Alphinity Concentrated Australian Share Fund

QUARTERLY REPORT – DECEMBER 2024

Not with a bang...

Market comment

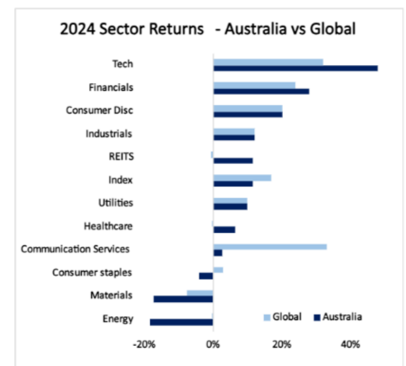
The Australian share market lost November's solid gain in December bringing its total return over the quarter to -0.8%, an ignominious finish to the year. Although it ended with a whimper, 2024 was a great year overall for equity investors, both here and offshore. Our market (ASX300 including dividends) returned 11.4%, a little better than the ~9% per annum it has averaged since 2010. The $A, which fell by 10%, from US69c to US62c over the year (5% on a trade-weighted basis), helped to produce extremely strong $A returns from some markets, including the US (+38%), Canada (+23%), Germany (+22%) and Japan (+19%). Regions best avoided, even in $A, were Brazil (-22%), Mexico (-18%) and South Korea (-11%).

Aside from election outcomes driving markets and the paucity of domestic earnings growth in half-yearly company reporting seasons, the modest response to the myriad China stimulus announcements was also a sign of the poor risk appetite in that region. Despite the announcement of numerous measures aimed at increasing fiscal spending and further easing of liquidity conditions, investors remained crowded in the safety of Chinese government bonds, the yields of which fell to a record low of 1.7%. While China's equity market enjoyed large gains towards the end of September, the lack of follow through, especially from offshore investors, suggests that market needs to see the economic data showing that these stimulus measures really are creating more domestic consumer demand.

The large divergence in fortunes here between the large Bank and Resource sectors was a theme throughout 2024. The ASX300 Banks index gained 31% while the ASX 300 Resources index fell by 19%, a 50% performance differential. This was a big issue for many value-style investors who were naturally underweight Banks, which have looked expensive for some time, while holding onto apparently cheap mining companies. Commodities have been generally weak this year, a trend that continued in the December quarter. Although the price of Oil rose a little in $US – a lot in $A – the $US price of copper fell by 11% over the quarter, while flat in $A. The prices of steel and key inputs, Iron Ore and Coking Coal, were also very soft as lack of demand in China and the increasing risk of punitive US tariffs weighed heavily. Gold didn't move much over the quarter in $US terms but was a lot higher in $A.

While the Federal Reserve Bank (Fed) cut US interest rates by 100bps in 2024, there was no reprieve for us.The Reserve Bank kept our rates at 4.35% all year, although recent commentary suggesting that inflation was moving towards target gave some hope that a February rate cut might come through. Things aren't as rosy across the ditch, with the Kiwis going into recession as its economy shrank 1.5% over the year.

Comparing sector performances for the year between Australia and global developed markets, Technology and Financials were the clear winners in both, while Materials and Energy stocks were consistent underperformers. Our Property stocks did much better, although this was largely driven by the outperformance of Goodman Group, which now exceeds 40% of the whole sector. Conversely our Communication Services sector did much worse: Telstra performed well over the year but was no match for names like Meta, Google and Netflix.



Portfolio comment

The Fund outperformed market pleasingly over both the December quarter and the whole year. The biggest contributors to returns were gaming machine maker Aristocrat Leisure, payments platform Block Inc, airline Qantas, IT service provider Technology One, accounting platform Xero, and insurer QBE; the main detractors were gold producer Newmont, retailer Super Retail Group and being underweight Commonwealth Bank. Over the year to December Aristocrat Leisure, data centre player Goodman Group, Technology One, big bank Westpac, financial platform Hub24, pallet pooler Brambles and insurer Suncorp were all strong contributors, as was not owning miners Fortescue. Main detractors for the year were miners Rio Tinto and BHP, Super Retail Group and gas producer Santos; being underweight CommBank and conglomerate Wesfarmers also hurt a little.

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)	-2.5	1.7	14.7	7.6	8.3	9.5	10.1
S&P/ASX 200 Acc. Index	-3.2	-0.8	11.4	7.4	8.1	8.5	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, 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

We should probably expect more subdued returns and higher volatility in 2025 than we experienced in 2024, given current valuations and the clouded macro outlook with economic indicators that can rapidly shift for better or worse. What is clear is that we are starting the year off a high bar, with the market having already rallied hard on expectations of multiple interest rate cuts as inflation declined, a better economic outcome than feared and expectations of pro-business and pro-growth policies under a Trump sweep. This euphoria, mainly anchored around the US, spread to our market, propelling the ASX300 to an elevated PE – around 19x – which, in order to be justified, either requires underlying earnings to catch up or for conditions to improve to the extent that future earnings growth looks better than it currently does. While expected earnings growth of only 1 or 2% for the whole market appears conservative and quite achievable, it is from a base that was continuously revised downwards throughout 2024 as macro uncertainties, higher interest rates and cost of living pressures impacted on companies' prospects.

While the level of hope is high, divergent macro scenario outcomes still abound. In the US, will Trump's "Make America Great Again" program, which likely includes tax cuts, increased fiscal spending, lower administrative burden and the acceleration of projects, lead to a lift of earnings? Or will immigration cuts and higher import tariffs keep the inflation genie out of the bottle requiring a more hawkish Fed, abating the propensity to spend? The equity market seems to think Trump will lead to economic growth for the US yet the bond market appears more circumspect, concerned it will lead to higher inflation, higher rates or more US government debt. The lift in bond yields since his nomination has highlighted the increased inflationary and deficit risks. Which is right? It will likely depend on one's time horizon but also on the sequence, pace and extent to which each lever gets pulled, and the flow-on to underlying earnings growth which, apart from the high-flying large technology stocks, has so far been quite muted.

Are we entering a new stage of international trade tariff wars that will sap global growth, or will deals and compromises be found? The response from China will be particularly relevant to Australia. Will president Xi cut a deal with Trump whereby tariff increases are partially replaced by promises of increased investments in the US, or will the rhetoric between these two giants escalate? How will this affect the type of measures China will unleash domestically to support its economy and address its deflation challenge? The response from China will be particularly relevant to Australia. Our view is that China is very determined to implement measures to lift the confidence of its consumers and their propensity to deploy their savings. While the bulk of these measures will be revealed at the March National Party Congress, more will be kept in the tank depending on how its negotiations with the US play out. Regardless, a meaningful infrastructure boost is unlikely so commodities are in for a volatile ride. Tariffs and the strong $US are clear headwinds, but counter measures may provide some relief.

Here too the dynamics are complex, with a tightly-contested election imminent, ongoing cost-of-living pressures and clouds over how the US-China dynamic will unfold. While the timing and extent of interest rate cuts is uncertain given our resilient labour market, it will provide some cushion/ growth tailwind when exercised by the Reserve Bank, as will the record Federal government spending over the next few years.

While our market valuation is elevated, its composition is challenging with Bank valuations trading at record highs despite scant earnings growth over the next couple of years. While the Bank trade began to run out of a bit of puff into the end of the year, there is the potential for a more material rotation away from banks after such a strong run, although the timing and trigger points are harder to call: a constructive China-US resolution supporting Resources as an alternative, or rate cuts supporting the Consumer and Property sectors? It is unclear, but in order for the rotation to happen in a sustainable manner, an underlying earnings leadership shift needs to take place as the Bank outperformance in 2024 was ultimately underpinned by their almost lone role in driving earnings upgrades for much of the year.

The market is starting the year with high expectations but there are significant unknowns that will progressively play out through the year. While the market speculates on economic outcomes, volatility is likely to lift. For any market or sector shift to take place in a sustained manner, it needs to be underpinned by earnings and this is where the strength of Alphinity's investment process comes through: not trying to forecast macro and/or multiple shifts but focusing on what we can measure and assess bottom-up through our on-the-ground research: company earnings.

Portfolio outlook

While the portfolio was well positioned through 2024 to generate robust alpha for our clients, vigilance is required as we enter 2025. The market appears expensive and values are not well supported by underlying earnings growth. All sectors other than Banks, Insurance, Property and Utilities have been experiencing negative earnings revisions for several months and, while we expect that the macro outcomes described above will trigger the next earnings leadership shift, we suspect this could take time to play out. Thus we are maintaining a fairly balanced, defensive portfolio skew given the wide range of possible outcomes. Stretched valuations also means that we have to back our positions with larger than usual conviction in the earnings surprise investment case, as we have found that companies that disappoint are generally punished by both multiple and earnings compressions: these are the growth traps we aim to avoid.

We retain a positive outlook on the Insurance sector but have taken some profits as we believe we are nearing the end of the premium rate increases cycle. Underwriters will still benefit from margin expansion thanks to lower claims cost inflation but top line growth is certainly slowing. We have exited Steadfast, an insurance broker mainly exposed to that top line, and have trimmed our other insurance exposures.

We have continued to trim Bank exposure to be a moderate underweight. The share prices of Banks have been supported by their positive relative earnings revisions, albeit they remain close to zero absolute growth so their performance has actually been mostly from multiple expansion. We may be close to a growth valuation trap in the Bank sector and see better opportunities elsewhere, but are timing our trimming carefully in light of their positive earnings momentum relative to the rest of the market.

We remain underweight the Australian consumer, both staple and discretionary, due to the ongoing cost of living pressure favouring promotions and down-trading, although we do maintain some exposure to the US consumer through companies like Aristocrat Leisure. We recently exited our long-standing and highly successful holding in CAR Group, operator of carsales.com, due to its strong share price which led to little upside to valuation, another change reflecting discipline. We will remain vigilant through 2025 for any sign of the consumer turning around, which might be driven by the commencement of a rate cutting cycle or by extra fiscal stimulus from the government, depending on the election outcome.

We maintain an underweight to Resources and Energy as costs continue to disappoint and commodity price expectations remain too high, putting more pressure on earnings. The strong $US and threats of trade wars are not helping either. We have been selective in our commodities exposure, preferring base metals and gold over lithium and bulk producers at this stage. Given the significant performance lag of these sectors and their relatively undemanding valuation, we are keeping a very close eye on market expectations and demand/supply fundamentals in order to identify any earnings turning points.

Earnings continue to look reasonably robust in Tech, as they do in the subsectors of Healthcare that we have added to recently. We hold idiosyncratic over-weight exposures across both sectors. This is also the case across sectors such as Industrials and Materials, where we have selectively added further to positions in those sectors which have more earnings upgrade potential. As always, we will adjust the positions in the Fund based on valuations and our conviction of future earnings surprises, a process that has proven to be successful over time.

We thank our readers for your interest and support over 2024 and extend, from the entire Alphinity Team, our very best wishes for 2025.

Top five active overweight positions as at 31 Dec 2024	Index weight %	Active weight %
Aristocrat Leisure Limited	1.8	3.6
Westpac Banking Corporation	4.6	3.6
Rio Tinto Limited	1.8	2.7
Goodman Group	2.8	2.7
Medibank Pvt Ltd	0.4	2.5

Asset allocation	31 Dec 2024 %	Range %
Securities	99.1	90-100
Cash	0.9	0-10

BTW

2024 will go down as a year of elections. There were polls held in countries containing more than half the world's population, and when you consider that about a quarter of the world doesn't even get to vote, a whole lot of democracy was exercised this year. In almost every instance, incumbents were either tossed out or bruised to a substantial degree. 19th century political philosopher Joseph de Maistre said "Every country has the government it deserves" – clearly many people think they deserved better! The exception was Russia, where Vladimir Putin was re-elected with 88% of the vote – an improvement even on his 77% support in 2018 – despite prosecuting a war that hasn't been going that well.

In the US, Biden crashed and burned in the first debate and was jettisoned in order to give the Democrats a fighting chance, while Trump came with a lot of baggage, including legal accusations, convictions and judgements against him. But US voters – those who bothered to vote anyway – rejected "more of the same" Harris and returned to Trump resoundingly, to the extent that his party also now controls both the House and the Senate. Amazingly, accusations of voter fraud and a rigged election have evaporated since the result and a peaceful transfer of power in January seems inevitable.

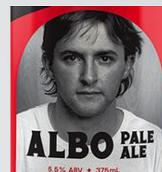
The UK was interesting, if only because it took one of the few shifts to the political left in 2024. The Conservative Party was replaced by Labour mid-year after its worst election since 1832, collecting just 23.7% of all votes and losing 251 seats. 211 of these went to Labour, giving it enough to form government. New PM Sir Kier Starmer had won a huge victory but his political honeymoon must have been the shortest ever and he was highly unpopular by the end of the year, possibly reflecting the dire economic and social state of post-Brexit UK and an unrealistic expectation on the part of the electorate about how quickly the new government could turn things around. It can't all be blamed on Starmer's recent call for Hamas to "return the sausages", embarrassing though that was!

Across the Channel, French President Macron scored an own-goal when he called a parliamentary election essentially to give the country a chance to prove it wasn't heading to the far right. Held three weeks prior to the Olympics, it proved quite the opposite and Macron was forced to cobble together an unholy alliance between two other parties in the centre and on the left in order to stave off the right – it is not a happy situation for anyone however, which has manifested in a couple of changes in Prime Minister since then, and possibly more to come. It would not be a great surprise to see another election held in France in 2025 although we expect Macron will do all he can to avoid it given what's happened elsewhere in the world.

South Korea also voted on its National Assembly in 2024, half way through then-President Yoon Suk-yeol's term. In December, in the midst of corruption allegations, President Yoon declared martial law which was not taken well by either the people or the parliament, and Yoon was impeached soon after. He was replaced by Han Duck-soo, a former PM, although Han was also impeached within weeks. It's not just the voters who are narky, legislators are too! Huge protests were taking place on both sides as we rolled into the new year, despite bitter winter weather in Seoul.

The big one however was in India. The most populous nation of all and by far the most populous democracy, 640 million Indian voters went to the polls in June. PM Narendra Modi started with 303 seats in the 550-seat parliament and seemed unstoppable during the campaign, talking himself up for a landslide of as many as 400 seats. As it turned out he didn't even get a majority: he only won 240 seats although he remains in power with the support of minor parties.

There are more elections coming in 2025, with likely drubbings for the incumbents in Canada and Germany. We will have a date with the (democracy) sausages ourselves: yes, it's almost three years since Albo took the top job. He won lots of seats in 2022 but only just reached a majority in the lower house, and missed out on one in the Senate. Australians have notoriously laid back attitudes about a lot of things but not politics it seems and recent polling won't give him much comfort: this election could be a tough slog. The opposition needs to win an implausible number of seats to get a majority in the lower house so Albo will likely retain government but he may need to rely on the support of Greens and/or Teals. Having said that, polls didn't see the size of the Trump swing either so anything could happen.



Why is the global electorate so grumpy? A common theme has been the cost of living. Inflation rose sharply under most of the governments on the receiving end of baseball bats this year, sharply crimping peoples' standards of living. The causes of that inflation are many but a key contributor was the huge amount of fiscal stimulus in the early part of the Covid pandemic, when many governments sprayed around cash in order to stave off the economic depression that could have been the result. The cash-splash worked but the consequences for the economies were harder to solve. Interestingly, one country that did not splash cash was China and its economy has been in the doldrums ever since; China doesn't have an inflation problem however, so maybe there's something in that.

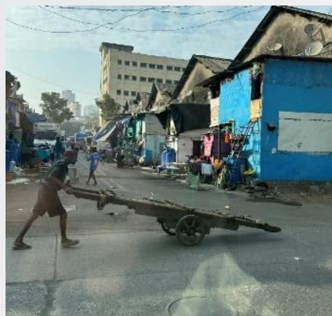
Earlier in the year, unaligned Washington-based think tank the Pew Research Center had surveyed the mood of voters in 24 democratic countries. It identified economics and inflation, as discussed, above as mood-killers, in addition to things like high levels of migration in many countries and frustration with out-of-touch political elites. 59% were dissatisfied with how their democracy was functioning, 74% said they didn't believe elected officials cared about what the people think, and 42% said no political party in their country represented their own views. Those are staggering proportions of populations to feel that the democratic process isn't working well for them. Maybe it helps to explain why strong leaders who tend to propose simple solutions to complex problems have found support in some countries? Only ten of the 24 national leaders had net favourable ratings, and Albo was one of the ten. That survey was taken well before Copacabana-gate and his opinion polls are much less favourable now!

Churchill once said, "democracy is the worst form of government – except for all the others that have been tried" and Pew confirmed that. Despite falling support, 77% of people still said that the representative democracy we enjoy is the best way to be governed. 70% said direct democracy (people voting on individual issues) had appeal; and 58% said technocracy (rule by appointed experts) did. Less favoured was having an autocrat (26%) or the military (15%) in charge.

Travellers' Tales

There was no pre-Christmas lull for the team and various members were traversing the world even in December, researching companies and looking for investment ideas. Jeff and Jess both headed to Asia, with Jeff proceeding on to the US. Before spending some brief Christmas holiday time with her family in Brisbane, Matisse went to the US to meet with companies in various cities and attend some conferences in New York.

Jeff and Jess spent two days in Singapore and three days in Mumbai (pictured). Singapore consisted of a series of meetings with financial companies and also with the management of French cosmetics company L'Oreal. They then spent two days with L'Oreal India at its annual capital markets day which included store visits, a consumer engagement session and various managements presentations.



Many large companies have signalled that India is a priority market, both for growth and as part of their supply chains. For example, Apple has just opened its fourth large iPhone manufacturing plant, French company Schneider Electric manufactures a lot of electrical components there, and companies like Microsoft and Amazon continue to expand data centre development. India also presents some particular ESG considerations, like human rights and gender equity, for both company operations and their supply chains. It was helpful to visit the country to understand better the local context, risks and opportunities.

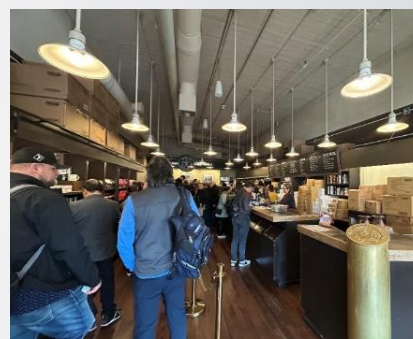
During one presentation it was said that there are two religions in India: Bollywood and Cricket, and we certainly saw evidence of Indian passion during the cricket test match series! From a consumer perspective, Indian people are tech savvy, deeply connected to the internet, prefer online shopping, want to receive their purchases fast, and spend up to three hours per day on social media. "Quick commerce" started in India and is now moving throughout broader Asia. This is ultra-fast delivery services, where there is 10 minute delivery of food, personal care and essentials/consumables. Goods are distributed within 3km of the order location from dark stores, which are restocked from larger distribution centres multiple times per day.

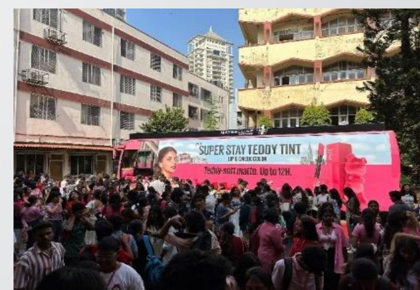
Like much of the Western world, consumers of beauty products in India are looking to influencers, social media, and elaborate product launches and market activations. Jeff and Jess attended the Maybelline Teddy Tint launch program (pictured on the right) in Mumbai.

They also met a store assistant working in a large pharmacy/general store who is placed there by Loreal to help customers find the "right" products, earning commission. Labour in India is abundant and inexpensive, and this was in evidence everywhere. Restaurants were overstaffed, people are employed just to push buttons in lifts, and at the hotel there was always someone jumping in to help with your bags.

Matisse's US trip focused mainly on consumer companies. She met with too many companies to list on this page, including Target, Krispy Kreme, Walmart, Starbucks, Wendy's, Williams Sonoma, Tesco, Marks and Spencer, Texas Roadhouse, Shark Ninja and Crocs – and that's only a few of them! She found a number of strong ideas to add to the 'bench' of stocks to be researched for possible inclusion in the Global Equity portfolio. Just as important, she also identified a number that are best avoided at this point in the cycle.

Pictured here → is the original Starbucks store in Seattle. She felt a real buzz at the Starbucks HQ, her impression was that the team feels energised and happy about the new and simplified strategy under its new CEO. No doubt there will be some easy wins through menu simplification and Starbucks margins could bottom out soon. The elephant in the room however is China, which has some challenges. The main issue in China seems to be that the value proposition of Starbucks' premium branding doesn't work as well as it does in other markets (we think that means it's too expensive). We Australians always chuckle smugly when we hear Starbucks being described as "premium", as its coffee was never good enough to make an impact here!





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