Alphinity Australian Share Fund

MONTHLY REPORT – JANUARY 2025

Cheap as Chips

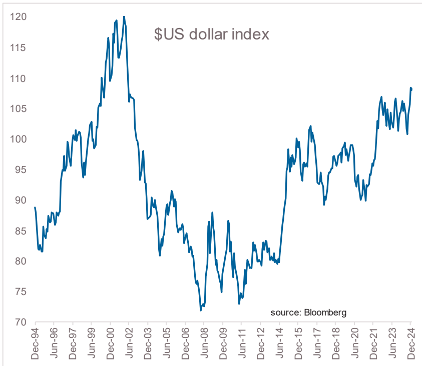
Market comment

Most Australians spend January at the beach, building up energy for the coming year. This year it was also a period of intense news activity for global equity markets, revolving mostly – but not exclusively – around the new US President.

Markets initially enjoyed a 'Trump Bump' in January, with the returning President being sworn into office. He wasted no time signing nearly 100 executive orders, imposing tariffs on a bunch of countries and threatening more to come. What began as market optimism around greater efficiency and more pro-growth policies quickly turned into share price volatility on the potentially inflationary effect of tariffs. China threw a curve ball late in the month with the release of DeepSeek, an AI model which was apparently developed at minimal cost, which caused a sharp sell-off in parts of the US tech sector, especially semiconductor and chip stocks such as Nvidia (see BTW). It didn't broaden into a full-scale panic though: other mega-cap stocks like Apple, Meta and Amazon actually gained as did some software companies, many of which would benefit from any volume increases that low-cost AI models might drive. There was also a 'buy the dip' mentality in place, and some of the harder-hit semiconductor names had recovered some of those losses by month end.

Australia was not really affected by the sell-off in semiconductor stocks and our market (ASX300 including dividends), rose a pleasing 4.5% to fresh all-time highs. It performed pretty well in $A terms relative to other global markets, with only a few in Europe doing better. Developed markets were up about 2.5% but Emerging markets were fairly flat, dominated by China which fell by 3.4%.

China was out of action for the last bit of January with the Lunar New Year. Happy New Year of the Snake by the way. The Yin Wood Snake is a symbol of empowerment but China's recent economic data has been anything but powerful with manufacturing, services and construction indices all pointing to a weak start to the year. The five year low in construction there was especially notable amid a deeper contraction in housing and little new infrastructure. And China is firmly in the sights of the new US President, who sees the large trade imbalance between the two countries as proof that China is ripping the US off rather than it just being able to do some things better or more cheaply, which is of further concern.



The $A remains soft, finishing the month just below US62c although currency weakness was not limited to us, it is as much a function of the $US appreciating against everything else, as the dollar index shows→. Commodities kicked off 2025 with no particular trend: iron ore was 4% firmer heading into lunar new year although other the bulk commodities, thermal and metallurgical coal, were both lower by 7-8%. The oil price rose a little while the Copper price was also quite firm, although some of the other base metals were soft: Zinc in particular was down 9%. The gold price was strong however, rising 6% to a new all-time high of $US2800/oz ($A4500) – to some extent this is a reflection of dollar strength and increasing risk aversion.

Australia's December quarter inflation was announced late in the month and it came in slightly lower than expected at 2.4% annualised. The PM, Treasurer and mortgage holders are all embracing that number as inflation is probably the critical input in determining whether the RBA eases ahead of a Federal Election that could be announced imminently, the sooner the better for the incumbent government which has been losing traction.

Portfolio comment

Despite substantial volatility during the month, the Fund ended up outperforming the strong market slightly in January. Gaming machine maker Aristocrat Leisure and finance platform Hub24 were the only positions to make a meaningful positive contribution and there were no notable detractors.

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)	4.6	6.7	17.6	11.3	8.6	9.0	9.7
S&P/ASX 300 Acc. Index	4.5	5.0	15.1	11.1	7.9	8.6	9.0

* 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, 31 December 2024.

^ 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 2010. The inception date for the returns for the Fund is 1 September 2010. For performance relating to previous periods, please contact the Fidante Partners Investor Services team on 1300 721 637 during Sydney business hours.

Market outlook

"Investors used to be indecisive but now they're not so sure". Just when we were enjoying some semblance of market order during 2024 (even if narrow, it was at least consistent), the inauguration of President Trump 2.0 has brought more volatility and uncertainty to start 2025, even if he is largely only doing what he said he would (when will we learn?). One month down, only 47 to go! Yes, he is pro-growth and pro-business as well as anti-regulation and red tape – all general positives for markets – but he is really more pro-America and with that comes many possible intended and unintended outcomes. While we watch with daily fascination and interest, we are reluctant this early in the piece to make definitive investment cases based on what Trump may or may not do, or even what he has done to date, given that we are not at all certain that by time of publication the announcements that were being made at time of writing around tariffs or other policies won't change materially! A fairly balanced portfolio with some flexibility feels appropriate for now. Perhaps some defensive characteristics could be beneficial at some point this year should the market decide to start thinking about risk for a change.

As we have noted in previous commentary, the market is no longer pricing in a soft landing, it has gone directly to pricing in a very bullish growth outlook. Pretty much everywhere you look, risk is largely being ignored in valuation, yet we now also have Trump. We would contend that whatever you think about Trump's plans or policies, his presidency represents a material increase in risk either way. At the very least some margin for error needs to be priced in at some point, even if one thinks Trump is largely bluster and will ultimately do the right thing for markets. The chance of a misstep has increased.

Another potentially material event in the past month was the DeepSeek announcement out of China, which gave the AI-thematic powered US market a minor heart attack in January. While we won't debate here what is real and what is not, and what the longer-term implications can be for that industry and thematic, it does reinforce our point around risk. For us, it is a reminder to remain focused on what is being priced into markets and individual stocks. While the direct implications may be negligible to a company's near-term earnings, it does tell us that perhaps the market overall is not properly pricing risk. Things rarely go up in a straight line forever, but it is often hard to point to the trigger that will see a reassessment of risk. As we often observe here at Alphinity, valuation can mean nothing for a long time until suddenly it means a whole lot. Things many not yet be flashing red, but perhaps they aren't quite as green as before.

At least the US market was driven by earnings upgrades through 2024, even if it was largely in a narrow band of stocks, We don't have that luxury in Australia. Our market has had two years of net negative earnings growth and still gone up, trying to follow the strong US lead. As such we have had two years of multiple re-rating for the market as a whole. What are the chances of this lasting another year? Looking at history, the odds seem low. Our market is presently expecting modest low to mid single-digit earnings growth, and the $A weakness may add a little bit more so there is at least some earnings support expected in 2025, albeit small and fragile.

What could provide more support is interest rates. In Australia, the economy continues to muddle through, and while it feels initially at least that it will be more of the same this year, it is fair to say the data is mixed. While some data shows a slow economy with low confidence in some areas, the consumer keeps turning up to buy stuff that's on sale, unemployment remains very low, and credit quality refuses to materially deteriorate. This doesn't scream the need for rate cuts to us, although arguably the good progress on inflation and rising global uncertainty might warrant a precautionary cut. We are not presently convinced however that it means we are about to embark on a material rate-cutting cycle in Australia, unless things really deteriorate (or if trade wars which could materially affect Australia really kick off, for instance via China). Nevertheless, any rate cuts would likely be taken well and will ultimately be beneficial to earnings, and that might help our market to some degree.

However, should the US market falter then so will Australia. We followed it up and would likely follow it down too, although probably with lower amplitude, especially if rate cuts extend. While company earnings continue to be a key driver of alpha and a mitigator of risk, we suspect broader market risk will become a bigger talking point as the year progresses.

Portfolio outlook

We have made few changes to the portfolio over the last month as we head into the February reporting season. This typically refocusses the market on earnings, although we acknowledge that, being only the first weeks of Trump's presidency, risk might get a good look in as well this time around. On top of this we are conscious of not only operational earnings momentum but also the potential impacts of currency this reporting season. With continued strong weakness in the $A against the $US, and with a large proportion of Australian company earnings coming from offshore, we are likely to hear a lot about that from companies, including its impact on outlooks, both positive and negative.

We feel the portfolio is relatively balanced in that respect, with a small number of companies on either side of the currency ledger, but by in large the portfolio is not materially impacted one way or another from currency. We will be most interested to see whether earnings revisions, which appear to have stabilised after two years of consistent downgrades, can finally turn into upgrades. Although we suspect outlook comments will contain a lot of caveats relating to possible trade wars, currency moves and direction of rates which may temper some upgrades. More importantly, from a portfolio construction point of view, is whether any upgrades start to broaden into more sectors. Last year relied mainly on banks and technology companies for upgrades, and those sectors unsurprisingly outperformed the market as a result.

For a sustainable improvement in our market to come about, we will likely need upgrades and earnings growth to broadening out. We don't hold big expectations here, and therefore continue to hold overweights in the more defensive healthcare names, insurance, utilities and technology. While bank upgrades will likely continue in a small way through the release of bad debt provisions, valuation sees us at a small underweight. We remain underweight the consumer but have added a little more to domestic rate-sensitive names in the sector and through property, and rate cuts should also help during the year. The direction of Resource earnings, and therefore the companies' performance, may well be the differentiator this year. Earnings are likely to fall on China's softness, although the degree and form of any stimulus through the year will no doubt also impact. We remain slightly underweight resource companies as we wait for more detail and more clarity on how Trump's tariff plans might play out.

Top five active overweight positions as at 31 Jan 2025	Index weight %	Active weight %
Aristocrat Leisure Limited	1.8	3.4
Amcor Limited	0.3	2.0
Westpac Banking Corporation	4.4	1.9
Medibank Pvt Ltd	0.4	1.8
Rio Tinto Limited	1.7	1.8
Asset allocation	**31 Jan 2025%**	**Range %**
Securities	98.4	90-100
Cash	1.6	0-10

BTW

As Donald Trump was sworn into office for the second time, the first convicted felon President in US history, he declared that he would kick-start America's new 'Golden Age'. Trump is a busy man: he has given himself a lot to achieve in his four-years. The 2024 election brought about sweeping changes, with Republicans gaining a majority in the U.S. Senate, maintaining its control of the House of Representatives, and taking the White House as well. His conservative picks for judges on the Supreme Court in recent years also means that legal opposition to his intended polices should be limited. Signing a huge number of executive orders, imposing tariffs on Canada and Mexico, withdrawing from the World Health Organisation, re-naming the Gulf of Mexico and putting a stop to government Diversity, Equity and Inclusion programs were just some of the measures announced on his first day in office. Buying Greenland and ending the Russia / Ukraine War wasn't achieved that day. Slack Trumpy! When asked by an interviewer hours after being sworn in whether he had stopped the war yet, he replied that the day was only half over. While still yet to achieve this feat, some heavy Russian sanctions might be coming soon to Putin.

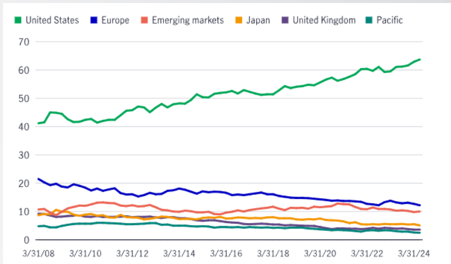
With chants of "MAGA" and "USA, USA" ringing loudly through rowdy conference halls and printed on all the Trump merch - anything from socks and underwear to Christmas stockings and wine glasses – there has been quietly growing industry of Trump Merch entrepreneurs. Talk about fast fashion! They're so nimble that any new meme of the moment can make its way onto T-shirts or baseball caps within days. According to an article in the New Yorker, the shadowy world of Trump merch selling at roadside stands, state fair booths and strip mall stores has become big business and a way for thousands of Americans to earn cash. It has created many jobs. The vendors are a mix of colourful characters, not dissimilar to a travelling circus. They are not necessarily passionate Trump fans; they are just savvy retail business-people trying to earn money. Many of them had supported Obama and sold Obama merchandise back in the day, and have simply switched to whatever is the hottest sell: the President-elect du jour. But one vendor asked: "have you ever seen a Biden flag?"


Source: New Yorker

According to Trump's former campaign manager, he's sold nearly a million red MAGA hats, at $US45 each. However, while most of the merch and the slogans were pretty clear and straight-forward, one of them, "Let's Go Brandon!", was more obtuse. What did it mean? Who is Brandon? It turns out it's a rather unsavoury negative comment directed at the then President.

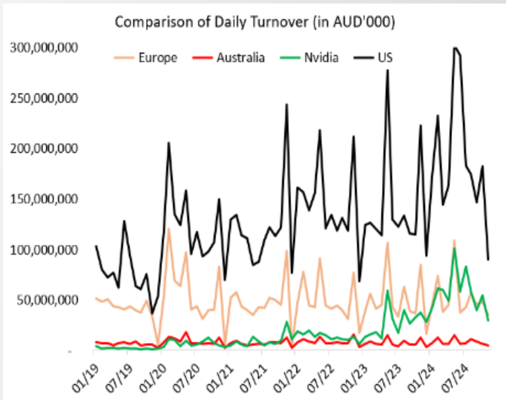
It actually started at a Nascar race in 2021 when Brandon Brown was being interviewed after a race. The crowd behind him was chanting: they were clearly yelling "F*** Joe Biden" but the reporter said they were chanting "Let's Go Brandon". We hope Brandon Brown's car racing career can live up to the hype his name created for Trump's campaign!

While Trump talks about the "Golden Age" he will be producing for the US, that age appears to have been largely in place for quite some time when it comes to the economy, and especially for equity markets. Unemployment is at longtime lows, economic growth has been impressive and, like here, stubborn inflation has come way down. The US equity markets have been on fire for years and its dominance of global markets has been incredible. While much has been talked about concentration risk with the Magnificent Seven, it's worth noting that even the US equal-weighted index (which removes the effects of those outsized stock weights) has also been constantly reaching all-time highs. The chart here → shows the regional proportions of the MSCI All country World Index: the US has risen from 40% of all equity cap just after the GFC in 2008 to around two thirds today. With this greater representation comes greater liquidity, an important factor when making investment decisions, outside of the earnings mantra we follow religiously.



Source: JH Investment Management

This chart → shows the daily trading values of US, Europe, Australia (we've also put Nvidia in there for fun. That one US company trades as much as all of Europe and several times more than the whole Australian market each day). It can be fascinating to watch these stocks trade during quarterly earnings releases. Most US stocks report after its market's 4pm close but stocks generally keep trading in the "after-market" for another four hours. For Aussie-based investors, this means the US market shuts at 8am but really continues to trade until midday. The MAG-7 stocks can trade more than the Australian market in the after-market window alone. A pretty scary thought, but it gives you a sense of the liquidity of US equities at the expense of other regions whose capital markets might have too much regulation (Europe), or lacks transparency (China) or has insufficient innovation to grow new companies.



Source : Alphinity / Bloomberg

(cont...)

BTW (...cont)

The US market is trading at all-time highs and US equities are also the most expensive they have ever been but a turning point can take place if something threatens to de-rail the US market. Nasdaq, which is largely made up of tech stocks, now trades at 27 times the value of its 12-month aggregate forward earnings, well above its 15-year average of just under 20x. It is also about double the equivalent 12-month estimated 14x multiple of the MSCI ACWI ex US Index, a good proxy for the rest of the world's equities. Its 15-year average is only a little lower at 13x, which confirms that the extraordinary AI premium is very much a US phenomenon.

Two recent risks have emerged that threaten sky-high US stock multiples: tariff uncertainty and Chinese technology innovation. Tariffs speak for themselves: inflationary and threatening further US rate reductions. In tech, the US has managed to keep China at bay for some time by restricting its access to the most advanced silicon chips. Notwithstanding this, Nvidia's has prospered greatly from the huge amount of capital the hyper-scalers (Meta, Amazon etc) have spent in order to secure their future AI growth plans. This was called into question in January by DeepSeek.

News that a hedge fund in China had released its own AI model, DeepSeek, jolted US tech stocks. Training AI models is not cheap: Open AI, Anthropic and their ilk have each spent more than $100m just on computing costs, not including the cost of building and powering massive data centres and buying thousands of Nvidia GPUs. DeepSeek came in and said "LOL, we did it for just $6m". It claimed to have used older, cheaper, lower-capability and un-sanctioned Nvidia Hopper chips, not the $40,000 Blackwell GPUs all the US AI players are using. One commentator likened DeepSeek to a Toyota Corolla winning the Indy 500. Nvidia shares fell 20% in a day, ~$US600 billion of market cap, although to be fair, that only erased four months of share price gains.

We're pretty sure the total cost of building DeepSeek was way higher than $6m, and we also suspect that the Chinese hedge fund involved might have taken short positions against some of the high-flying US tech names before the release, but regardless of the truth, that fear has now been registered in the mind of the market and it will take a while for those prior premium ratings to be recovered. There is also the possibility of skullduggery, with investigations now going on into whether some advanced chips had made it into China through the back door.

The DeepSeek app has been downloaded widely and seems to be producing some good results despite supposedly being developed for a fraction of the cost of others. It is also Open Source, meaning the code is public and anyone with the skills can check their work. On the down side are data security concerns given its domicile and doubts about how reliable and impartial DeepSeek really is. For instance, if you ask what happened in Tiananmen Square in 1989 you get the response "Sorry, that's beyond my current scope. Let's talk about something else." Ask about the Uyghur people and you get a motherhood statement directly from Beijing. It's still very early days so how this development will pan out is still unknown but one thing is clear: the technology gap between China and the US is narrowing at the same time the valuation gap between US and Chinese shares has never been as wide.

Back in the US, the crypto craziness continues. Despite expressing extreme scepticism back in 2021 ("it's a scam"), Trump now embraces this popular but little-understood entity. While Bitcoin has arguably achieved the mainstream, trading at around $US100,000 per coin on the basis of perceived shortage of supply and some weird false equivalency with gold bullion, there are more than 10,000 other coins out there. According to one authority, the total value of all crypto is ~$US3 trillion. Bitcoin makes up two thirds of that and Ethereum about a tenth; after those two they drop off quite quickly. First buddy Elon's favourite, Dogecoin, is #9 and apparently still worth about $US50 billion in total. These are staggering numbers, built on the fiction that the last traded price is an appropriate value for all coins on issue. [Glass houses here: yes we know that's also how the equity market works but at least equities are visible and liquid, publish regular financial accounts and trade transparently on public markets, which all provides a bit of rigour to their prices. Even so there can be big anomalies.]

Two more coins were added to the crypto firmament in January. Continuing his record of shamelessly exploiting his position for commercial gain, just days before his inauguration $TRUMP and $MELANIA were released. Both are meme coins with no functional utility. If you look far enough into the official website you find the disclaimer: *"Trump Memes are intended to function as an expression of support for, and engagement with, the ideals and beliefs embodied by the symbol $TRUMP and the associated artwork, and are not intended to be, or to be the subject of, an investment opportunity, investment contract, or security of any type".* And wild speculation in order to make (or lose) money.

There were 200 million $TRUMP coins put into circulation, which were 'worth' about $US5 billion at the end of January, making it the 30th biggest coin out there. Another 800 million $TRUMP coins are still owned by Trump's company and these will be progressively 'released' (i.e. sold) over the next three years. If the coins retain any value at all, Trump should be in for a pretty big windfall over that time. It's either very impressive or very concerning that such huge value ca be 'created' from nothing, but that's the way of crypto. Anyway, $TRUMP was issued at the price of $US7 on January 18th – days before his inauguration – and rose as high as $75 the next day. It's been pretty much one-way traffic since then however, falling to $25 by the end of the month.

Less impressive, and only the 90th biggest coin at ~$800 million, was $MELANIA. It is explained by similar verbiage to $TRUMP: *Melania memes are digital collectibles intended to function as an expression of support for and engagement with the values embodied by the symbol MELANIA. and the associated artwork, and are not intended to be, or to be the subject of, an investment opportunity, investment contract, or security of any type.*

We're not sure what it means either. But hopefully it has provided some funds to help her buy more of those protective hats to ensure that any attempted kisses from the Donald remain only of the air variety!

Traveller's Tale

Jessica went to Moomba in January. Not to the dorky festival in Melbourne, to the gas project run by Santos in the northeastern corner of South Australia. Braving the 40+^{o}C heat, she went to witness the opening of Santos' next big thing: its carbon capture and storage (CCS) project. It is designed to store up to 1.7 million tonnes of carbon dioxide (CO_2) per year, which is equivalent to ~10% of South Australia's annual CO_2 emissions. It is one of the largest operational CCS projects in the world, and Santos reckons it is also one of the lowest cost CCS projects globally with a lifecycle cost of less than US$30 per tonne of CO_2.

The Cooper Basin, where Moomba is located, covers 130,000 km^2 and stretches 500 kilometres from east to west. There's not a lot else there: the operational team needs to bring in or generate everything they need to sustain the roughly 1000 people who work in the gas fields on any one day servicing 150 separate gas fields and 1000 producing gas wells.

A group of about 80 people, including staff, project partners and other key stakeholders like Jess, flew in for the day to see the new facility and hear about the achievements of the project team. The site tour was brief and they were only able to view it from outside the fence, but she still had a great overview of what a CCS project actually looks like.

Essentially, it is a bunch of pipes and pumps in a shed and she was struck by just how simple it all was. In fact, there is nothing really special at the site at all. This is not to downplay the achievement of the company in getting this project up and running, or the capital that has been spent building the pipeline infrastructure across a gas field the size of England. However, in the end, the technology and infrastructure involved is relatively simple. CO_2 is captured at the Moomba gas plant and fed through dehydration units, it then goes through a four-stage modified natural gas compressor, and finally the CO_2 itself is sent out to five injection wells in a steel pipe.

First injection at Moomba started six months ago and, so far, the team has achieved 98% effectiveness. The main limitation is during days of extreme heat as they need to reduce the power of the compressors; other than that everything has been working as expected. From here, the focus moves to monitoring and making sure that there are no adverse impacts from injecting CO2 back into the empty gas reservoirs.

At this point, there is only one other working CCS project in Australia, which is at Gorgon off the north coast of Western Australia. Chevron's Gorgon CCS plant is the largest in the world with the ability to store 4 million tonnes of CO_2 per year. Its plant injects the CO_2 into a giant sandstone formation two kilometres under Barrow Island. Both projects have been heavily criticised by environmental groups, as well as some investors and community members. CCS is still controversial and any mention of it tends to provoke heated opposition from some circles. Many believe it would be better not to extract the gas which produces the CO_2 at all, and that storing it underground is a risky and temporary measure, and it is only a stop-gap ahead of the full transition to renewables. From what we saw during the site visit however, this could well be a turning point for CCS in Australia.

CCS is generally an expensive activity to undertake but there are some unique attributes of the Moomba project which help the economics stack up. Firstly, CO_2 separation was already taking place at the site and secondly, all the infrastructure is quite close together. Only 50km of pipeline needed to be built: compared to the many hundreds of kms that might be needed for offshore CCS projects this is almost nothing. Santos plans to build additional CCS projects across Australia and, although the jury is still out as to whether the economics will work as well as they do at Moomba, the outlook is positive.

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