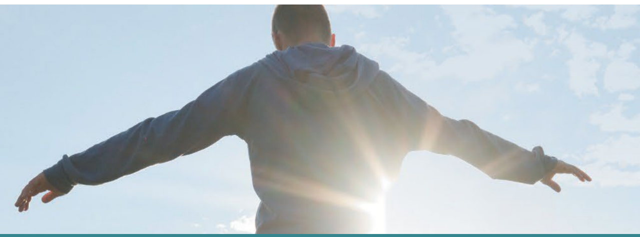


Alphinity Sustainable Share Fund

MONTHLY REPORT – NOVEMBER 2023

On the Rebound

Market comment

The market (ASX300 including dividends) recovered its October losses in the first couple of days of November then spent the rest of the month drifting higher, closing up 5% for the month. It was largely the same driver as October as well: bond yields. US bonds reacted to signs of moderating inflation there by yields falling a substantial 0.5%. Our ten year bonds did the same, essentially taking them back to where they started October, despite our inflation looking stuck at much higher levels than the US.

Australia performed well relative to other global markets, decisively better than most Asian markets but only slightly beating the US S&P500 in $A terms, but lagging US tech (Nasdaq +6%) and some European markets (Germany +8%, Sweden +10%). Emerging Markets overall gained almost 4% in $A, largely thanks to Latin America. Brazil rose by 10%, but the new libertarian Argentine president-elect, Javier Milei's mandate for radical action pushed that country's share market up by 40% (in Pesos) and 30% in $A. Milei has pledged to take a chainsaw to public spending, shut down the Argentine Central Bank and adopt the $US as its currency, replacing the much derided and devalued Peso. Argentinians will be living in interesting times.

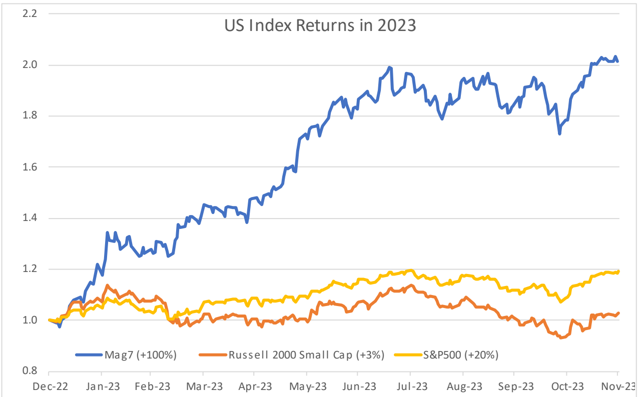
An extraordinary feature of US share market performance this year was the "Magnificent Seven" stocks – Meta (Facebook), Apple, Alphabet (Google), Nvidia, Tesla, Microsoft, Amazon – doing most of the heavy lifting. As the adjacent chart shows, the S&P 500 index has done well this year, returning 20% for the first 11 months, its total market value rising from $US33.5 trillion to $40 trillion. But if you made up a "S&P 493" (i.e. the 500 excluding the Mag7) the bulk of companies contributed little to this 20%. The total market cap of the Mag7 doubled to be worth a touch over $US10 trillion; $5 trillion of the S&P500's $6.5 trillion of appreciation was from just seven companies. Small cap stocks (the Russell 2000) returned only 4% for the period. Stock picking is difficult enough at the best of times but this extreme narrowness made 2023 particularly tough for US equity managers. We feel their pain.

Encouragingly, there was a degree of broadening out of performance in November. This was evident in our market at the sector level, with recently beaten-up sectors like Healthcare (+12%) and Real Estate (+11%) being the best performers for the month, while Energy (-7%), Utilities (-6%) and Consumer Staples (-1%) were weaker.

The $US lost nearly 4% against the $A and 3% against its trade weighted basket of global currencies as expectations that the US Federal Reserve Bank would cut rates early next year again gained traction. The $US fall also spurred a rally in the gold price, which moved above $US2,000/oz for the first time and sent gold mining companies higher. Oil prices declined for second straight month, falling by around 10% in $A terms. OPEC+ delayed its meeting and seems no closer to resolving a deadlock over oil output quotas for some African members. This delay further hindered the oil price, which is helping to lower headline inflation. Base metal prices were on the soft side, reflecting the struggling China economy, with Nickel 12% lower in $A, and Aluminium down almost 7%. Metallurgical Coal fell by 4% although, perversely, the price of Iron Ore actually rose fractionally. Lithium was another big decliner, down 23% for the month after a glut appears to be forming thanks to soft electric vehicle sales in some markets.

Portfolio comment

The Fund outperformed the market in November. The best performers were building products maker James Hardie Industries, hearing device company Cochlear and industrial property company Goodman Group; not owning gas companies Woodside Energy or Santos or struggling takeover target Origin Energy also helped. The detractors were insurer QBE, supermarket operator Woolworths and health insurer Medibank Private; not owning iron ore producer Fortescue Metals also hurt a little.



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)	5.2	-1.8	0.6	5.6	9.6	8.1	9.1
S&P/ASX 300 Acc. Index	5.1	-1.8	1.1	7.0	8.7	7.2	8.1

* 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, 30 November 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 2011. The inception date for the returns for the Fund is 1 September 2011. For performance relating to previous periods, please contact the Fidante Partners Investor Services team on 1300 721 637 during Sydney business hours.

Market outlook

The US equity market in October sold off on concern that the economy was running too strongly and that another rate rise might be needed to tame inflation, but a softer-than-expected inflation figure in November reversed that view and the market now seems to be reassured that the US economy is cooling meaningfully. The most recent quarter's reported earnings surprised positively across most sectors but full year earnings were largely unchanged. Has the Fed managed to engineer a slower economy without triggering a recession, a much-desired soft landing? Time will tell, although history suggests that soft landings have been rare once the slowdown has begun, especially when it is accompanied by a period of material and rapid rate tightening as we have seen over the last year and a half. We would expect the earnings resilience the US has shown to date to be more significantly tested in in 2024.

At home, a more cautious tone about getting inflation under control was set by Michele Bullock, Australia's new Reserve Bank Governor, underscored by a further rate hike on Melbourne Cup Day. Although inflation here too has slowed, the Governor subsequently expressed concerns that Australia inflation is becoming more homegrown rather than being due to global supply chains as had largely been the case previously: demand is simply still higher than supply, especially for Services. Given the lack of spare capacity in the economy, a more meaningful demand slowdown will be required.

Lower bond yields triggered another sharp rotation during November, with interest rate sensitive names outperforming. The equity market has more recently chosen to look "across the valley" of lower earnings, taking the view that we are at or close to peak rates, and that the odds of a recession here is discounted. Given the Governor's comments and the steep tightening to date, this appears somewhat optimistic to us.

Earnings trends don't support this sector rotation. Property and Health Care companies for example, which were the two best performing sectors in November, are still experiencing negative earnings revisions in aggregate. From a Retail perspective, Black Friday sales appear to have been strong. However, this seems to have been largely driven by consumers seeking savings in this high cost of living environment likely pulling forward Christmas sales. For the whole of 2023, retail sales look to be flat to slightly positive, which is the weakest for some years. While there is no consumer recession so far, clearly some consumer segments are adjusting their spending patterns, leading to an uneven outlook.

The resilient consumer is also showing up as net positive for the Banking sector, which is yet to see any meaningful deterioration in credit quality given ongoing strong employment and wage growth. While operational results remain under pressure for the banks thanks to slow credit growth, cost increases and competitive impacts on interest margins, meaning earnings overall will likely fall in 2024, very strong balance sheet provisioning and robust capital levels mean the likelihood of material downside risk to Bank earnings, and therefore dividends, in the foreseeable future is quite low. The resilient macro environment has led to minimal credit losses against the Banks' historically well provisioned balance sheets.

The outlook for Resource companies is becoming increasingly bifurcated with iron ore producers seeing significant earnings upgrades and lithium producers continue to see earnings expectations being cut. More support from the Chinese government, limited additions to supply in 2024 and low steel and ore inventories are supporting an elevated iron ore price. Lithium producers, on the other hand, continue to face a mismatch between demand and supply leading to inventory destocking. Energy earnings also appear to carry some downside risk as OPEC discipline looks challenged.

Portfolio outlook

While we do not ignore the macro environment and the implications of a possible soft-landing scenario here and in the US, we pick stocks bottom-up with a keen focus on the likelihood of earnings surprises. We find this is the only compass we can really rely on in a world in which the macro sentiment can shift from month-to-month, and sometimes even day-to-day. Our 'on the ground' research allows us to keep our fingers on the pulse of the companies we follow and own. Over November, Stephane met companies in Perth, Johan in Melbourne, Stuart in Brisbane, and Andrew in the UK.

Over the course of the month, we continued to add to the Iron Ore producers, primarily BHP and Rio Tinto, and are now over-weight that commodity as we see material earnings upside in the year ahead. We have added to existing positions in the tech space, notably in the high quality but defensive Technology One, following its encouraging result. We funded these additions by selling down positions in companies that have either largely attained their investment case or whose outlook is starting to appear more challenged. In November we trimmed Telstra and exited our remaining small position in Mineral Resources.

While the Fund's portfolio remains defensively biased, considering earnings leadership has tended to be in those companies with resilient earnings and strong pricing power, we have made a few moves lately that have turned it a little more cyclical following the earnings upgrades of some cyclical companies.

As we look into 2024, there are a number of challenges facing our economy and those of our major trading partners which might require some deft management on the part of monetary authorities. Critical to the outcome will be interest rates, short term and long term, which are important drivers both of people's spending patterns and company valuations. We've seen over the past year that markets have been overly-quick to anticipate and price in the end of rate hikes, well before the Central Banks' inflation targets have been met, and this has led to bouts of disappointment when those Central Banks restate their determination. We suspect the same thing might be happening again, here and in the US, and that further action might be needed early next year – or at least threatened – in order for their authority to be reasserted.

While Alphinity's crystal ball is not particularly clear, we do know that our market currently has quite modest expectations of overall earnings growth for next year, in the low single digit per cent. If it can achieve that, maintain its current multiple and keep paying similar dividends, equities could achieve a high single-digit total return. Should those low expectations be met or even slightly exceeded, returns could be even better.

Asset allocation	30 Nov 2023 %	Range %
Securities	97.5	90-100
Cash	2.5	0-10

Top five active overweight positions as at 30 Nov 2023	Index weight %	Active weight %
Medibank Pvt Ltd	0.4	3.3
Goodman Group	1.8	2.9
Rio Tinto Limited	2.1	2.6
Woolworths Group Ltd	2.0	2.6
QBE Insurance Group Limited	1.1	2.6

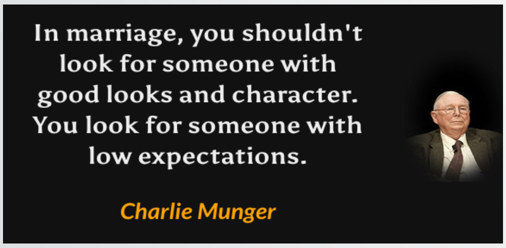
Vale Charlie

It's axiomatic in our industry that likening your own or your firm's investment philosophy to famed US value investor Warren Buffett is the equivalent of, when in an argument, accusing the other side of Nazism: you lose credibility immediately and completely. There is only one Warren Buffett. No other professional investor in the world has the mandate flexibility to buy anything they want, or his unlimited time-frame. Few people also have the amount of captive money Buffett has. Nor his starting point, which was in the early part of the booming post-WWII US economy, followed by decades of growth and becoming a size that eclipses all others. No one either had his 'sidekick', Charlie Munger. Munger was the man Buffett credited for refining his investment style and enabling Buffett to drive his investment company, Berkshire Hathaway, to its current success by focusing on the quality of companies, not just their cheapness. As Munger would say: "A great business at a fair price is superior to a fair business at a great price."

Charlie Munger died in November. It's never a great surprise when a 99-year old dies – he was just five weeks short of his 100th birthday – but we were sad to learn of his passing. Munger not only clearly had a wise investment head, he had a strong philosophy about the things that are important in life. He also had a sharp wit, as expressed in his many pithy one-liners.

Alphinity is not a value manager. While valuation is certainly a critical part of our investment process, for us there is much more to investing than just buying cheap companies and hoping they become less cheap. But Charlie's long tenure, both in financial markets and in life, generated a lot of wisdom we can all learn from – regardless of investment style.

Probably our favourite Munger quote, which we may have used before in these pages, is about the importance of expectations in framing events. He divorced his first wife, Nancy, quite early but his second marriage, to another Nancy, lasted from 1956 until she died in 2010. 54 years is an impressive effort and he was asked once what was his secret. "The first rule of a happy married life is low expectations… If you have unrealistic expectations, you're going to be miserable all your life. And I was good at having low expectations". On another occasion he gave similar advice, but self-deprecatingly turned it against himself.



That works for life but also for investing. We've found that a company doesn't necessarily need to have a high rate of earnings growth to be a good investment, it just needs to be able to do better than the market thinks it will, i.e. surprise the market positively. So if the market has low expectations of a company's earnings potential and our research concludes it can do better, it might actually be worth investing in – even if the rate of growth is low. We also aim to avoid companies with the opposite, where market expectations are high and unlikely to be achieved. These types of companies tend to not just disappoint on earnings, leading to downgrades, but also often have a multiple de-rating to provide additional under-performance.

A few of his gems: Munger was a voracious reader, and couldn't understand anyone who wasn't. His daughter, in her younger years, referred to him as "a book with legs". He was always interested in the world and wanted to learn as much as he could about it: "I know no wise person who doesn't read a lot." "I constantly see people rise in life who are not the smartest, sometimes not even the most diligent, but they are learning machines. They go to bed every night a little wiser than they were when they got up, and boy, does that help, particularly when you have a long run ahead of you.

His advice about getting ahead in life was "…spend less than you earn, avoid toxic people, toxic activities, keep learning all your life, defer gratification because you prefer it that way, and if you do it all this way you will succeed. If not, you will need a lot of unusual luck." "Three rules for a career: (1) Don't sell anything you wouldn't buy yourself; (2) Don't work for anyone you don't respect and admire; and (3) Work only with people you enjoy."

He was hardly an 'everyman' however, as another piece of his wisdom revealed: "The way to get rich is to keep $10 million in your checking account in case a good deal comes along." While solid advice, it isn't an option for most! But don't resent his wealth: "There is nothing more counterproductive than envy. Someone in the world will always be better than you. Of all the sins, envy is easily the worst, because you can't even have any fun with it. It's a total net loss."

Investment success is not about being the smartest, in his view, it is as much about not doing dumb things: "It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent." Also, "knowing what you don't know is more useful than being brilliant". But equally, blunders will happen, you just need to learn from them: "There's no way that you can live an adequate life without many mistakes. In fact, one trick in life is to get so you can handle mistakes".

Supposed market experts were fair game: "People have always had this craving to have someone tell them the future. Long ago, kings would hire people to read sheep guts. There's always been a market for people who pretend to know the future. Listening to today's forecasters is just as crazy as when the king hired the guy to look at the sheep guts."

Formal education was important to him, but only up to a point. "I get flack for saying [when I visit a college to give a speech], "This is a nice college, but the really great educator is McDonald's ... McDonald's hires people with bad work habits, trains them, and teaches them to come to work on time and have good work habits. I think a lot of what goes on there is better than at Harvard". And not just McDonald's; he was a big fan of, and investor in, Walmart. "I like Wal-Mart's culture. As far as I'm concerned, Wal-Mart is one of the glories of civilisation".

He was not a fan of assets that weren't capable of generating a return other than from price movements, like gold or cryptocurrencies. He described Bitcoin as 'rat poison squared' and 'partly fraud and partly delusion'. "I don't like either fraud or delusion. And the delusion may be more extreme than the fraud". And when it came to the shiny stuff, "I don't have the slightest interest in gold… If you're capable of understanding the world, you have a moral obligation to become rational. And I don't see how you become rational hoarding gold."

So farewell Charlie. We will miss his wit and wisdom, and may never see another like him.

Alphinity Sustainable Share Fund

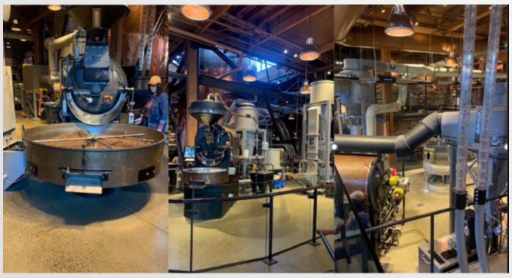
MONTHLY REPORT – NOVEMBER 2023

Travellers' Tales

Most people associate the aforementioned Magnificent Seven stocks with Silicon Valley but two of the largest of the seven, Microsoft and Amazon, are actually based in Seattle, Washington. Global PM Mary spent some time in the Pacific Northwest region of the USA in November meeting with those magnificent two as well as a number of companies in the Global Equity portfolio based in that general area such as Nike, Starbucks and Costco.

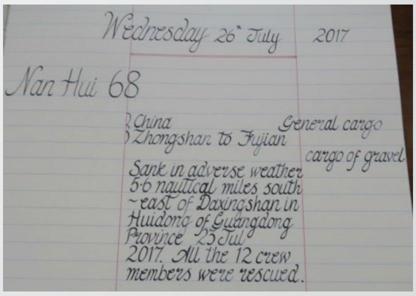
Unfortunately, airline mishaps are universal, and her luggage didn't turn up; it turned out it never actually left the runway (Hawaiian Airlines was the guilty party this time, not Qantas). The result was that Mary had to attend some of her meetings in running shoes, although that was appropriate considering the pace of her schedule. She had been wearing head-to-toe Lululemon on the plane but luckily managed to get hold of some other clothes in time for her meeting with Nike in Oregon. It's not good form to show up at management meetings wearing apparel from a key competitor!

One of the highlights of her trip was going to a Starbucks roastery. Starbucks doesn't get a great rap from coffee snobs in Australia – one of the few markets where Starbucks has needed to close stores – but relative to coffee in the US it's pretty much as good as it gets. At the roastery (below) she was able to sample a few items from their famous seasonal menu. Pumpkin spice cappuccinos, peppermint mochas and gingerbread lattes were all available. Sounds great! Weighing in at a hefty 400 calories each, these "coffees" are targeted primarily at the US market and are more like seasonal desserts, but they are sure to drive sales growth for Starbucks in the fourth quarter. Happy Holidays!



Meanwhile, Andrew went to London to meet with a number of banks and insurers to gain industry insights. While at Lloyd's, which is of course the epicentre of global insurance, the insurer of insurers, he was shown the famous Lutine Bell, its ornate surrounds clearly from different age to the modern building it resides in. The bell came from the ship La Lutine, which sank in the North Sea in 1799 with 240 crew, 239 of whom perished, and more than £1 million worth of bullion on board. According to the Bank of England's inflation calculator, that would be about £130 million worth today. Apparently much of the bullion was lost but they did manage to recover the bell in 1858 during salvage operations. It was a huge financial blow for Lloyd's members but it did cement the system's reputation for settling even the largest losses.

For a long time, the bell was rung to notify insurers that a ship had gone down, although an electronic bell is now used as the old bell has become quite fragile. It is now only used on momentous occasions, such as the recent coronation of King Charles III or the September 11 terrorist attacks. There is also a book on display nearby, written in a beautiful archaic cursive, which records the ships lost at sea. Lloyd's has many of these books in its vaults, covering its 350 years of operation, but has thus far resisted any urge to go electronic. We hope it never does.



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