Alphinity INVESTMENT MANAGEMENT

Monthly comment – January 2013

Alphinity Wholesale Concentrated Australian Share Fund

A very happy new year

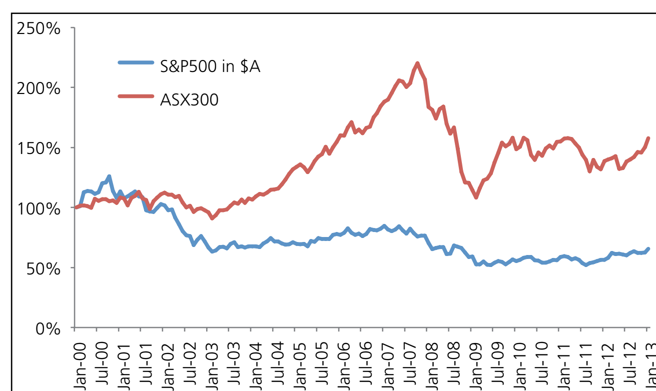
Market comment

The new year opened on a very happy note, with the market building on the strong performance of the last six months. The S&P/ASX 300 Accumulation Index (including dividends) was up 5%, and the Fund did considerably better than that. With most of the focus this month on the beach rather than the bourse, domestic financial news was fairly scant at least until the end of the month when the Prime Minister announced the date of this year's election – and effectively started the longest-running election campaign in the country's history.

Global markets were also strong, helping sentiment in Australia. The US reporting season kicked off well with the majority of results beating broking analyst expectations, underlining how negative US analysts had generally become, and how anchored in the past estimates can be. It will be interesting to see if the same trend will take place in Australia during reporting season. While our economic backdrop may have been less conducive expectations heading into the February reporting season are generally low so any signs of improvement should be very well received.

The US market (S&P 500) also finished the month up 5% and is now within spitting distance of its September 2007 all-time high. The Australian market (ASX300) remains some 26% below its all-time high, which was set at pretty much the same time. While this 'under-performance' may seem a little depressing, closer inspection shows that the rampant Australian dollar ($A) accounts for two thirds of the disparity. In fact for an $A investor, the US market peaked at the time of the Sydney Olympics, September 2000, and its current level (ignoring dividends, which tend to be quite low in the US) is still 45% below their entry level. By contrast Australian shares in $A (also ignoring dividends) are up by 65% in that period, and up 160% including dividends.

The best performing markets in January were in some of the more challenged European economies. Including a 3% appreciation of the Euro against the $A, Italy rose 10%, and Greece 6%. The UK was up 3.6% despite a small adverse currency move, while the US, Germany, France and Shanghai all returned about the same as Australia. Japan's market was up 7% in its local currency but a continuation of last year's depreciation rendered it flat in $A.



Fund details

Alphinity Wholesale Concentrated Australian Share Fund	
APIR code	HOW0026AU
FUM ($A million)	16.5
Asset allocation	Australian equity: 98.5%, Cash: 1.5%

Fund performance* – as at 31 January 2013

	1 month (%)	Quarter (%)	1 year (% p.a.)	2 years (% p.a.)	Since inception (% p.a.)
Alphinity Wholesale Concentrated Australian Share Fund	6.2	10.5	25.2	7.7	11.1
S&P/ASX 200 Accumulation Index	5.0	9.0	20.1	6.2	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.** The Fund changed investment manager and investment methodology on 12 July 2010, at which time Alphinity Investment Management commenced managing the Funds and started the transitioning of the portfolios to a structure consistent with Alphinity's investment views. The transition was completed on 31 August 2010. Therefore, the inception date for the returns for the Funds is 1 September 2010. For performance for previous periods please contact Fidante's Investor Services team on 13 51 53 (during Sydney business hours).

Top 5 active overweight positions as at 31 January 2013

Alphinity Wholesale Concentrated Australian Share Fund

Issuer name	Index weight	Active weight
Westpac Banking Corporation	7.3%	6.6%
Australia and New Zealand Banking Corporation	6.1%	4.9%
Rio Tinto Limited	2.4%	4.6%
Insurance Australia Group Limited	0.9%	3.6%
Lend Lease Corporation Limited	0.5%	3.4%

Commodity prices were generally soft in January, largely explaining the underperformance of the materials sector stocks. Precious metal prices were mixed: gold was fairly flat but both silver and platinum appreciated sharply. As alluded to above, the $A slipped a little against the Euro, appreciated a little against the British pound and a lot against the Japanese yen, and was flat against the US dollar.

Portfolio comment

The portfolio performed very well in January, capitalising on the strong returns generated in 2012. Individual positive stock contributions were from a broad spread of stocks and sectors, including property developer Lend Lease, online advertising platform Carsales.com, major bank Westpac, global media conglomerate News Corporation, and being underweight diversified resource player BHP. The only individually meaningful detractors were from the other resource major, Rio Tinto, and not owning major bank NAB which reversed a little of its recent underperformance against its peers in January.

Market outlook

The equity market has traded higher over recent months, largely based on two themes: an improved global outlook and lower domestic interest rates. These factors will make alternative investments less attractive and support economic activity (and therefore corporate earnings). Investors will now look to the February reporting season for signs of these themes' validation and, while expectations are set reasonably low, earnings on the whole are unlikely to surprise positively. This may cause the market to pause after the strong run over the last six months. However, we believe investors have reasons to be more patient this time than in the last couple of years.

Our optimism is centered around the fact that we are still quite early in the cycle for both of the above-mentioned themes. As long as both are trending in the right direction, and with the Reserve Bank of Australia likely to cut again if activity doesn't start to pick up over the next few months, investors in our view will be paid for their patience. With a dividend yield of 4.5% (including franking around 6%), equities continue to look cheap relative to bonds and cash (3% and falling). And the cost of being a patient equity holder is falling, not increasing.

Portfolio outlook

The Fund's strong outperformance over the last year has been driven by good stock selection, whereby avoiding some of the big disappointers was almost as important as finding the winners. In recent months more cyclical stocks, primarily some of last year's laggards, have made a bit of a comeback but their outperformance hasn't been universal and in January the higher dividend stocks took the lead again. We believe this validates our current portfolio positioning with a foot in both camps. The low interest rate environment is likely to continue to support the 'yield stocks' as long as they deliver on their earnings expectations and thus dividend payments, while at the same time the potential impact of lower rates on the overall economy and the more cyclical part of the equity market should not be ignored.

While current market sentiment has lifted most stocks we would expect the next few months will determine how much of a stimulus the rate cuts have been in general, and more importantly which individual companies have been able to improve operating performance. With additions such as retailer Myer and share registry Computershare, and a reduction in our underweight to Resources at the expense of some of the more stable infrastructure companies like Transurban and Sydney Airport, we believe we have included some of the early beneficiaries of stronger financial markets and improving consumer sentiment.

Traveller's tales

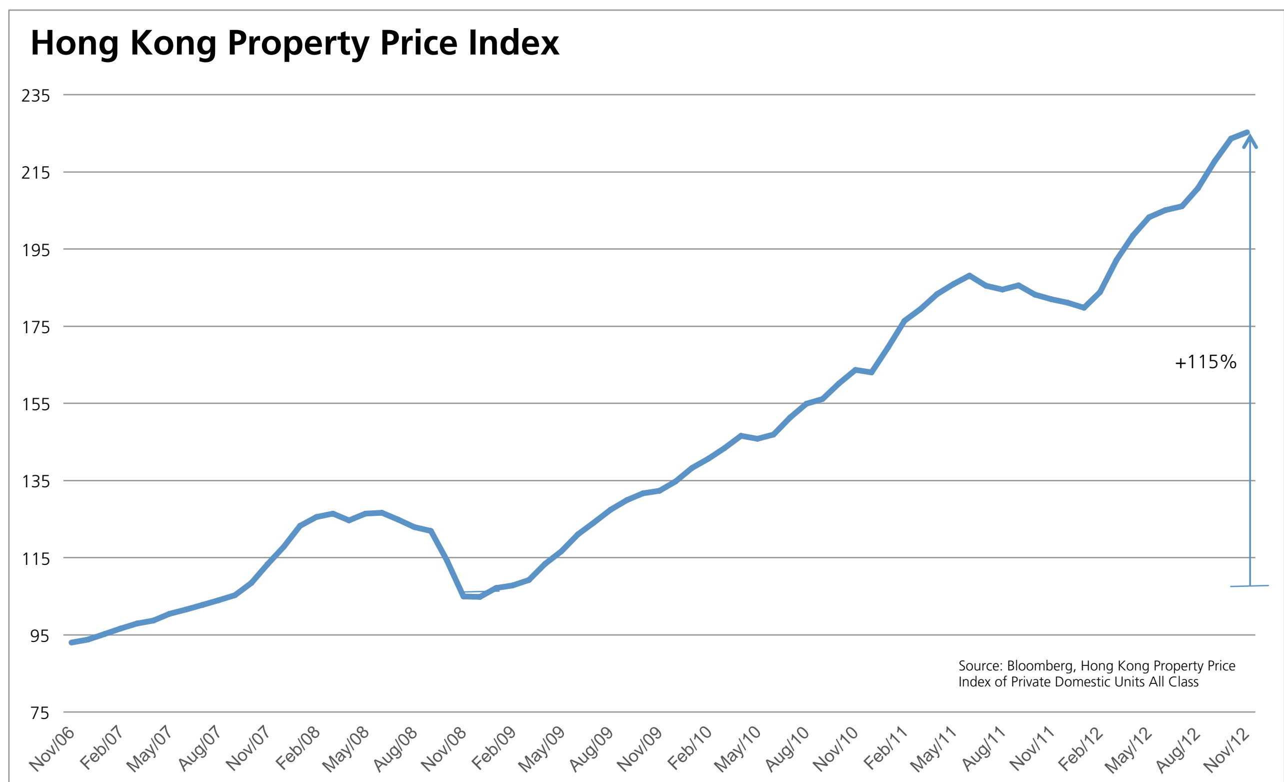
Andrew was travelling through Singapore and Hong Kong recently and noticed everyone talking about the special measures being put in place to curb housing price growth. These include limiting mortgage terms to maximum 30 years in Hong Kong and 35 in Singapore (they were longer than that?!!), limiting mortgage payments a maximum 40% of buyers' monthly incomes for Hong Kong investment properties and increasing stamp duty in both regions.

This compares to Australia where the governments – state and federal – for all their posturing about affordable housing generally only ever intervene to increase prices by stimulating demand: first home owners grant for example. One can only imagine how long a government in Australia would last if its policy were to act to lower the value of peoples' Australian dream!

Places like Hong Kong are in a bit of a bind due to an unintended consequence of US monetary policy, which has been characterised by various iterations of so-called quantitative easing. When you have a pegged currency, as Hong Kong does, or interbank lending rates linked to US Federal Reserve rate like Singapore, you end up with extremely low lending rates. The formula of US-style monetary policy plus Asia-style growth equals asset bubbles, hence the direct housing intervention. The chart reminds us of the saying about a horse bolting and a door. Asset bubbles rarely end well.

Property prices in Hong Kong have more than doubled since the start of 2009 and are up by over 250% from the lows after the post-1997 property crash. The prior peak was in 1997, and prices fell by 70% over the following six years. In 2012, Hong Kong prices finally surpassed those 1997 peaks.

It does serve to put Australia's house price 'problem' into context. According to the Australian Bureau of Statistics, our house prices are up a (relatively) leisurely 16.9% in total or 3.9% p.a since the start of 2009. While official interest rates have fallen materially in the past year, those nasty banks have effectively been intervening on the government's behalf by not passing on the rate cuts in full, hence limiting the amount of stimulus being felt in the housing sector.



BTW

Being a millionaire in $US isn't quite the exclusive club that it once was, especially with the soft $US of recent years. Communist China has embraced capitalism with alacrity, to the extent that millionaires are just about ten-a-penny: the new big thing is to be a billionaire. According to that font of all knowledge, Wikipedia, there were 95 billionaires in China in 2012, the third-most of any country. The US had the most with 425, and Russia had 96, only one more than China.

From there the number dropped almost by half: Germany had 55 and India 48. Hong Kong had 38, Taiwan 24 and although Macau doesn't get a mention we're quite sure it has a few, so Greater China could easily claim second spot with about 160. On a per-capita basis China is still quite low with only 0.07 per million citizens; looking at it on that basis the winner was Monaco with 65 per million (of course it only has a tiny population so the total number of billionaires is 'only' two). The US had 1.3 per million people, about the same as Switzerland and Sweden. Belgium only had two billionaires.
So how does Australia shape up? With 18 billionaires in total, we come out at 0.76 per million. NZ is only a touch behind with 0.65: that's three billionaires in total (two of them are brothers, and all three made their money through 'investments'). Looking at the composition of how Australian billionaires accumulated their wealth there is, not surprisingly, a decent number of miners.

In fact five of the 18 were in Resources, four in Real Estate, and three in Finance (including one fund manager – nice one Kerr!). One each was from Gambling, Media, Health Care, Logistics, Construction and Retail. The average wealth was $US3.6 billion, and the average age was 61. Average happiness was not recorded but, from what we see in the press, it is fair to assume that their family lives are no less dysfunctional than the rest of the population, and quite possibly more in some cases.

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