Alphinity Global Sustainable Equity Fund (Managed Fund)

QUARTERLY REPORT – SEPTEMBER 2023

Performance[1]	1 Month %	3 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	Since Inception[2] % p.a.
Fund return (net)	-4.9	-2.5	10.5	-	-	5.3
MSCI World Net Total Return Index (AUD)	-4.0	-0.4	21.5	-	-	7.8

Fund facts

Portfolio managers	Jeff Thomson, Mary Manning, Jonas Palmqvist, Trent Masters, Chris Willcocks.
APIR code	HOW1000AU
Inception date	3 June 2021
ASX Code	XASG
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	$82m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%
Carbon Intensity (ave weighted) Scope 1 & 2	136.7 (vs MSCI Benchmark 150.6)

Top 10 positions

Company	Sector	%
Alphabet	Info. Technology	7.5
Microsoft	Info. Technology	7.2
MasterCard	Financials	5.3
Procter & Gamble	Consumer Staples	5.1
Trane Technologies	Industrials	4.6
Cadence	Info. Technology	4.4
Linde	Materials	4.4
Accenture	Info. Technology	4.0
Novo Nordisk	Health Care	4.0
Schneider Electric	Industrials	4.0
Total		**50.6**

Data Source: Fidante Partners Limited, 30 September 2023

Fund features

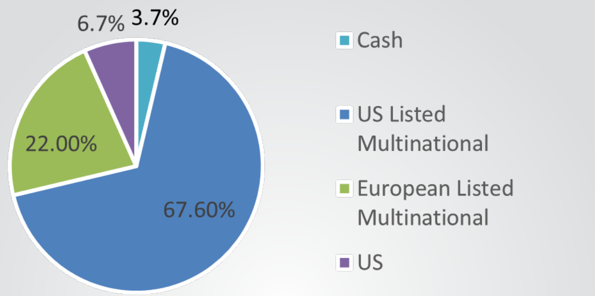
Sustainable: A long only, concentrated portfolio of 25-40 global companies with strong ESG practices that contribute towards at least one of the UN sustainable development goals. Diversified across sectors and regions.

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.

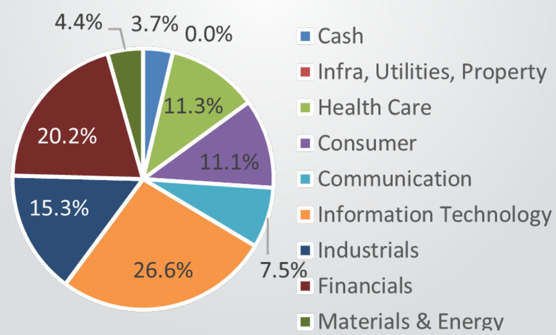
Talent: A united and deeply experienced team of global portfolio managers each with an average of 22 years of financial experience.

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



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. Past performance is not a reliable indicator of future performance.

2 The inception date for the Fund is 3 June 2021

3 Numbers may not add due to roundi

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alphinity INVESTMENT MANAGEMENT

Alphinity Global Sustainable Equity Fund
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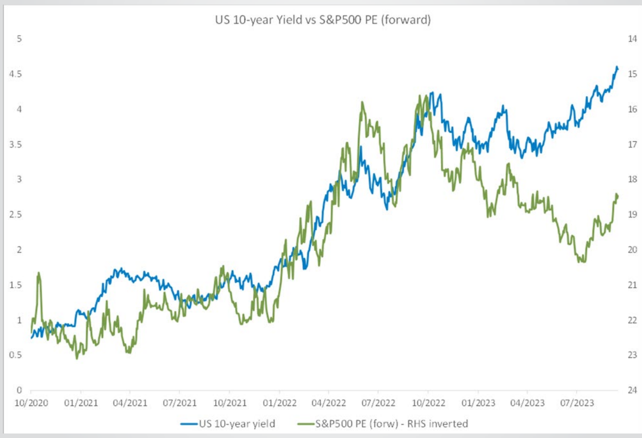
Market comment and outlook

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.

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.

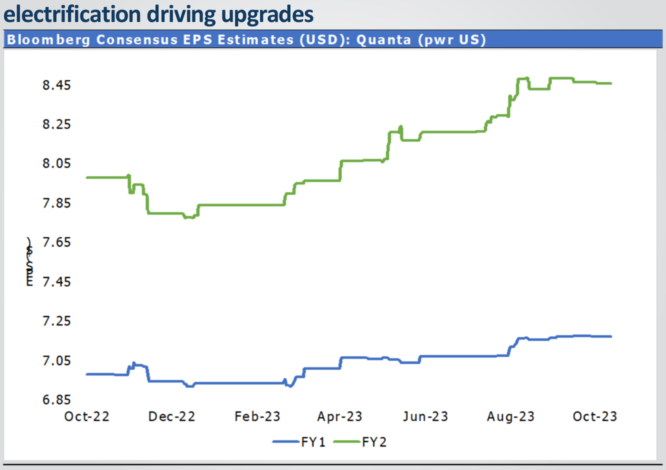
At a sector level, more growth-biased companies in Software, Semiconductors, Communication and Consumer Discretionary are seeing the strongest upgrades, with the picture in Cyclicals more mixed (Industrials strengthening, Materials and Banks lagging). High-level earnings expectations in more Defensive 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 Quanta Services (leading specialty infrastructure solutions provider; electrification driving upgrades), Zoetis (earnings has turned a corner post lockdown disruptions) and Partners wealth group (leading alternatives manager, with upgrades from infrastructure and evergreen products).

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. We also divested our position in Samsung SDI following a weak earnings report and continued to take profits in other technology positions such as ASML, On Semiconductor and Cadence. 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 Deutsche Boerse and Otis Elevators as well as trimmed back Chubb. We sold out of NextEra Energy Partners following the warning of lower dividend growth due to higher financing costs.

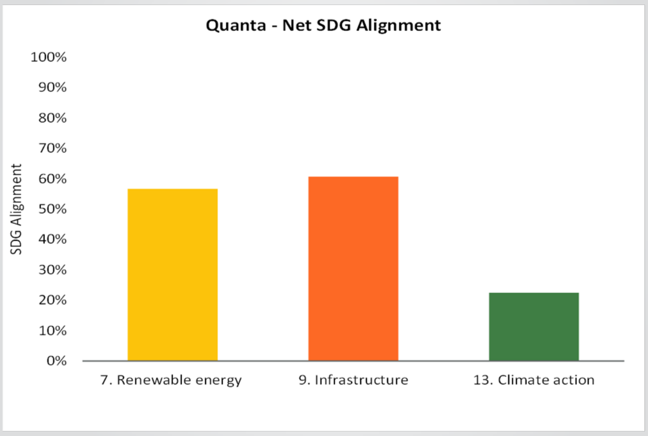
The portfolio continued to see significantly better earnings revisions than the market during the quarter, and should continue to generate a superior earnings growth, which we expect to drive portfolio performance. The investment team was again travelling widely overseas during the quarter to meet companies across different sectors and geographies, building conviction in investment cases as the earnings cycle continues to evolve.

Quanta – Leading specialty infrastructure solutions provider; electrification driving upgrades



Source: Bloomberg, 30 September 2023

Quanta – Net SDG Score: 140%: Positive Alignment to SDG 7, 9 & 13



Source: Alphinity, Bloomberg, 30 September 2023

Alphinity ESG & Sustainability Commentary

PRI in Person

In early October, Moana (ESG and sustainability analyst) attended the PRI conference in Tokyo. The tagline for the week was to 'Move From Commitment to Action' and it was an opportunity to engage in meaningful conversations with global ESG leaders and gain a sense of the various topics and initiatives that responsible investment leaders are turning their attention to in the ESG space. Physical climate risk was a strong theme given the backdrop of natural disasters experienced in Japan, but also the risk of overshooting the 1.5-degree commitment with summer heat observed in recent months by NASA. With global emissions still rising and estimates that we are on the pathway for above 2-degree warming, the focus on adaptive capacity and proper planning for weather-related risks was a focus in many of the panels.

Nature and biodiversity were also high on the agenda. Six of the nine planetary boundaries have been overstepped and there certainly appeared to be a broader uplift in awareness of the dependency of our society with natural ecosystems systems. Nature sits at the crux also for climate action, and this was a timely discussion considering the Taskforce on Nature-Related Financial Risks were finalised last month. During New York Climate Week, the TNFD published its final recommendations and guidance to help organisations get started on nature-related assessment and disclosure, building on existing climate reporting practice.

A speaker from the WWF was calling for strong investor action on deforestation, and that this should – by default – be considered within a climate strategy for investors. While companies have been taking action on nature, collecting and analysing data is still a challenge in the investment space. However, there is momentum around deforestation, complemented by new regulation such as the EU's deforestation free policy, as well as collaborative bodies such as the Nature Action 100+ emerging. The conversation around reforestation and avoiding deforestation should not be overlooked and we anticipate will pick up alongside transition efforts.

ESG Engagement Summary – 3Q23 Snapshot – 15 dedicated meetings so far

Company	Purpose
Essilor Luxoticca Jul-23	Focus on expanding access to eyecare globally, with ESG commitments on climate and waste and development of human rights strategy.
Walmex Jul-23	Initial meeting to confirm access point of products to low income consumers. Walmex integrated a sophisticated ESG strategy lead by US parent Targeted discussion on managing animal welfare in supply chains.
Arch Capital Aug-23	Confirm overall risk management approach to sensitive industries, ruling out EACOP and possible tax implications from Bermuda regulation changes.
Novo Nordisk Aug-23	Confirm long term effectiveness of obesity medication and associated controls to manage misuse, compounding and regulatory risk.
Motorola Solutions Aug-23	Conversation with lead of ethics and data privacy to gain comfort around protection of consumer data in products sold, and KYC for high risk technologies such as facial recognition.
Onsemi **Aug-23**	Onsemi has divested its highest water stress asset in Belgium, and is developing a water strategy that will be published after its SBTI emissions target is finalised. Currently 42% of water is recycled. Onsemi is also expanding its silicon carbide business presents a green opportunity through efficiency gains, especially in the EV market, via similar production processes for other chips.
Zoetis Sept-23	Zoetis decreased the antibiotics portfolio and enhanced its overall AMR strategy in recent ESG report. We offered direct feedback on areas such as incorporating specific metrics and measurable targets to support the AMR strategy. Continued focus areas include the monitoring of active pharmaceutical ingredients (APIs) in water discharges, as well as reporting on progress on the downstream application of antibiotics.
Otis Sept-23	Communicate concerns around ongoing history of contractor and employee fatalities and discuss improvements in the safety strategy, including collecting contractor safety data. Feedback provided to company via letter.

Source: Alphinity, 30 September 2023

Antimicrobial Resistance – An emerging ESG consideration

When used correctly, antimicrobials play a key role in treating human and animal health. Antibiotics in particular have saved millions of lives since the 1940s and have contributed significantly to the life expectancy we see today. But microorganisms are becoming more resistant to contemporary medicine. Without responsible antimicrobial use, disease prevention and research into alternatives, the systemic risk posed by antimicrobial resistance (AMR) could be extremely disruptive. This has brought awareness from policymakers, industry bodies and investors of late. This report explores the ESG considerations related to AMR and the importance of stewardship and company engagement in the healthcare and food sectors to address this risk.

Introduction:

Antimicrobials – antibiotics, antivirals, antifungals and antiparasitics – are widely used to prevent and treat infections in humans, aquaculture, livestock, and crop production. These agents have transformed modern healthcare, enabling the treatment of diseases that were once uncurable. Antibiotics in particular have played a vital role in the success of medical procedures such as organ transplants and cancer treatment.

However, the misuse of antimicrobials could lead to a considerable economic cost and financial risk for investors. If antimicrobials are not prescribed and used for their intended purposes, disease-causing microorganisms, or microbes, can become immune to the medication that once suppressed them. This worsens the spread of disease, severe illness and associated deaths, a phenomenon referred to as AMR.

In general terms, AMR is about the survival of the fittest. By introducing antimicrobials into a system, an environment is created whereby the strongest microbes can survive and multiply. The impact is essentially two-fold. Firstly, diseases can become more severe and secondly, infections are increasingly difficult to treat as medicines lose their potency.

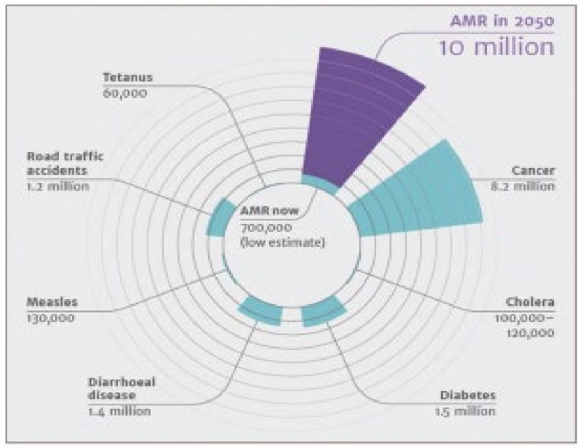
While these impacts are relatively straightforward to understand and manage at the individual or group level, the systemic risks are more complex and coming to the attention of stakeholders. The threat of antibiotics becoming ineffective, and even one day obsolete, has prompted policymakers to acknowledge AMR as a serious danger to human health, food security and economic stability. The United Nations has openly called for more robust management of AMR, with the World Health Organization (WHO) listing AMR among the top ten threats to global health. 2 Shareholders too are voicing their concerns in the area of animal agriculture.

This report offers perspectives on the systemic risk posed by AMR and key ESG considerations for investors. This research has an emphasis on the healthcare and food sectors as we believe they are exposed to the most significant risks, and equally, can influence the system-wide impacts of AMR. We outline examples of good management of the risks, and questions that can be asked of companies to delve deeper into their AMR strategies.

AMR as a systematic risk

The first comprehensive global AMR analysis estimated that resistance itself caused 1.27 million deaths in 2019 – more deaths than HIV/AIDS or malaria combined – and that antimicrobial resistant infections played a role in 4.95 million deaths. 6 A study commissioned by the UK Government estimated that this number could rise to 10 million people by 2050.

Attributable AMR deaths in 2050 compared to other major causes of mortality[8]



Key ESG considerations of AMR

AMR is a broad and complex issue. AMR is challenging to monitor and emerges across a range of environments and regions. As such, the management of AMR is not confined to one industry but requires a holistic strategy across supply chains and end markets. This is often referred to by regulators and research institutes as the 'One Health' approach that balances the interests of the planet, people and economy. From an investment perspective however, we believe AMR can be distilled into a subset of core ESG considerations and that the materiality of a company's AMR exposure can be assessed. The following graphic aims to illustrate the various drivers of AMR, the systemic risks and the different industry-level considerations as we understand them. We anticipate that the highest AMR exposures sit within pharmaceuticals (animals and human), food production and food retail. This conclusion is based on preliminary research and a materiality matrix that accounts for:

- Maturity - level of AMR knowledge or understanding; and
- Influence - degree of control to manage AMR.

Author: Moana Nottage – ESG & Sustainability analyst

Find a copy of the full note here: [Antimicrobial resistance: Relevance to investors - Alphinity]

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