Alphinity Australian Share Fund

QUARTERLY REPORT – JUNE 2025

Dire Straits

Market comment

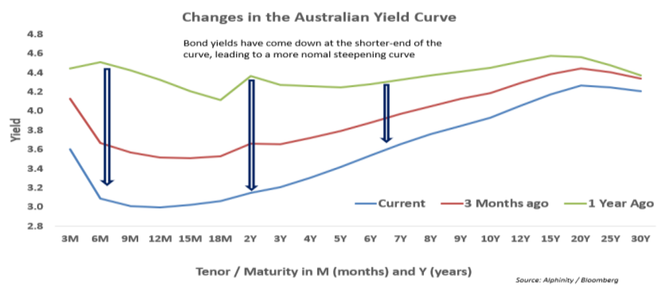
The market surprised with its resilience in the June quarter. The period exhibited increasing uncertainty around the world's key economic driver, the USA, and not just because of its tariff machinations. War-drums were beating ever louder in the Middle East, threatening a key oil thoroughfare, the Straits of Hormuz. One would think that government dysfunction and rioting in the streets in the US, bunker-busting bombs being dropped on Iran and a spiking oil price might make investors a tad cautious; rather they seemed happy enough to keep buying anything and everything, pushing share indices to fresh all-time highs here in June and setting new highs in many other regions as well. Our own market (ASX300 including dividends) finished just off its highs, rising by a solid 9.5% over the June quarter. This was better than the $A returns from the US (+5%), Europe (+6.5%) and most of Asia. We were not as strong as Korea, which rocketed 28% after elections provided greater political certainty, but much better than Argentina's poor showing, -15% in pesos and -27% in $A.

The prolonged weakness in the $US, which is down more than 6% last quarter, and the fall in bond yields was supportive for both US equity markets and also for Emerging Markets, in which most countries reliant on imports benefited as their currencies strengthened. Further talks of 'trade truces' between China and the US toward the end of June propelled markets to new record highs, although much of the heavy lifting across Emerging Markets was driven by Korea and Taiwan, while Hong Kong and China relatively underperformed.

Back home, we continued with the same trend of Technology (+27%) and Financials (+14%) driving returns, while the more defensive sectors like Consumer Staples (+4%), Utilities (+1%) and Healthcare (+1%) all lagged. Miners have delivered disappointing returns over the last five years, but there were some signs of life with a rebound in late June. The Materials sector closed almost flat in the June quarter, despite some sharp declines in the prices of various commodities, although any change to a pessimistic view on China and any bounce in prices could see this underperformance gap quickly close. The index of Metals and Mining stocks managed a 6% total return over the last five years, comparing poorly with a 220% return for the banks index over the same timeframe.

Energy stocks had a rare reprieve, rising despite the falling oil price, although the biggest winners were probably oil traders who stood to make healthy profits from all the volatility. Apart from the brief spike in the oil price when Iran and Israel traded blows, economic data points to softening inflation numbers. Indeed, May inflation here came in slightly lower than expectations, which prompted the Reserve Bank to cut interest rates for the second time in this cycle; consensus is for another cut when it next meets in July.

Bond yields have fallen a lot recently. The chart below shows moves in the yield curve out to 30-year maturities over time. The curve has steepened to be more "normal", with falling yields at the short end.



Portfolio comment

The Fund outperformed the market over the June quarter. The biggest positives were from safety app Life360, IT provider Technology One, and financial platform Hub24. Chief detractors were packaging company Amcor, miner Rio Tinto, rubber glove-maker Ansell and energy producer AGL; being underweight Comm Bank also hurt. The Fund outperformed the market nicely over the year to June, with strong contributions from Technology One, gaming machine maker Aristocrat Leisure, Life360, Hub24, airline Qantas, health insurer Medibank Private; not owning iron ore miner Fortescue Metals also helped. The only detractor of similar magnitude over the year was being underweight CommBank.

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)	1.8	9.7	16.7	13.7	12.4	9.3	9.6
S&P/ASX 300 Acc. Index	1.4	9.5	13.7	13.3	11.8	8.8	8.9

* 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 June 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 1300 721 637 during Sydney business hours.

Market outlook

"Resilience", "Hope", "Complacency" are words that come to our minds when describing current market conditions. The market keeps pushing up to record levels regardless of what is thrown at it. This month's pre-emptive attack on Iran hardly dented the market's enthusiasm despite the threat of disruption to 20% of global oil flows, averted thanks to a swift yet fragile ceasefire. Another economic bomb, the US "reciprocal tariffs" declared on "Liberation Day" back in April, then delayed by 90 days, could come back into effect on July 9 unless "better" (for the US) deals are agreed, or a further extension is granted. To date, the 90 deals in 90 days promised looks optimistic with just one agreed (UK), and an agreed (undisclosed) "framework" for a deal with China. Recent talks of a trade truce have also helped, although our Prime Minister can't even get an audience with the US President to make our sacrificial offering.

In the meantime, companies we speak with indicate that they are delaying investment and hiring decisions given prevailing uncertainties, which does not help economic activity. Economic data in the US is starting to reflect this: consumer spending has softened, housing construction activity has weakened further, and GDP growth has been revised downward by 1% pa since January. The US Fed acknowledges this but still describes the US economy as resilient, maintaining instead its focus on inflation, with concern it might lift over the next few months on the back of the tariff implementation. If the data turns out to be more benign than expected by September, rate cuts should follow, and the market is pricing three cuts to US rates by year end. Yet, despite all the uncertainty which is starting to bleed into negative earnings revisions, the market seems to be taking the view that the worst is behind it, that tariffs will de-escalate, interest rates will be cut further, and that the rise of AI and the tax cuts in the so-called Big Beautiful Bill will keep fuelling growth. If the market is right, earnings will need to be revised upwards to start justifying the elevated market multiple. "Complacency" is the word that most resonates with our investment team at this stage (not the team, but the environment!). Risks have increased meaningfully and earnings are declining, yet valuations do not reflect the increased risk versus a few months ago. We keep scratching our heads, but we are aware that valuations can remain out of sync with earnings for a long time – but they will matter eventually.

At home, the surge of the Australian market to almost record highs also feels fragile, albeit less so than the US as there is a glimmer of economic hope here. Lower inflation provides ammunition for our Reserve Bank to keep cutting interest rates and fuel some needed relief. Indeed, three more cuts are expected by year end. Earnings revisions however need to start turning positive after three years of decline in order to justify the current elevated market multiple of 19.5x. So far though there is no evidence of such an inflection point. On the contrary, expectations for market earnings to grow by approximately 8% in 2026 appear optimistic in the context of an economy that is still soft: for instance, building approvals and retail sales have again disappointed in June. The coming interest rate cuts could however eventually provide that earnings inflection point for Consumer and Property stocks and highly geared companies.

In the meantime, for the first time we can recall, there are now just 30 liquid companies in our market which are experiencing positive earnings revisions, a number of which are fairly speculative Gold stocks. Such a narrow set of companies goes some way to explaining why some names are still attract investment flows despite their eye-watering valuations.

CBA, with its modest positive earnings revisions, trades at more than 30x this year's earnings despite generating minimal earnings growth. It has become the most expensive bank in the world and now has a capitalisation 70% higher than the second largest Australian listed company, BHP. For CBA to correct however, its earnings would have to crack, or more likely, other companies in the rest of the market would have to start getting positive revisions to appear relatively more attractive.

Resource stocks – other than gold miners – are certainly not ticking that box! China's official steel production declined by a surprising 7% in May, driving iron ore lower. China's old economy industries and its consumers are under renewed pressure, with our most recent conversations suggesting confidence is faltering yet again. Energy stocks surged and plummeted with the unfolding events in Iran this month. Should the situation in the Middle East remain controlled, the prospects of oil stocks (Santos aside thanks to a takeover bid) would be challenged given the global over-supply.

Of note, we have seen a surge in IPOs and equity raisings recently with Virgin, Xero, GemLife Communities and Greatland Resources being some of the names taking advantage of the market conditions. Ultimately, however, it will be earnings revisions that will dictate the enduring direction of the market. This should keep playing to our strengths.

Portfolio outlook

The market has become quite polarised between cheap stocks which keep disappointing on earnings and expensive stocks meeting or beating expectations. This, combined with a very narrow list of companies currently delivering positive revisions, makes putting together a portfolio of quality, undervalued stocks undergoing positive earnings revisions quite challenging and requires us to accept that "meet" is the new "beat" for the moment. Our portfolio remains quite defensive, despite still holding a number of cyclical and growth exposures underpinned by idiosyncratic earnings upside investment cases.

Over recent months we have continued to decrease our Bank exposure to a modest under-weight as their valuations are increasingly demanding, especially for Commonwealth Bank. We are cautious about our Resource exposure, except for Gold. We don't hold any steel, lithium, rare earths or base metal pure play companies for the moment and are slightly underweight iron ore. We have also trimmed our Staples exposure as price conduct between the three large players (Woolworths, Coles and Aldi) is appearing to deteriorate, putting pressure on margins.

We remain overweight Insurance as our holdings in that sector have kept growing their premiums (the writer might say excessively so in the case of his house!) and at the same time benefit from the start of cost deflation. We are alert to the fact we have passed the peak here in terms of premium rate increases, but profits still look strong for now. We like the defensive quality of Telecommunications, supported by recent mobile price lifts. We also hold selective exposures in the Consumer Discretionary, Materials, Industrial, Technology and Property sectors. We are very conscious that the market keeps wanting to rotate towards cheaper stocks and while, as always, we are closely monitoring for any enduring signs of earnings leadership changes, there has been no material shift to date. Any meaningful changes to the portfolio would require us to be confident in a sustained shift in earnings leadership, as typically cheap valuations alone are insufficient, as they reflect more the company's poor outlook and heightened risk of future earnings downgrades. Our focus on finding reasonably valued, quality businesses in earnings upgrade cycles continues to help us navigate these turbulent markets.

BTW

A lot of ink and more than a few tears have been spilled over Commonwealth Bank of Australia (CBA) recently. As has been widely reported, after a stellar performance recently CBA has become not just the most expensive trading bank in the world but also one of the largest. Australia's economy generally punches well above its population weight but even so, the 13th biggest economy having the world's sixth biggest bank feels a bit wrong.

Most of the tears have been from fund managers and their clients. Being "expensive" – i.e. trading at a higher earnings multiple than both the market and its peers – has meant that many managers are underweight CBA and, according to press reports, some have no CBA shares at all. Being such a big company, this has become a significant performance issue. 18 months ago, at the start of 2024, CBA was trading at $110 per share, which was about 19x the FY25 forecast earnings at the time of $5.70 per share, not cheap for a bank. At that time, it made up 8% of the benchmark ASX300.

By the end of June 2025, it was trading close to $190. As this chart, courtesy of Goldman Sachs, shows CBA's share price is up ~70% (80% including dividends), and it is now trading on 31x expected FY25 earnings. Those earnings have been upgraded by about 10%, to $6.10, since the start of 2024 (these upgrades are important – we'll come back to that later). But at $190, it now make up a whopping 12% of the ASX300. The whole market is also higher, although by a much smaller 18%. However considering CBA was such a big proportion of the overall market rise, the other 299 non-CBA stocks returned a lot less than 18%, just 13% overall. In other words, CBA alone accounted for more than a third of the entire market's total returns in the past 18 months.

That's an extraordinary number for one company and it has several implications. One is that if your fund didn't own any CBA shares 18 months ago or since – which is feasible as it was generally thought to be quite expensive back then, you would have underperformed a lot. Who would be zero weight such a big company? Apparently, some funds were. Glass houses here: we too were underweight CBA during the period but only modestly. So, while it detracted from this Fund's outperformance this year, the detraction was relatively small and was offset by overweights in other banks – particularly Westpac which was another strong performer. Some might see this as lacking in conviction, but we actually see it as good risk management. It certainly worked in your favour! Once again, earnings revisions win.

Why has CBA been so strong when everyone is underweight? That's actually one of the reasons explaining its performance. If you don't own the shares, you can't express the view it is over-valued by selling the shares! The popularity of index funds is also a factor: these don't allocate the funds according to the best investment opportunities, merely by the prevailing index weight. So, someone putting a million dollars into an index fund today would be buying $120,000 of CBA shares regardless of how over-valued CBA might be. Indiscriminate buying such as this has pushed the price higher.

We've also heard that some large domestic asset owners who use external managers had observed that their managers were universally underweight CBA so, in order to control the performance risk, they were exposed to (rightly as it turned out, but also self-fulfilling), they bought CBA themselves – that too would have pushed the price higher.

Back to the upgrades. We've found over many years that the companies which perform well tend to be those whose earnings surprise the market positively over time. So, a company which might appear to be a bit expensive is really not when those higher earnings become evident. This is a core part of Alphinity's investment process and largely explains our Funds' outperformance during most market conditions. In a year where company earnings upgrades were limited in scale and number, any company getting upgrades, regardless of size, is likely to be well rewarded. CBA might be a large outlier example of this but was an incredibly important one for your portfolio in 2025.

Where to from here for CBA? We've learned over the years that "irrational" things like this can go on for quite some time so we're not selling out. Whatever else, one of the reasons for CBA being expensive is that it's a well-managed, high-quality company which generates strong returns, so while this earnings upgrade cycle continues, we see no urgent need to bail out completely.

The more expensive it gets, however, the more we will trim the position. But our deep consideration of risk means we would be unlikely to ever sell out completely. Certainly not now, when its relative earnings revisions remain one of the best in the market.

Top five active overweight positions as at 30 June 2025	Index weight %	Active weight %
Newmont Corp	0.4	2.9
QBE Insurance Group Limited	1.3	2.1
Amcor Limited	0.3	1.9
Medibank Pvt Ltd	0.5	1.8
JB Hi-Fi Limited	0.5	1.8

Asset allocation as at 30 June 2025	%	Range %
Securities	99.0	90-100
Cash	1.1	0-10

Travellers' Tales

Our Head of ESG and Sustainability, Jessica, went to Korea, Taiwan, and China in June in order to better understand the sustainability of AI and Data Centres. She saw a diverse range of companies including Naver Corp, SK Hynix, Samsung, Delta Electronics, Baidu, and Tencent. Arriving at Shanghai Airport, Jess was greeted by a wall-sized screen promoting ESG. It's as if they knew she was coming!

Nearly two years after Chat GPT launched, expectations for growth in Generative AI remain high. The major hyperscalers—Google, Microsoft, Amazon, and Meta—spent around $US200 billion on AI infrastructure in 2024. Major tech companies and experts highlighted soaring AI infrastructure investments, with projections of as much as $US350 billion this year, driven by demand for GPUs, data centres, and AI training models. Despite various geopolitical challenges such as tariffs, chip bans and nationalisation risks, organisations are proactively diversifying manufacturing locations and developing local chips in order to mitigate risks while maintaining strong growth forecasts for AI spending.

Companies were cautiously confident about the way tariffs and geopolitics would pan out. Taiwanese companies Delta Electronics and Voltronic both began diversifying in 2018 under Trump 1.0 and further during COVID. They are considering replacing Vietnamese and Indian factories in places such as the United Arab Emirates, and it only takes the 6-12 months to relocate or set up a new factory. There was a general sense of uncertainty. SK Hynix, for example, noted an uncertain second half outlook due to demand fluctuations. Samsung said it is waiting on final confirmation of any direct tariffs for Korea.

The US Chip ban is still evolving, with Taiwan's announcement about Hauwei and SMIC being added to the export control list. The message during the trip from companies like Baidu and Tencent was that they are managing the potential risks of a ban through more efficient models, strategic use of GPU/CPUs, stockpiling and developing local chips and/or programs. Baidu, for example, is developing its own chips and reckons its Kunlun chip cluster is good enough to train DeepSeek-like AI models.

Capital spending (capex) was less of a focus during the meetings. Most companies said they haven't seen a slow down because of demand, and that uncertainty in the broader market is more of an issue. Delta Electronics said it generally gets 12 months' notice on capital plans for major customers, but more notice where R&D is needed. Samsung noted that capex has been flat with most infrastructure investment to be completed this year. Jess also met with an analyst from CITIC specifically to talk about AI spending: they believe that regardless of DeepSeek, AI capex will continue to grow despite falling chip costs, as demand is increasing so much.

The ethical questions around AI were certainly on show. She saw a demonstration of an AI interview program, in which an AI bot conducts pre-screening interviews to generate short lists of suitable candidates; an AI companion and AI avatars for use in social care and in gaming, and also to sell products on social media; and facial recognition software that has reportedly been used for the surveillance and internment of Uyghurs and other ethnic and religious minorities in China's Xinjiang region. She also saw some great use cases of AI in healthcare and diagnostics, bookings and travel management, education, marketing, and translation. Tencent and Baidu were clear leaders in the responsible use of AI (RAI): both had clear governance structures in place related to RAI and were able to describe how ethics, human rights, and reputational components were also considered.

That's not a table, THIS is a table! Is this the world's biggest lazy Susan? It was certainly a nice lunch option for Jess and some friends in Shanghai. When in Taiwan she found some unusual food and beverage items, including canned asparagus juice. Yum.

Andrey, who covers all things in tech for the domestic team, went to the UK to visit companies including Xero (accounting software) and Technology One. He landed in sunny Birmingham (jokes on sunny) for a local government IT conference where he met some council CEOs and CIOs. Tech One already has a number of local government contracts in the UK but there still appears to be strong tailwinds for the next several years. Many councils will be consolidating and reviewing their ERP software, and Tech One has the best product. Its SaaS+ offering is also resonating well, and the longer-term market opportunity seems bigger than it appeared last time he was there. UK councils appear to have many large adjacent software needs which are currently served by legacy on premise incumbents but without an integrated offering. Technology One could build a unique product over time through targeted research and acquisitions, just as it did in Australia.

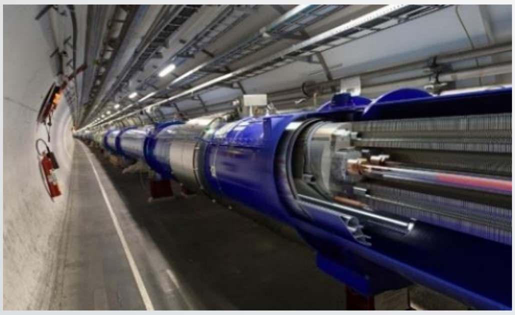
Away from sunny Birmingham and into a nice London summer, Andrey also got the chance to meet with Xero, one of the world's leading accounting software companies. He came back from this trip more bullish after speaking with management, with what he believes is a larger opportunity than the market is expecting. This involves making tax digital, a multi-year program. Out of every ten new accounting cloud software subscriptions, five of these go to Xero. There's around 1 million small business every year coming onto software for digital tax, so the future runway is massive. Additionally, the company recently launched an AI product "Just Ask Xero". So far, the feedback hasn't been great with not too many people using it, but they are working on a deeper AI tool which has had positive feedback from a small sample of accountants trialling it.

BTW2

We were intrigued to see an article recently regarding what seemed to be achieving something that has eluded mankind for millennia: turning lead into gold. Known as Alchemy, this was the stuff of legend, starting as far back as ancient Egypt and continuing through many civilisations before ultimately fizzling out in the medieval times. It wasn't a complete waste of time though, as some of those efforts laid the foundations of modern chemistry.

But apparently it has now happened! Does this herald the end of gold mining and the impending collapse of its rampant price, which has increased tenfold in $A terms since 2000? It all happened at CERN – *Conseil Européen pour la Recherche Nucléaire* – a scientific undertaking based near Geneva, Switzerland. CERN was established in 1954 and now has 25 member countries, all in or close to Europe, and various Australian universities also participate in research there. It was one of those great organisations founded in those more optimistic years after World War II, when it was still thought that cooperation between countries for a common end was a better way forward than just bombing each other. How naïve!

CERN somehow managed to get those 25 countries to agree to put in an astounding amount of money over the course of a decade starting in the mid-1990s to build the Large Hadron Collider (LHC, picture below from CERN), a particle accelerator in a 27km-radius circular tunnel deep under the border of France and Switzerland, filled with technology. It was originally budgeted at CHF2.5billion ($A3 billion at the time) but that inevitably blew out to about €9 billion/$A14 billion, almost five times the original estimated cost. Seems that even in Switzerland big projects can come in late and well above budget!



The LHC goes down in history as the most expensive scientific instrument ever built. When it first started firing up in 2009 there was some public fear that, by re-creating conditions similar to those immediately after the beginning of the universe, that it might set off a set of events, such as creating a black hole, which might destroy the earth. That didn't happen, obviously, and the outcome of LHC experiments have been more benign. Apparently useful to the development of our knowledge of physics, but at a level that far exceeds our expertise to judge.

Anyway, back to the gold. While the properties of metals couldn't be changed by chemical means, the development of nuclear physics in the 20th Century showed that some heavy metals could. So earlier this year they took the nucleus of some lead particles, fired them around the collider and smashed them into each other. As the CERN press release said: "*the very high speed at which lead nuclei travel in the LHC (corresponding to 99.999993% of the speed of light) causes the electromagnetic field lines to be squashed into a thin pancake, transverse to the direction of motion, producing a short-lived pulse of photons. Often, this triggers a process called electromagnetic dissociation, whereby a photon interacting with a nucleus can excite oscillations of its internal structure, resulting in the ejection of small numbers of neutrons and protons. To create gold (a nucleus containing 79 protons), three protons must be removed from a lead nucleus in the LHC beams*."

Achieving alchemy, making gold from lead, might be overstating things a bit. It's certainly not time to go out and corner the lead market in advance of large-scale gold creation. To start with, you'd first need to build your own particle accelerator and those clearly don't come cheaply, even if they're smaller than the LHC. Then you'd probably need to build a nuke to provide the vast amount of electricity required to run the thing. In any case, the large increase in supply as a result would soon put a dent in the gold price – scarcity is it main appeal. CERN said you would need trillions times more gold than was produced in that experiment to get enough to make a piece of jewellery. But it is still a great moment in science, and worth celebrating. Who knows where science will be taken by these sorts of experiments?

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