Alphinity Concentrated Australian Share Fund

MONTHLY REPORT – MAY 2025

TACO time

Market comment

We all love a good acronym and, towards the end of May, a new one emerged: TACO. The TACO trade was to buy shares when the market tanked on the announcement of huge tariffs in the expectation that the tariffs will soon be reversed: Trump Always Chickens Out. The Art of the Deal is to make outrageous and clearly unacceptable demands then, at the first sign of resistance, either walk it back substantially or drop them altogether. Trump clearly sees this as a masterful negotiating tactic but the rest of the world is increasingly seeing the US as mercurial and unreliable. In the short term however, after the initial Liberation Day panic in early April, it hasn't had much of an impact on equities. Trump was clearly stung by being called TACO: the risk now is he might not as readily pull back from some of his more extreme claims in the future. While markets have been volatile, ours finished up solidly in May, 4% higher (ASX300 including dividends), finishing the month at an all-time high.

Other markets were strong too, led by the US bouncing-back after Trump recanted on the rather silly levels of tariffs he'd initially proposed. The bounce in $A terms was stronger in other markets, the US in particular where the tech-focused Nasdaq rose by 9% and the broad S&P500 a more moderate 5.4%. Europe had similar returns to ours and Asian markets were also higher but generally a bit less. We continue to have a slightly uneasy feeling, however: surely that can't be all there is after the imposition of the highest US tariff regime seen in decades, even despite the temporary backdowns and the questions over its legality? We probably need to wait a while for the real impact to become evident.

The calm way in which Australia conducted our election in May was a stark contrast to the hoopla around the US election just six months ago. While the US election was years in the making and then several more months until the new President actually took office, ours was carried out (largely) respectfully and swiftly, with not much more than a month between calling it to swearing in the new Cabinet. The incumbent was re-elected solidly, owing no little thanks to Trump's shenanigans. It was a less pleasing outcome for his opponents: not only did the leaders of both the Liberals and the Greens lose their own seats, the opposition Coalition itself temporarily imploded soon after. While the election seems to have cemented Labor in power for several electoral cycles to come, we all know that politics can change quickly. But the size of the Labor majority is now such that Albo is firmly ensconced for the foreseeable future. He now probably has the best chance of determining his own retirement date of any Prime Minister since Menzies.

Perhaps the most significant piece of news this month was the Reserve Bank of Australia (RBA), when announcing the second cut of the current interest rate cycle, effectively saying that inflation is no longer its main concern: now it is the threat of recession. A combination of very good economic luck and reasonably good economic management has kept Australia mercifully free from recession for the past 30 years, except for the very early days of Covid when the government demanded we all stay home and hide under the doona for a couple of months. That the RBA is so concerned makes us concerned too, notwithstanding the Bank's fairly patchy record of predicting outcomes. The reason for its concern was not made clear but it is most likely the slowing of global economic growth thanks to US tariff uncertainty. The direct impact on Australia of tariffs is reasonably modest considering the relative unimportance of the US as an export destination. Of more impact would be if arrangements with our major export markets, which would flow on to their demand for our exports. But whatever transpires, it does feel like there will be further interest rate cuts over the course of 2025.

Commodity prices generally bounced back from April's sharp falls in May and share prices followed. The price of Tapis Oil ticked up 2.5% in $A terms although Iron Ore fell by 2.6%. The prices of the various base metals also recovered slightly, mostly up a couple of per cent. Late in the month the 25% Steel and Aluminium tariff imposed by the US in March was doubled to 50% after Japanese company Nippon Steel bought US Steel, which helped the $A hot rolled coil steel price to rise by 5%.

Portfolio comment

The Fund did a little better than the market in May. The biggest contributors were tech service provider Technology One, safety app Life 360, airline Qantas, financial platform Hub24 and being underweight Aristocrat Leisure. On the detracting side were diversified miner Rio Tinto, energy provider AGL and gold miner Newmont. Not owning Macquarie Group also hurt.

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)	4.3	4.9	16.9	10.1	12.3	9.1	10.2
S&P/ASX 200 Acc. Index	4.2	4.3	13.4	9.6	12.1	8.1	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 May 2025.

^ 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 1300721637 during Sydney business hours.

Market outlook

We start our outlook with a caveat: everything here is current as of time of writing. Whatever material impacts Trump causes between then and when you read this is out of our hands! That said, we are tempted to just refer you to last month's outlook as it still pretty much sums up the environment. Despite the daily headlines, we aren't really much more informed on likely outcomes: more confused perhaps; certainly a little more amused (Trump and Musk were always going to break up weren't they?), but not much more informed. Like all countries on the tariff list, we await some kind of actual outcome. It is hard to play the game with conviction when you don't know what the rules are. The 90-day reprieve is ticking down steadily and, at last count, only one country has agreed to a 'framework' to come up with an agreement, whatever that means.

So, as we said last month, uncertainty still reigns: contradictory and changing statements from the White House rule the day, earnings are still in downgrade mode, nothing has actually been decided or concluded in trade negotiations, the $US remains under pressure, China is holding out, and Australia continues to be in a better position than most. Probably the key change is that the long end of the bond yield curve continues to inch up as risk premia grow while inflationary concerns remain. On the other hand, we have the ever-present concern around slowing economic growth that may require rate cuts.

What we certainly did not have on our bingo card was the ongoing strength of the equity market in the face of all of this uncertainty and earnings pressure. The Australian market is now up calendar year to date and has fully retraced its February highs. With earnings being downgraded as well, the market multiple is largely back to recent highs and the VIX uncertainty index is back to 'nothing to see here': i.e. below 20. What is clear is that implied risk continues to rise. We have noted many times that valuations, as represented by an earnings multiple, tells you very little about when to buy or sell a stock or index. It does however tell you the degree of risk in buying or selling at that point. With valuations back to their highs, long bond yields higher (for now), uncertainty still high, and earnings in downgrade mode, buying equities here is clearly higher risk than it was earlier in the year, and any unexpected outcomes could once again see potentially meaningful reactions one way or the other.

Our primary concern is that the flow-on impacts from all the tariff threats, the trade uncertainty and company uncertainty, is yet to be fully reflected in slower economic activity and, therefore, earnings. It is hard to reconcile all the data we are seeing (which, to be fair, has been so far a little better than expected) with the degree of macro uncertainty. We have seen some pull-forward of trade and activity to get ahead of any tariff implications; we have seen trade re-routing; we have seen some tariffs be taken off certain goods (often within days or hours of going on), and we have seen many companies not yet applying tariff pass through in prices. So it largely feels like a timing issue to us. As we noted in our March note, it is worth remembering, that these things are usually not played out in days and weeks or even months, but more likely quarters or even years. Patience is required. To date there may be some pockets of weakening but little of note, and the market is buying that relative positivity for now. And the TACO trade of course!

As such we remain relatively cautious and earnings certainty remains our key focus. "Meet" is the new "Beat" (i.e. just coming in line with earnings expectations is a good outcome). It is not too surprising to us that what performed well in this bounce had good earnings while the overall market had downgrades. Technology stocks in Australia had a strong bounce on strong earnings reports. Gold did well as upgrades came through. Insurance earnings continue to remain resilient and Banks held their own despite high valuations: Commonwealth and NAB had upgrades and the others largely met. Select domestic consumer stocks did well – JB Hi-Fi and Wesfarmers for example – as the Australian economy is holding up OK and now the rate cuts are coming through will help earnings going forward. Companies which exhibited growth qualities also did well in a market scrambling to find any earnings growth at all. For these trends to change, the market drivers need to change. We keep looking for it but nothing is evident yet. Having said that, we still find it hard to believe there can be yet another year (the fourth?) of falling aggregate market earnings expectations and have multiple expansion drive the market still higher. One of the two is likely to give way. Either earnings start to get upgrades and justify the higher multiple, or the market multiple contracts to meet lower earnings expectations. Given we currently see greater risk to earnings than upside, the latter feels more likely at some point. Australian domestic earnings seem more likely to grow and get upgrades than offshore for now. Overall we will have to find performance in more alpha rather than relying on beta, unless we see a major delta.

Portfolio outlook

It is fair to say that the longer this market cycle goes on, the harder it is getting to find genuine upgrade stock candidates. The number of individual companies experiencing earnings upgrades is one of the lowest we have seen for many years. As such, meeting the market's earnings expectations is a good outcome, and this leads you down a more defensive earnings path. Unsurprisingly, the portfolio remains skewed to earnings upgrades relative to the market. It is also unsurprising then that we have made few changes to the portfolio, given that little has changed in earnings leadership. As mentioned above, we think it is more likely that domestic Australian earnings will do better than those from offshore. The Australian economy has been resilient, and thus far less impacted by the trade war. We are now well into a rate cutting cycle, inflation remains on the right track, and the consumer feels like it bottomed late last year. While we are not suggesting a new cyclical trend of any conviction, the downside domestically seems limited for now.

As such we have continued to add the more domestic, cyclical exposures, and decrease offshore. We remain slightly more defensively positioned overall however, holding fewer global cyclicals. The Fund continues to reflect earnings upgrades and resilience in the market, being overweight Insurance, Utilities, Telecoms, Staples and Healthcare, and remaining underweight Energy, Metals and Mining and Industrials. We continue to be a little underweight the Banks, although earnings are resilient and we are selectively overweight where valuations look reasonable. We concur that CBA's absolute valuation is fundamentally unjustifiable over the long term; however its earnings have been bullet-proof and stand out against the market by having upgrades, which sees us remain a holder in a relative sense, albeit in an increasingly underweight position as valuation gets more and more stretched. It is hard to see the catalyst near term for a major reversal, but the risks are growing.

So boring but steady. In this market, we'll take boring.

Top five active overweight positions as at 31 May 2025	Index weight %	Active weight %
Medibank Pvt Ltd	0.5	3.1
Newmont Corp	0.4	3.1
QBE Insurance Group Limited	1.4	3.0
Qantas Airways Limited	0.6	2.9
Amcor Limited	0.3	2.5

Asset allocation as at 31 May 2025	%	Range %
Securities	98.9	90-100
Cash	1.1	0-10

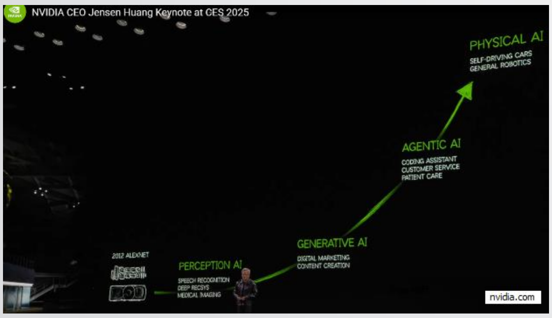
BTW

Is there an AI bubble? Are we just at the start of a super-cycle or has it already popped? These are the questions on the minds of many investors. Indeed, there has been come concern over cheap Chinese AI models like DeepSeek and what the 'commoditisation' of AI means for the future spending plans of the world's three biggest hyper-scalers: Microsoft, Amazon and Google. They are the biggest buyers of Nvidia's GPUs to drive their data centres. We've recently seen some of the heat coming out of these high flying stocks. Expectations had become so great that even a double-digit earnings beat from Nvidia wasn't enough to please the market. If it grew 20%, the market wanted 25% and that's where reality versus expectations becomes so important. If a company grows earnings by 100%, but the market has it priced for 120% growth then just doubling your earnings might be considered a 'bad' result, relative to expectations.

Technology companies often come up with innovative ways to justify their supposed valuations. Forget earnings and cashflows, (and even Price/Earnings ratios, as earnings often don't exist): think more along the lines of TAM (total addressable market) or even the late 1990s tech-boom's classic 'multiple of eyeballs', where the number of people looking at a website was thought to be an almost certain leading indicator of future growth.

A popular metric more recently used in tech companies is ARR – annual recurring revenue – but the necessary degree of scepticism towards its use was summed up well by one venture capitalist who repurposed Voltaire's observation when he tweeted "just as the Holy Roman Empire was neither Holy, or Roman, or an Empire, ARR today is neither annual nor recurring, and perhaps not even revenue".

While it pays to be a bit sceptical when a company talks about its TAM, which is often a somewhat unattainable, even unmeasurable number, we do need to cut them a little slack. AI companies are usually priced for high growth, reflecting the expectation they will be able to take a share of a huge market. We can't predict the future but maybe Nvidia's CEO can? At the 2025 Consumer Electronics Show in January, Nvidia CEO Jensen Huang (below, in one of his trademark leather jackets) presented on the future of AI in his 90-minute keynote speech. The dominant theme was that physical AI will be the next frontier of innovation. The image below shows the Nvidia CEO providing his roadmap for how AI use cases will evolve. The AI cycle that is now evolving from Generative to Agentic AI, where agent AI bots will be used alongside workers to enhance efficiency. Microsoft's CoPilot is an example (albeit not a great one) of Agentic AI, and the term co-pilot actually describes it pretty well: a tool designed to collaborate with and help the user.

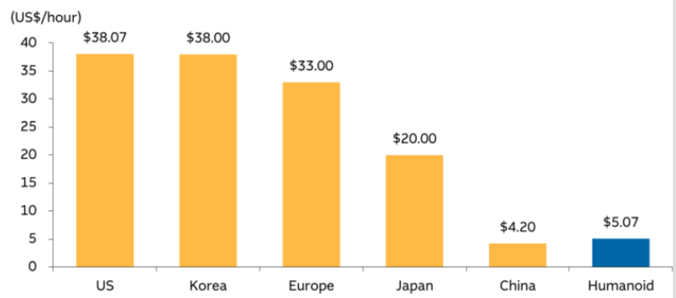


The next evolutionary step in the AI cycle is moving from Agentic to Physical AI, which will involve the creation of person-like robots known as "humanoids". Investment interest in humanoids is gaining traction and could become the next big market theme. We've seen concepts of humanoid robots for decades now, popularised by science fictions films and stories. While HAL9000 from 2001: A Space Odyssey didn't have the body to be a real humanoid, there were many others which did including T-800 in the Terminator films and, of course, that lovable droid from Star Wars, C3-PO. But there are two big reasons why robots are evolving into reality: the evolution of Physical AI technology and a structural shift in manufacturing jobs around the world.

Manufacturing is experiencing a worker shortage in many countries as baby boomers retire and younger generations generally seek higher paying, less labour-intensive jobs. This structural shift is occurring at the same time that AI development is taking place. It seems when the world is faced with a problem, a solution is found. Somewhat analogous to the US obesity epidemic and the creation of weight loss drugs that may provide the solution, the changing workforce and ageing population is also in need of a solution. It could be in the form of humanoid robots.

It is possible estimate a TAM for humanoid robots. Human labour makes up around 30% of global GDP and you can approximate the proportion of the workforce that could be replaced. Morgan Stanley estimates that the physical embodiment of AI has an overall TAM is around $US60 trillion in total. Macquarie estimates a TAM specifically for Humanoid Robots should reach $US1.7 trillion pre annum by 2050, which is a similar size to the global light vehicle market. Macquarie estimates that the hourly operational equivalent labour cost of Humanoid robots, assuming they cost $US100,000 and taking into account time off for battery recharging, servicing etc, would be around $US5 per hour. This is a fraction of a humanoid human in most developed countries. And if Tesla's prediction that the price of a robot will eventually be $US20,000 were correct, the hourly rate would be just $US1.40. Trump's dream of US manufacturing jobs returning seems even more unlikely to be realised.

Hourly wage at automotive plants in different geographies vs humanoid robot



Source: Company data, Macquarie Research, March 2025

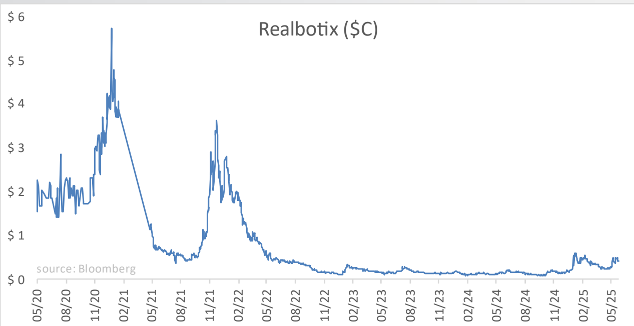
There are many potential applications of humanoid robots when it comes to labour efficiency, everywhere from industrial automation in factories to helping surgeons perform operations. Aside from the benefits to the labour force, the other interesting avenue being explored is what humanoids can do in terms of social care, especially with the elderly or with people experiencing loneliness, either due to age, incapacity or some other social condition.

BTW (...cont)

The term 'Social AI' will become more important in the future with the world facing an ageing population and a loneliness epidemic, not just in the elderly but also at an alarming rate in younger generations. There is some irony in that the main culprit in the growing isolation in younger generations is Social Media, yet Social Media itself is heavily reliant on AI. Thus an AI solution in the form of robots could help solve a loneliness problem that AI itself is at least partly responsible for.

Back at CES 2025, the next hottest place to be after Jensen's speech was at the human robot stand hosted by Canadian tech company Realbotix. It was packed as it showed off its latest human robots, said to be the most realistic in the world. With the Realbotix model, you will soon be able to buy into a platform which could deliver multiple robot faces and personalities. Its modular design allows you to easily pack up your robot and take it on holiday with you. And it apparently takes just 30 seconds to remove a face and install a new one, and a new personality. Simple! Pictured below on the right (from realbotix.com) is Realbotix's brand ambassador, Arya, alongside two other models of varying age and glamour. Arya was apparently recently

appointed to a non-executive role as an advisor to Realbotix's board of directors. We believe this to be the first time an AI-powered robot has ever been used on the Board of a publicly traded company. A big tick for diversity. Looking at the recent share price in Realbotix, which raised capital at C50c per share in 2009 and is now trading below that, at 42c in May, less than a tenth of its peak price in 2020, we hope Arya can offer the board some advice on how to boost the company's stock price!



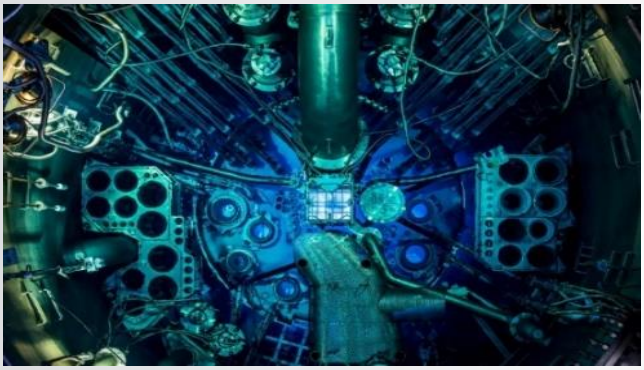
When designing something specifically for the elderly or people suffering from loneliness, depression or dementia, private Israeli company Intuition Robotics launched its ElliQ robot in the US, aimed at keeping older people active, connected and engaged. While certainly not for everyone, these types of robots could go some way in helping in the aged care industry. And it also shows that robots can be effective without actually looking like humans. ElliQ (below) just looks like a big eye on a lamp that sits on the table, but some studies have found that robots with simple gestures, like turning to face their companion as he/she talks and moves around, have proved effective. There are deep learning AI models behind them so they "know" their companions very well and can have conversations with them, also being alert as to when they wake up at certain times or forget to take their medication.

Bottom line is that the robots are coming (that's Jensen Huang at CES again below with some robotic friends) and we have to hope they will be relatively benign. Those we've described above are not too threatening and could even be quite helpful, although no substitute for genuine human interaction.

They are certainly less scary than those creepy, sometimes armed, robot dogs increasingly popular with armies around the world. Dogoids have some advantages over humanoids as having four legs obviates the worst of the balance challenges presented by needing to get by with only two. As long as the robots are just destroying each other we're not too concerned but there are some deeper questions involved, which AI is not well equipped to answer, before we let them start attacking humans. Hopefully the final decision makers have strong moral compasses or it could be the end of us all!

Travellers' Tales

Jess went nuclear in May. As part of our ongoing research into the merits (or otherwise) of nuclear energy she took a trip to Lucas Heights, in the southern outskirts of Sydney, where Australia's only nuclear reactor has resided for the past 60+ years. (Security wouldn't let her take photos so the picture of the OPAL [Open Pool Australian Lightwater] reactor below is from ANSTO's website.) OPAL is not a pressurised reactor and uses a very small amount of Uranium, so is low risk from a safety and space perspective. The resounding defeat of the Coalition in this month's election probably means nuclear is unlikely to be part of Australia's energy future any time soon but whether we should invest in it remains an active topic for our global equity portfolios.



Australia has a complex relationship with nuclear. With one of the biggest reserves of Uranium in the world one would think it would be an obvious candidate for generating low emission baseload power but various state and Federal laws put in place in the 1980s prohibit nuclear energy. There would need to be state and federal political agreement – problematic at the best of times – to change this so even if it manage to garner sufficient get public support it would be many years before the first sod could be turned on our first electricity-generating reactor. Now that the Nationals are the only party firmly supporting nuclear we can probably write it off for now, possibly ever.

Lucas Heights is primarily a research facility but it also makes and exports a wide variety of medical isotopes for treatment of many different diseases and conditions, including thyroid and various cancers. It also makes around half the world's semi-conducting silicon, which is used in making microchips and solar cells.

Meanwhile, Jacob jetted off to the US to see a bunch of companies in the consumer space, covering New York, Columbus (Ohio) and Las Vegas in less than a week. After suffering a material downswing during and following the pandemic it appears that The City That Never Sleeps is well and truly revived and into post-resurgence phase.

This was Jake's first visit to New York post-Covid and he was greeted by the hustle and bustle for which the city is famous; there were no signs of the desolate streets that was the talk of financial markets for quite some time post reopening. Times Square was full of tourists and all the restaurants and bars across the city seemed to be bursting with patrons.

Central Park was equally busy with the new and novel addition of a large number of Pickleball courts, all of which were frantic with activity on the pleasant Sunday afternoon of his arrival: fair to say that sport is well and truly in the middle of a boom at the moment! For the more commercially-minded among us, the prices of food and accommodation were signalling loud and clear that NYC was indeed back, and there were no signs of the cautious consumer one might expect to result from the recent tariff imbroglio.

In contrast with New York, Jake found the vibe in Las Vegas to be muted compared to his visits in the last couple of years. While the slot floors of the casinos were well occupied there was still plenty of spare capacity at many of the tables, a sharp contrast with last year when it was well and truly at capacity. Being a huge convention destination, this partially reflected a number of very big events that had just finished, resulting in an exodus of visitors, although he suspects it could also be the first signs of softening consumer demand as people reassess their spending priorities in light of increased economic uncertainty.

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