and smartphones, which gave rise to the modern-day corporate behemoths of Apple, Google, and Amazon. Then sometimes they are not – consider 3D TVs, the Segway or the WiFi-enabled Juicero. But beyond the pure commercialisation potential of a technological breakthrough, there is a second dimension to the investment case, which is time. Because being too early can be the same as being wrong. Take autonomous and electric vehicles for example.

Before I had kids, I fully expected that by now I'd be shipping them off to Saturday sport in an electric and autonomous vehicle while being able to watch their games thanks to a telecast from a personalised drone. Yet there I was last Saturday, some nine years later, standing in the mud and rain at a suburban field after battling morning traffic in my internal combustion engine vehicle. Meanwhile, EV focused companies such as Faraday Future, Fisker, and Better Place have failed, while in autonomy, Ford and Volkswagen invested $3.6 billion into Argo AI before it closed its doors and Uber gave up on any autonomous aspirations. And the 2019 Elon Musk promise of one million robo-taxis by the end of 2020 remains somewhere out on the distant horizon (along with my free time on Saturdays).

But there has been one piece of emerging tech that has genuine and immediate potential, and that is artificial intelligence, or AI. AI is one of the fastest growing and most disruptive technologies of our time. From voice assistants and self-driving cars to personalised medicine and financial analysis, AI is revolutionising the way we live and work. As a result, it has become a major area of investment for businesses, governments, and individual investors alike (FYI, ChatGPT wrote that last section).

It is a tectonic shift in technology opening a plethora of tangible use cases and commercialisation potential, and the timing is now. Using Microsoft as an obvious example, the integration of AI across their platform creates tangible and valuable product extensions. Microsoft has close to 500 million paying Office users and generates approximately $150 per user per year. One of the first AI product extensions for Microsoft is Teams Premium, an extension that comes with automatic minutes, personalised highlights, and AI generated summaries and action points.

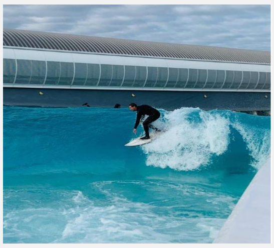
For a copy of the full note, please visit our website: [The AI revolution is no segway - Alphinity]

Traveller's Tale

Our global portfolio managers were as usual globe-trotting in May, visiting companies around the world and gaining valuable insights that help feed our investment process. Mary went to China, while Jeff and Chris both went to Europe visiting more than 50 companies between them in less than two weeks. They had a day of cross-over in Paris, but sadly no time to catch some of the tennis at the French Open.

Trent, Alphinity's global PM covering Tech decided he needed a mini-break from the roller-coaster ride of US Tech investing so he embarked on a two-day trip to Melbourne's Urbn Surf. One can't help noting the similarity between riding the wave of AI stocks and getting your head smashed by your own surfboard on a real wave. Just out of shot was the monster Nvidia wave swallowing up everyone in its path. Just keep riding that AI wave!

Before



After

While Trent was ducking waves and dodging surfboards, Mary was gaining valuable insights on the ground in China and Hong Kong. Much has been made about the demise of Hong Kong and the concurrent rise of Singapore as the heart of the financial industry in Asia. These stories are greatly exaggerated. Hong Kong is booming with a renewed energy after 3 years of lock downs.

The Alphinity Global Fund currently has no direct investments in China, but the fund does have considerable indirect exposure via MNCs like LVMH, Starbucks, L'Oreal, Otis and Linde. LVMH has been one of the largest positions in the Alphinity Global Fund and has been a strong contributor to alpha over the last 12 months.

Given the remarkable outperformance of the luxury sector, part of Mary's trip was to form a view on the outlook for the sector from here. Are the best days in the past? Over the course of 2 days she visited over 20 different luxury stores in Shenzhen and Hong Kong - Dior, Louis Vuitton, Gucci, Balenciaga, Bottega Veneta, Burberry, Prada, Miu Miu, Fendi, Tiffany's, Cartier and Rolex. Must be fun to cover the luxury sector!

Her view is that demand for luxury goods in China continues to be strong. This cohort is ultra-rich and is largely insulated from the macro uncertainties plaguing other less wealthy cohorts of Chinese consumers.

The outlook for luxury and masstige consumption in the US is a more pressing risk than normalisation of luxury sales in China.

EVs are another global sector with significant exposure to China. Mary visited BYD and Tesla showrooms, visited local EV charging stations and met with management of Pony.ai, China's largest EV robotaxi company.

Tesla's erratic approach to pricing seems to have taken a toll on demand. Consumers are choosing to wait and see if prices go down further before they commit to a purchase, which is a negative for both Tesla and its EV competitors. The roll out of EV infrastructure is impressive with the Minle Charging Station in Shenzhen boasting almost 700 rechargers in one location.

On Pony.ai robotaxis, Mary says "Call me old fashioned, but I prefer drivers in my cars!" Pony.ai as a company is impressive in that it has achieved Level 4 Autonomous Driving (AD) technology much faster than Google's Waymo or GM's Cruise. However, from a behavioural perspective, driverless cars will take some getting used to before widescale adoption in China or anywhere else.

The Alphinity Global Fund has no direct exposure to EVs, but Global Sustainable Fund has a position in EV battery maker Samsung SDI. If the demand for EVs in China deteriorates from here and battery capacity keeps ramping in the US due to the tax incentives provided by the Inflation Reduction Act (IRA) the price of batteries will likely suffer. This is the key dynamic to monitor going forward.

Finally, Mary attended the Morgan Stanley 2023 China Summit to get an update on the Big Tech stocks in China. Alibaba appears to be a darling of yesteryear. There is considerable uncertainty about the long-term growth trajectory of the core e-commerce business and investors are worried about the ability of the company to execute the restructuring IPOs at the valuations the market expects. Gaming companies like NetEase and Tencent, as well as AI beneficiaries like Baidu, have a considerably better outlook than the Chinese e-commerce stocks.

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