Alphinity Global Equity Fund (Managed Fund)

QUARTERLY REPORT – DECEMBER 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)	0.7	4.8	16.3	12.0	14.0	13.2	11.7
MSCI World Net Total Return Index (AUD)[3]	1.9	5.4	23.0	11.8	13.5	11.7	11.2

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	$482m
Distributions	Annually at 30 June
Min. Investment	$10,000
Max. cash position	20%

Top 10 positions

Company	Sector	%
Microsoft	Info. Technology	6.2
Alphabet	Communication Services	6.0
Nvidia	Info. Technology	4.5
ConocoPhillips	Energy	3.8
Parker Hannifin	Industrials	3.7
Accenture	Info. Technology	3.5
Zoetis	Health Care	3.4
Novo Nordisk	Health Care	3.4
Trane Technologies	Industrials	3.4
London Stock Exchange	Financials	3.4
Total		**41.2**

Fund features

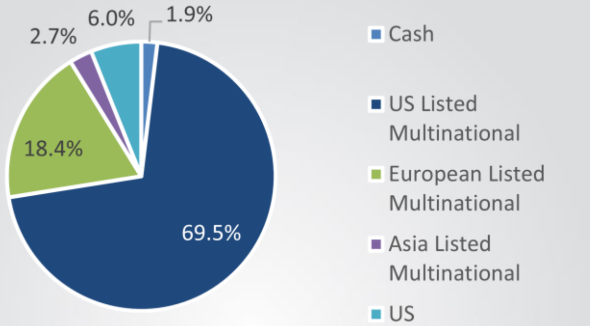
Concentrated: A long only, concentrated portfolio of 25-40 of our best ideas, highly diversified across sectors and regions. A truly global fund consistently exposed to powerful trends reshaping our world.

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.

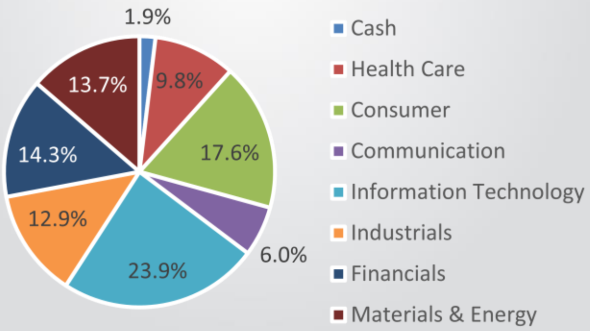
Talent: A united and deeply experienced team of global portfolio managers each with an average of 22 years of financial experience.

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

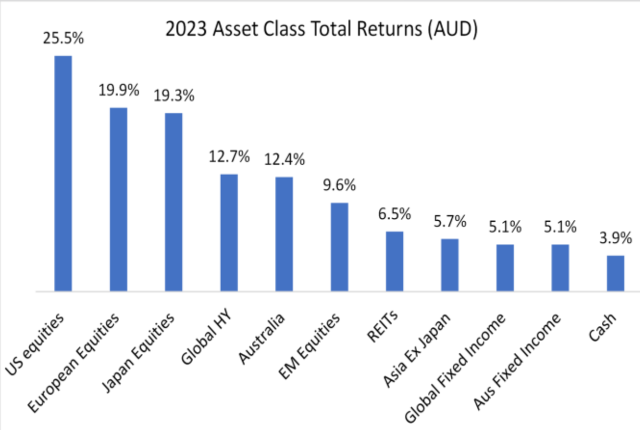


Data Source: Fidante Partners Limited, 31 December 2023
1 Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.
2 The inception date for the Fund is 21 December 2015
3 From 21 December 2015 to 30 April 2019, the Benchmark was the MSCI World Equity ex Australia (Net) Index. The current index is effective from 1 May 2019

Market comment and outlook

Positive equity market performance during the December quarter was mostly in response to lower inflation data and more dovish Fed commentary, pushing bond yields lower and easing financial conditions. Global shares closed the quarter up 4.7% in AUD (+11% in USD terms) with the US S&P 500 index +4.8% and the European Stoxx 600 +4.9%. Technology stocks again outperformed the broader market with the Nasdaq gaining 7% in AUD terms, helped by strong performances in most of the "Mag-7" group of mega-cap companies.

DM Equities outperformed other asset classes in 2023

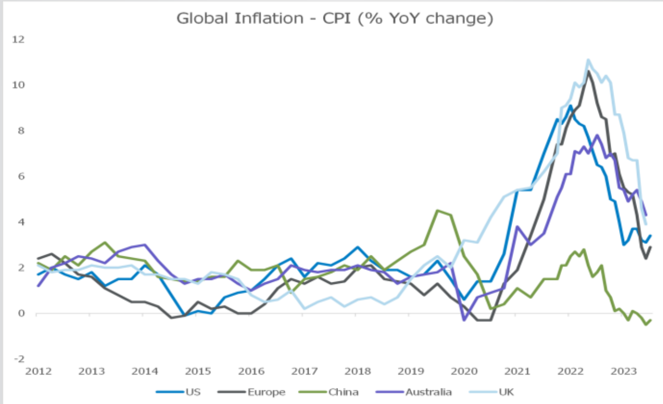


Source: Bloomberg, 31 December 2023

The macro data showed the desired combination of declining inflation in the US and in Europe, while also showing a healthy labour market where jobs were growing above expectations, adding further weight to a 'goldilocks' soft-landing outcome at the end of this rate hiking cycle, whereby rates can come down and a recession can still be avoided. The falling inflation was largely driven by energy prices declining on delays to OPEC production meetings and due to warmer weather throughout the Northern Hemisphere winter. Oil prices fell 12% over the quarter to close at USD77/bbl. US CPI came in slightly below expectations in October, and more than halved from 6.5% last December back to 3.1%. US mortgage rates (30-year fixed) fell to 6.8% in December, its lowest level since June which aided homebuilders on the expectation the Fed will start cutting rates in 2024.

Performance in emerging markets lagged developed markets throughout 2023 and the final quarter was no exception. While political outcomes influenced LatAm markets like Argentina and Brazil, where far right leader victories had a positive impact, weakness in China and Hong Kong persisted. China's Shanghai Composite fell 7.6% over the quarter in AUD terms, while Hong Kong declined by 9.6%. The Chinese economy continued to soften with stimulus efforts thus far proving ineffective in supporting the housing sector.

Disinflation trend intact across all key global regions – only China in deflation

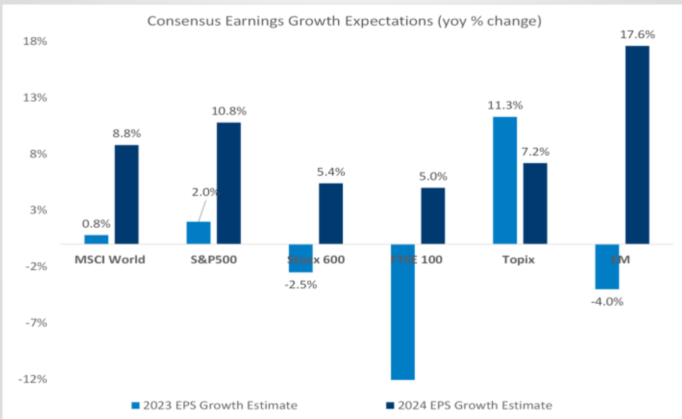


Source: Bloomberg, 31 December 2023

Portfolio comment and outlook

Inflation is trending lower in the U.S., and real-time data suggests that it will likely continue to do so for the foreseeable future at least. At the same time, U.S. economic growth appears to be decelerating again. Banks are tightening credit standards and the cumulative impact of rate hikes continue to feed into the real economy. Labour markets have remained resilient so far, however there are now signs of 'normalisation' there as well; and both consumers and businesses appear more cautious. All of this suggests that the Fed has likely done hiking for now and could begin cutting rates in 2024. An easing in financial conditions would be positive for risk assets, especially as we approach the 'wall of maturities' that corporates face from 2025 onwards. In the meantime, we remain vigilant about the near-term outlook for growth and corporate earnings. Policy error remains a significant concern, while geopolitical and election-related risks are also likely to continue to be prominent in 2024.

Consensus expects a rebound in EPS growth in 2024 across all key regions



Source: Alphinity, Factset, 31 December 2023

Alphinity Global Equity Fund

QARTERLY REPOR T – DECEMBER 2023

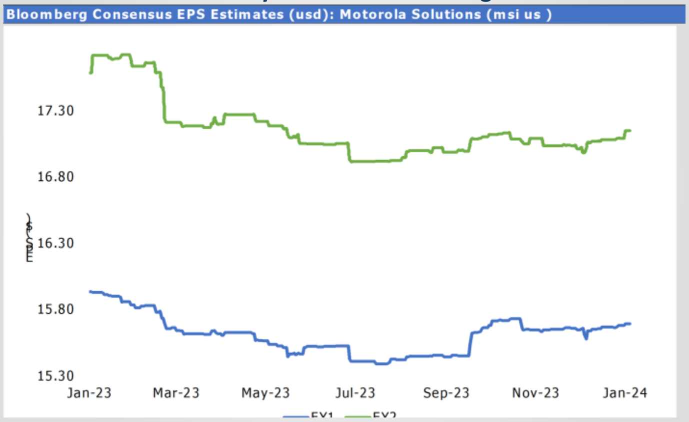
Global corporate earnings overall look set to finish 2023 with flat growth for the year, although analysts currently expect a recovery to +8% growth in 2024, which may turn out to be optimistic. Earnings revisions over the last three months are modestly negative, with overall downgrades of -0.5%/-1.0% for 2023 and 2024 respectively. IT Software, Hardware & Semiconductors and Consumer Discretionary continue to lead with upgrades. It's interesting to see a mix of both defensive and cyclical sectors with the weakest analyst revisions, including Materials, Real Estate, HealthCare and Consumer Staples.

In 2023, market leadership rotated away from Defensive sectors such as Utilities, Real Estate and Consumer Staples, to primarily select Growth sectors and specifically the 'magnificent seven' group of mega-cap stocks. While these stocks together represent ~30% of the S&P 500 market capitalisation, they delivered ~60% of the year's market returns (down from a peak of ~117% at the end of October). Historically, such periods of extreme market narrowness have tended to be temporary, and it's notable that the market already appears to be broadening somewhat. It's likely that investment risks and opportunities may shift again as we head into 2024, especially if the Fed pivots decisively. There are some early signs of new price and earnings leadership in very select, cyclical parts of the market including memory semiconductors, homebuilders and industrial distribution, for example. We will continue to watch this closely given the maturity of the current downcycle, however so far it seems too early to draw definitive conclusions for broader market leadership.

During the fourth quarter, we exited a long-held position in On Semi after a disappointing earnings report, which included a weak order book and low forward visibility. This was replaced with a new position in Motorola Solutions, which reported strongly and guided higher. We expect Motorola to be a long-term winner from increased investments in public safety. We also added SK Hynix to the portfolio on the back of a good quarterly report and growing signs the memory semiconductor cycle has turned. Elsewhere we initiated new positions in Costco (the leading membership warehouse retailer) and Partners Group (a high-quality private market manager), where we have conviction on the outlook for earnings growth. This was financed through divestments of LVMH (long earnings upgrade cycle came to an end) and Edward Lifesciences (procedure growth investment case not playing out as well as expected). We also added positions in US cyclicals Ferguson and Sherwin-Williams, increasing our exposure to the US residential cycle which appears under appreciated by analyst estimates for the companies. This was financed by trimming Cadence Design Systems (rising valuation) as well as defensives Waste Connections and Pepsi, among others.

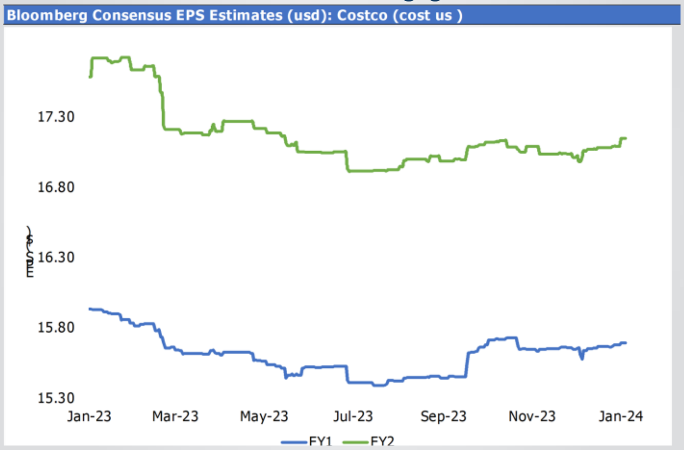
Overall positioning has not changed materially, with the portfolio well-positioned in high-quality, reasonably valued growth cases, well diversified across different sectors including Financial, Consumer Discretionary, Industrials, Communications, Health Care and Technology. We have over the last few quarters added some selective cyclical exposure where we have established stock-specific, fundamental earnings conviction. The Portfolio continues to see significantly better earnings revisions than the market and should continue to generate a superior earnings growth in 2023-2025, which we expect to drive performance over time. The investment team has once again travelled widely over the last few months to meet and research companies across different sectors and geographies as the earnings cycle continues to evolve.

Motorola Solutions – Winner from increased investment in public safety with a record backlog



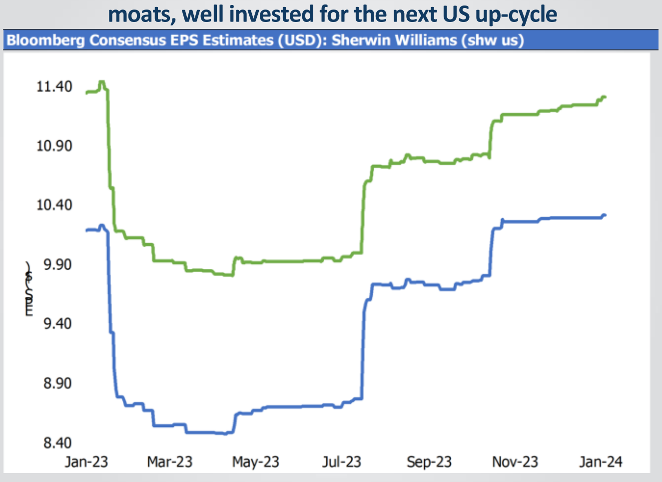
Source: Bloomberg, 31 December 2023

Costco - Unrivalled value underpins fiercely loyal club membership and consistent earnings growth



Source: Bloomberg, 31 December 2023

Sherwin-Williams – Quality paints manufacturer with strong moats, well invested for the next US up-cycle



Source: Bloomberg, 31 December 2023

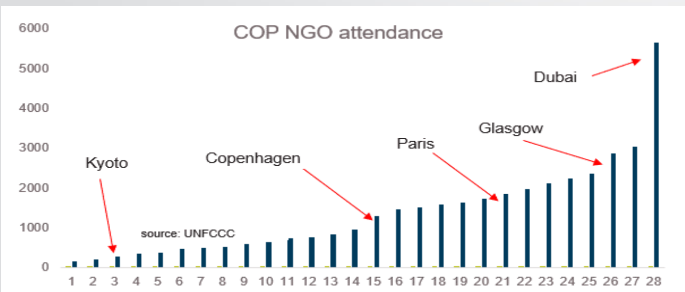
COP 28 Summary

COP28 took place in the United Arab Emirates (UAE) in December. COP stands for Conference Of the Parties. This used to be UN-speak for a meeting of minds to discuss any topic but seems now to be exclusively associated with the UN Climate Change Conference. We're not sure if anyone thought it through to this extent beforehand but the idea of tens of thousands of people – hundreds of thousands by some accounts when unofficial hangers on are included – flying vast distances to an oil-producing desert country, where you can ski indoors even when it's 50º outside and where air conditioning is required all year round, to talk about the urgent need to reduce carbon emissions does risk a minor brain explosion.

That the person in charge, Dr. Sultan Al Jaber, also heads up UAE's national oil company was also difficult for many to accept, although he argued that his deep inside knowledge of that industry positioned him well to know what the real issues were and how achievable the potential solutions were. That turned out to be a valid argument, with a surprisingly strong call coming out of the COP for the world to transition away from fossil fuels. 'Transitioning away' is softer than what some were calling for, like phasing out' or 'ceasing to use', but the distinction is subtle and inserting that language can only be interpreted as a step forward. In addition, the phrase 'fossil fuels' had never even appeared in a COP communique previously, so COP28 at least called out that particular elephant in the room.

There have been lots of COPs, 28 in fact. The most notable COPs were #3 in Kyoto in 1997, from which the Kyoto Protocol was issued; #15 in Copenhagen in 2009, at which then-PM Kevin Rudd accused China of very poor behaviour involving rodents; #21 in Paris in 2015, attended by then-PM Malcolm Turnbull, from which the Paris Agreement was issued which aimed to limit warming to 1.5ºC; and of course COP26 in Glasgow in 2021 at which ScoMo made Australia's first formal, albeit reluctant, commitment to net zero. The UAE event seems to have been far better organised than COP27 in Egypt last year, despite its vastly higher attendance. It did not have the same issues around catering, potable water or essential plumbing that had 27ers walking through sewage at one point. COP28, by comparison, ran very smoothly.

More than 100 world leaders attended, including Syrian bad boy Bashir Al Assad whose issues would appear to be more imminent than 2050. The big guns – Joe Biden, Xi Jinping, Vlad Putin and Anthony Albanese – all stayed away but sent emissaries. Some 100,000 people attended COP28, double the number at COP27, and a staggering 400,000 more registered for the public area, the Green Zone. Some likened the crowds to being in Disneyland. There was huge inflation in NGOs – non-government organisations – which accounted for around half the attendees. The chart below shows the trend in the number of NGOs involved. Each one would likely have a few dozen delegates.



The variety of NGOs attending was also intriguing. COP categorised them into BINGOs (business and industry NGOs); ENGOs (environmental NGOs); RINGOs (research and independent NGOs); TUNGOs (trade union NGOs); YOUNGOs (youth NGOs); IPOs (indigenous peoples organizations); Farmers; and LGMAs (local government and municipal authorities). There was also a multitude of industry lobbyists who didn't qualify as NGOs, which are not-for-profit, including 2453 lobbyists for the fossil fuel industry according to one report.

The delegations of some countries were huge. China sent more than 1,000 people and Brazil more than 3,000. The UAE itself had 4,000 but at least they didn't need to travel. We had difficulty finding out how big the official Australian contingent was but we were well represented by our Climate Change Minister, his assistant minister and a multitude of bureaucrats. There were a few Opposition MPs there too, whose agenda seemed to be pushing nuclear energy as the solution to our energy challenge – a solution which hadn't occurred to them when in government not that long ago. It is clearly much easier to push nukes when you can't do anything about it. The Climate Change Minister surprised many by actively advocating the end of fossil fuel use, despite Australia's status as a large exporter of gas and coal.

Have we reached peak COP? Probably not, history suggests that boondoggles like this take on a life of their own, but there might be a degree of retreat after this one. COP29, is being held in oil/gas major Azerbaijan and the logistics suggests there might be fewer attendees, as Baku will struggle to match the easy access and accommodation Dubai offered. COP30 in 2025 will be back to another large oil producer, Brazil, and Australia is in the running to host COP31 in 2026. It is a little ironic that the fossil fuel superpowers appear to be in the COP ascendency!

In the near term (i.e. up to 2030) COP28 concluded that all countries need to ramp up renewables and be more energy-efficient but for the period after that the answer for emissions-free power seemed to be nuclear. The COP set a goal to triple global nuclear generation by 2050, the date by which net CO_2 emissions are hoped to be zero. Considering it can take more than a decade to just plan and build a large-scale nuclear power plant, the world will need to get a move on. Some place their hopes in "quick and cheap" SMRs – small modular reactors – although even they take some years and many billions of dollars to deploy. Australia will benefit from our Uranium reserves if this comes to pass, although there still remains ideological and locational aversion to propagating nuclear energy here.

It's easy to be cynical about big events like COPs but they do serve a purpose: just to have 200 countries arrive at broad agreement about the need to achieve something big is quite a feat, even if it might prove trickier to execute.

Traveller's Tales

Alphinity's year of travel kept up its momentum in December, with global portfolio manager Chris making his last international trip for the year, this time to Japan, going to Tokyo, Osaka and Kyoto. Plane delays, lost luggage and missed flights are par for the course for a global PM but he'd had a clean run all year until this final trip. His return flight being cancelled just three hours before departure threw a small spanner in the works, but he took the opportunity to squeeze in another round of sushi, so it was time not wasted!

While the food in Japan was outstanding, the reason for heading there was to meet with some of the world leading industrial companies, and companies that have a role in the automation of manufacturing processes were high on the list. Japan is the leader in Robots, Cobots (robots cooperating with humans) and sensors. It is one of the leaders in warehouse automation and semiconductor equipment. Chris had great meetings with companies like Keyence, Yaskawa, & SMC. He toured Minebea-Mitsumi's new showroom, where they have on display a transparent car (above) showing all the bearings and sensors that they make for the production process. He saw Komatsu's latest electric digger and Kubota's small agriculture machinery. A final highlight was meeting with Secom, a large security company, where he spent some time talking to their virtual security guard (right), although he was left unsure as to how it would chase after an offender.

Japan is a fascinating country with an interesting financial history and culture. In the 1980s it was considered to be a global leader in technology and innovation. By the end of 1989, eight of the 10 largest companies globally were Japanese, with US's IBM and Exxon rounding out the top 10. At one point, real estate values in Tokyo traded for nearly 350x those in Manhattan and the entire Japanese property market was estimated to be worth over four times that of the US. This proved to be unsustainable.

Just three years later not a single Japanese company made the top 10 list. The Nikkei 225 index peaked on the last day of 1989 and spent the next two decades falling before reaching its nadir in 2009, some 80% lower. Since then, the Japanese equity market has slowly recovered and in 2023 came to within ~10% of its 1989 level. In local currency terms, the Nikkei had a very strong 2023, up 28% and outperforming even the magnificent seven-inflated S&P500. The Yen, which depreciated by 10% against the $US, explains quite a bit of this, but there is also renewed optimism that change is finally afoot within corporate Japan.

To start with, the Tokyo Stock Exchange has been restructured. There have been new recommendations made by the Exchange whereby companies are required to trade on a price-to-book greater than 1x or explain how they plan to get there, and strong encouragement has been given for companies to engage more frequently with investors. Real reform of Japanese governance has been talked about for decades and the changes here are small, and in some cases qualitative, hence a healthy degree of scepticism, but they are a potential signal of intent.

And there is some evidence that companies are responding. For example the Toyota Group has begun unwinding some of its cross shareholdings, stock buybacks are picking up and there has recently even been a few attempts at hostile takeovers. Change does not seem to occur rapidly in Japanese markets, but our Global Equity Fund is watching closely for investment opportunities while remaining focused, above all else, on company fundamentals.

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