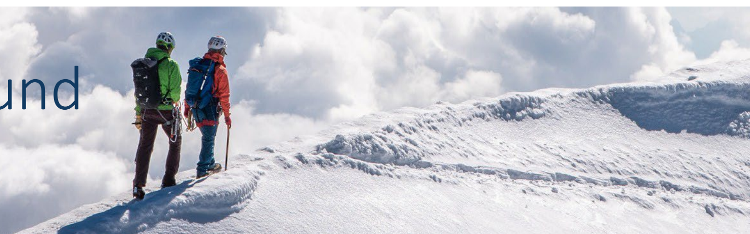


Alphinity Global Equity Fund (Managed Fund)

QUARTERLY REPORT – SEPTEMBER 2023

Performance[1]	1 Month %	Quarter %	1 Year %	3 Years % p.a.	5 Years % p.a.	7 Years % p.a.	Since Inception[2] % p.a.
Fund return (net)	-4.6	-2.7	12.2	12.3	10.7	13.5	11.5
MSCI World Net Total Return Index (AUD)[3]	-4.0	-0.4	21.5	11.9	9.7	12.1	10.8

Fund facts

Portfolio managers	Jonas Palmqvist, Jeff Thomson, Trent Masters, Mary Manning, Chris Willcocks.
APIR code	HOW0164AU
Inception date	21 December 2015
ASX Code	XALG
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	$442m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
Alphabet	Communication Services	6.7
Microsoft	Info. Technology	6.3
Linde	Commodities	4.0
Trane Technologies	Industrials	3.9
ConocoPhillips	Energy	3.8
Cadence	Info. Technology	3.8
Nvidia	Info. Technology	3.7
Waste Connections	Industrials	3.7
Parker Hannifin	Industrials	3.6
Marsh McLennan	Insurance	3.6
Total		**43.1**

Fund features

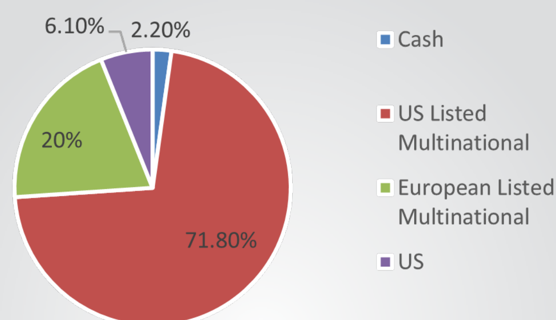
Concentrated: A long only, concentrated portfolio of 25-40 of our best ideas, highly diversified across sectors and regions. A truly global fund consistently exposed to powerful trends reshaping our world.

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.

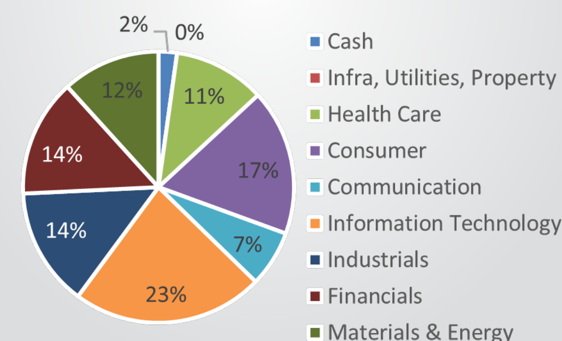
Talent: A united and deeply experienced team of global portfolio managers each with an average of 22 years of financial experience.

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, 30 September 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 May 2019

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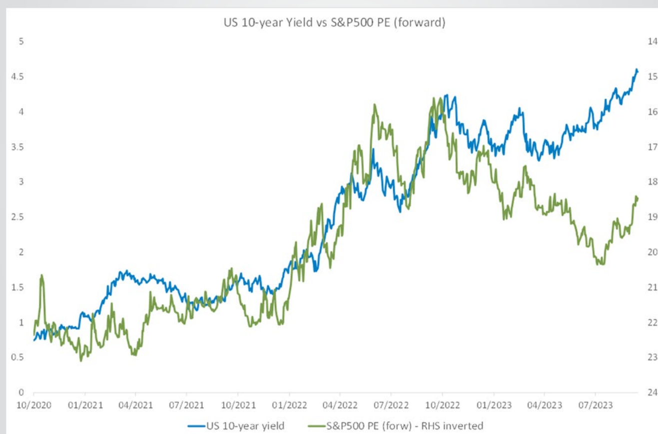
alphinity INVESTMENT MANAGEMENT

Market comment and outlook

Despite a solid start to the September quarter, equity markets came under pressure last month as rising bond yields and expectations of higher rates for longer contributed to the market's worst monthly decline since last December. The MSCI World index fell 0.4% over the quarter in AUD terms, with a weaker Australian dollar helping returns in local currency. In USD terms, the same benchmark fell 3.8%. The US S&P 500 index fell 3.7% while European shares lost 2.5% driven by weakness in rate sensitive sectors like Technology, Property and Utilities. Energy stocks were the stand-out performers as oil prices rose 23% to USD92.20/barrel.

Rapid rise in 10 bond yields hurting equity valuations



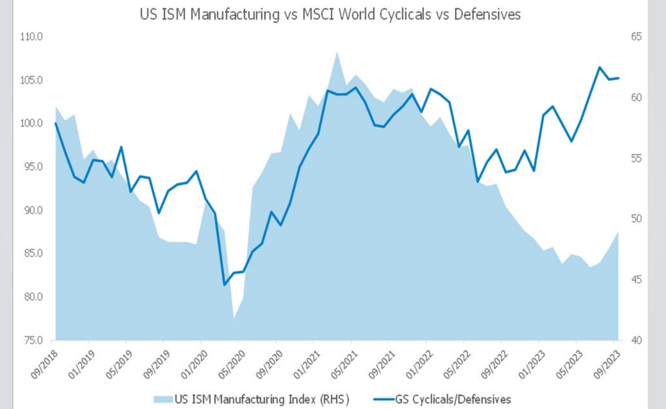
Source: Bloomberg, 30 September 2023

The sharp move higher in bond yields to levels not seen in over a decade led to the realisation that without a recessionary shock, we'll need to live with higher rates. The sell-off in bonds has been driven by persistent inflation and the central bank response, but also there have been supply / demand imbalances at play, where countries like China and Japan have been selling US Treasuries and increasing supply, while demand at auctions has reduced. Aussie 10-year yields jumped 46 basis points to 4.49% while US 10- year yields rose by a similar margin to 4.57%. US 30-year mortgage rates jumped above 7.5% which negatively impacted US homebuilders.

With markets still digesting the effect of AI disruption in technology and labour, another disruptor in weight loss drugs took the mantle as the latest thematic for investors to grapple with. Novo Nordisk's drug originally designed to treat diabetes is now being used as a successful weight loss drug, along with other successful trials to treat kidney disease. The response to sell a wide range of healthcare stocks with varying degrees of association will most likely prove over-done, but this was the short-term reaction in September.

The US economy grew around 2% QoQ (annualised) which is marginally below expectations, although jobs data continued to surprise to the upside with nonfarm payrolls adding 336k jobs last month, well above expectations for 170k. Combine stronger jobs data with sticky inflation (CPI print of 3.7% YoY vs 3.6% exp) the Fed is left with some work to do and both bond and equity markets reacted accordingly.

A growing cyclical recovery with bottoming of economic activity



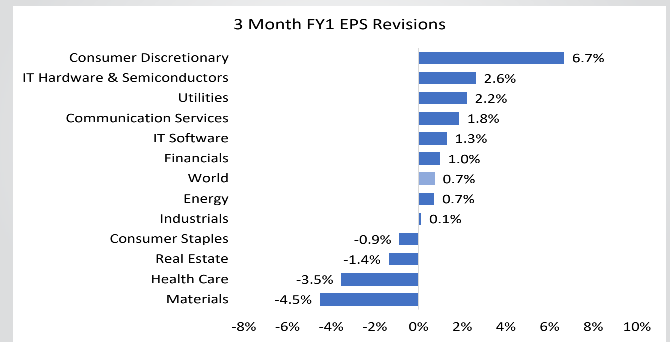
Source: Alphinity, Bloomberg, 30 September 2023

Portfolio comment and outlook

The rapid rise in bond yields in the recent quarter had an impact across equity markets and happened against a backdrop of mixed macro signals. The resilient US labour market and apparent bottoming of both US manufacturing PMI as well as the global earnings cycle, all indicate that the economic growth outlook is certainly stronger than feared earlier in the year. They also point to a growing cyclical recovery in stock markets. Nevertheless, risks from the lagged, cumulative impact of Fed rate hikes remain, and elsewhere macro data has been more mixed, and we're observing an unusually wide range in market forecasts for economic growth in 2023-24. So, while the growth outlook is certainly stronger than feared at the start of the year, visibility into 2024 remains low.

Corporate earnings reflect a similar picture. With fears of an imminent recession abating, negative revisions have slowed significantly and in fact inflected slightly positive recently. The second quarter reporting season was better than expected, with beats, both by number and magnitude, higher than normal. Forward guidance remained more cautious, driving mixed price responses, however despite this, earnings expectations for both 2023 and 2024 have edged higher. For example, EPS revisions for '23/'24 earnings are +0.3%/+0.6% over the last three months, which is a notable improvement from the previous negative trend of -2% to -3% per quarter.

Positive earnings revisions broadening out



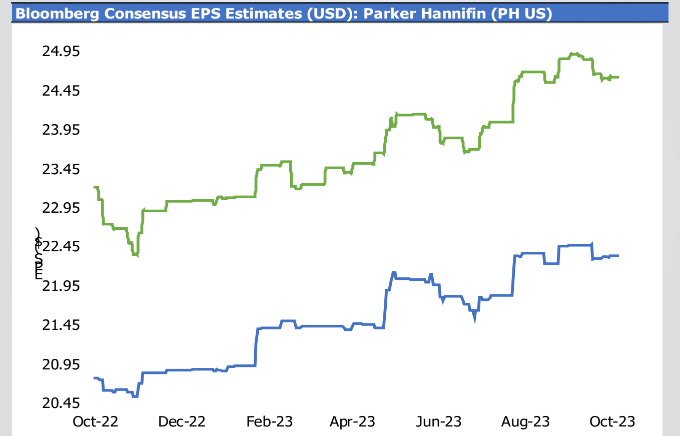
Source: Bloomberg, 30 September 2023

At a sector level, more growth-biased companies in Software, Semiconductors, Communication and Consumer Discretionary are seeing the strongest upgrades, with the picture in Cyclicals more mixed (Industrials strengthening, Materials and Banks lagging). High-level earnings expectations in more Defensive sectors like Health Care, Consumer Staples and Real Estate continue to slip. So far this year, market leadership has rotated back to growth stocks and away from defensive sectors such as Utilities, Real Estate and Consumer Staples. A notable feature this year has been an unusually narrow leadership, with the so-called 'magnificent seven' group of mega-cap growth stocks, which make up ~30% of the S&P 500 market capitalisation, having delivered ~90% of the YTD return through to end September. Historically, such periods of extreme narrowness have tended to be temporary, and we see a gradual broadening of market leadership as likely to play out in markets.

Activity during the quarter was stock specific and driven by changing earnings outlooks. We initiated a new position in Novo Nordisk following positive trial results and higher conviction about the long-term potential for their obesity drugs to also address other co-morbidities. Other new positions included Parker Hannifin (cheap, high quality diversified industrial manufacturer with leading margins and cashflows) and Ferrari (high-quality luxury autos with limited cyclicality). We also initiated two positions in the US Energy sector during the quarter, ConocoPhillips, and Baker Hughes, as oil and gas prices and supply/demand balances are lifting future earnings expectations. Fortinet and Keysight both reported broadly in-line results, however order/billings trends and guidance for both were unexpectedly weak. Earnings recovery is uncertain and consequently we exited both positions.

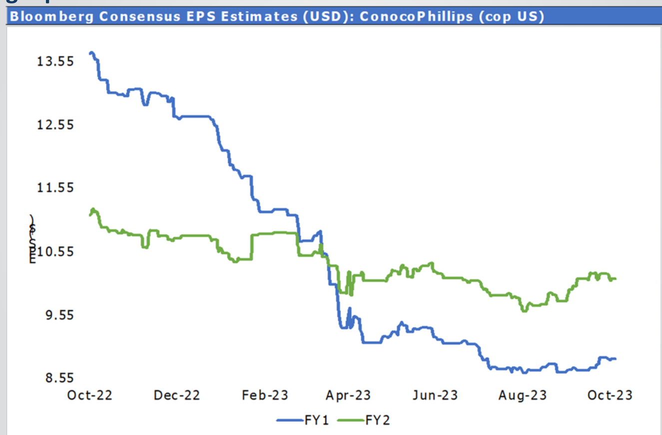
Overall, the portfolio remains well-positioned in quality growth cases, but importantly these investments sit across many different sectors, not just in technology stocks (also Financials, Consumer Discretionary, Industrials, Communications, Health Care). In addition, we have gradually added to our cyclical exposure where we have established stock-specific, fundamental earnings conviction. This has been primarily funded from some of our more defensive holdings, which are falling out of process for us. On this note, we divested McDonald's, Deutsche Boerse and NextEra, as well as trimmed back Pepsi. The portfolio continued to see significantly better earnings revisions than the market during the quarter, and should continue to generate a superior earnings growth, which we expect to drive portfolio performance. The investment team was again travelling widely overseas during the quarter to meet companies across different sectors and geographies, building conviction in investment cases as the earnings cycle continues to evolve.

Parker Hannifin – High quality defensive industrial manufacturer-in strong beat & raise driven by aerospace



Source: Bloomberg, 30 September 2023.

Conoco Phillips back in an earnings upgrade cycle on higher oil and gas prices



Source: Bloomberg, 30 September 2023

What's on our mind – Ferrari: The CASE for RACE

Ferrari (RACE IM) is one of the world's most iconic brands. It's also an amazing stock. Ferrari was founded in Italy in the 1940s and was spun off from Stellantis in 2016 under the ticker RACE IM.

The IPO price was EUR43 and Ferrari is currently trading at ~EUR300 for a 600% return since listing. The analysis below outlines the Case for RACE and highlights 4 main reasons to why we love the stock.

Reason #1: High margin, high return, high growth business
Ferrari has achieved the holy trinity of high returns, high growth and a reasonable valuation. RACE boasts gross margins of ~50%, net margins of over 20% and an ROE of approximately 40%. This margin and non-cyclical earnings profile is why Ferrari is typically considered a luxury stock like Hermes, rather than an auto stock like GM, Ford or even Mercedes.

Metric	Ferrari	Hermes	LVMH	Mercedes	Ford
Gross Margin	51%	72%	69%	22%	14%
EBITDA Margin	38%	42%	30%	17%	10%
Net Margin	20%	30%	19%	9%	5%
ROE	41%	22%	27%	16%	18%
PE	40x	50x	24x	5x	6x

Reason #2: A+ industry structure leads to earnings visibility and upgrades
When I was a student at Harvard Business School I did many case studies applying the Porter's 5 Forces Framework. The 5 Forces is an analytical tool developed by Michael Porter in the late 1970s to analyse industry structure and competitive environments.
From this perspective, Ferrari is literally the textbook case of an A+ company. They are a heritage brand with incredibly high barriers to entry, they have few competitors, few substitutes, price insensitive customers with very little bargaining power, and a supply chain that is localised and very difficult to replicate.
The net result is that Ferrari has an immense level of control over its own earnings and strong earnings visibility. Management upgraded its FY23 revenue guidance, adjusted EBIT margin guidance as well as adjusted EPS and FCF estimates at the last result. More importantly, this upgrade cycle is a consistent pattern shown by RACE management since listing.

Reason #3: Impressive Brand Recognition and Unique Positioning Among Auto Peers
Ferrari is repeatedly recognised as one of the world's leading brands and they are confident in what their brand stands for and who their target customer is. Most auto meetings these days are focused on the transition to EVs and the rise of autonomous driving (AD). While these are important strategic directions for the auto sector as a whole, it often feels like the companies are in a RACE (no pun intended) to out electrify and out tech each other.
Ferrari is refreshingly contrarian on both these fronts. Ferrari management has made a strong commitment NOT to get into autonomous driving (AD). The whole point of buying a Ferrari is to drive it yourself!
While Ferrari is a leader in hybrids with approximately 45% of deliveries already in the hybrid space, it's first fully electric car will not be presented until 2025 with the first deliveries the following year. They do not expect pure EVs to be more than 5% of total shipments by 2026. Part of this is strategic positioning that one of the great joys (so I am told) of owning a Ferrari is the vrooooom, sound it makes when you start the ICE engine. EVs don't vroom so Ferrari plans to continue to develop ICE engines into the 2030s.

Reason #4: Technological leader
Technological leadership comes in part from the company's F1 racing pedigree. Scuderia Ferrari has been racing in the Formula 1 World Championship since the series was launched in 1950. RACE transfers technologies initially developed for racing to its road cars, which reinforces the brand identity and the scarcity value of the vehicles. Examples include steering wheel paddles for gear shifting, the use and development of composite materials, which make cars lighter and faster, and technology related to hybrid propulsion. RACE road cars have also benefited from the know-how acquired in the wind tunnel by racing car development teams, enjoying greater stability as they reach high speeds.

Investment Risks
Of course, no stock is without risks. For Ferrari, the main risks are that it is a single brand, single product company and therefore lack the diversification of a luxury stock like LVMH or a more diversified auto company like Mercedes or Tesla. From a governance perspective, this is still to some extent a family endeavour with the Agnelli family de facto controlling approximately 51% of the voting rights of the company. Finally, Euronext Milan is not the most liquid market so the Average Daily Traded Value (ADTV) of Ferrari as a EUR50 billion market cap company, is less than it would be if it was traded in the US or France.

Conclusion
The case for RACE is clear. Ferrari is a high margin, high return, high growth company operating in a competitive environment with high barriers to entry, few competitors, leading technology and loyal customers. What's not to like about Ferrari?

Author: Mary Manning – Global Portfolio Manager
Find a copy of the full note here:
Ferrari: The case for RACE (RACE IM) - Alphinity

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