

In iso

Market comment

One of the more reliable phenomena in global markets is the Santa Claus Rally, during which markets generally rise strongly in the few weeks before Christmas. Like all such seasonal market trends, it happens every year except for when it doesn't. This year he was very late, the rally only starting on December 21st. Was he stuck in quarantine? Our market (ASX300 including dividends) was up 2.7% in December itself but only 2.2% over the quarter, closing out a nicely positive 2021. It recorded rises in ten months; only September and November saw small falls. Global markets did a bit better than ours over the quarter, with gains of 9% in the US and 5% in Europe and the UK. Asia lagged however, with Japan and Hong Kong 6% lower.

Australia was middle of the pack across 2021, returns being held back by our currency which fell 6% over the year, from \$US0.76c to \$0.725. Our 17.5% total return lagged the North American markets' ~30% and Europe's ~20% but did far better than many markets in Asia, including -17% for Chinese shares listed in HK, -13% for Brazil and -8% for Hong Kong itself.



The Omicron variant of Covid 19 was unknown at the start of the quarter but dominating news flow by the end with huge case numbers globally and locally but a lower occurrence of serious outcomes than the prior Delta strain. Arriving as it did during the northern winter meant a new round of shutdowns in a number of European countries. Delta had lost significant global market share by the end of 2021.

Commodity prices were generally firm over the December quarter. The bulks diverged somewhat, with Thermal Coal off 26% from its spike in September although at \$US170/tonne it is still considerably higher than the ~\$80 at which it started the year. Iron Ore fell 7% to \$US112/tonne, higher than its November lows but still -26% across the year. Conversely, Coking Coal, used in steel production, rose 6%. Base metals were quite strong across the quarter, with Copper and Lead both up close to 10%, Nickel and Tin both a little over 10%, and Zinc the clear winner, rising 20%. Oil prices were fairly flat although there were some huge intra-month swings, more than 10% in each direction, as demand expectations swayed with Omicron fear and relief.

From a sectoral viewpoint, the best returns came from Mining, Materials and Utilities, each of which returned 10% or more, while Energy stocks were the weakest, losing 8% and underperforming the oil price. Tech and Financials were also notably weaker, falling 5% and 3% respectively.

Portfolio comment

The Fund outperformed the market in the December quarter and for the whole of 2021. The best contributors were industrial property specialist Goodman Group, global asset manager Macquarie Group, diversified miner BHP, and plumbing products manufacturer Reliance Worldwide. Not owning credit providers Westpac or Afterpay also helped returns substantially. The only meaningful detractors were gas exploration company Santos and from not owning iron ore miner Fortescue Metals Group.

Macquarie Group was the biggest positive contributor to performance in 2021, followed by not owning Afterpay. Value was also added by long positions in Reliance Worldwide, building products firm James Hardie, Goodman Group, National Australia Bank and medical diagnostics company Sonic Healthcare. Not owning Telstra detracted from performance over the year, as did gas producer Woodside Petroleum.

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)	2.7	2.8	19.1	14.7	10.4	12.5	10.8
S&P/ASX 200 Acc. Index	2.7	2.1	17.2	13.6	9.8	10.8	9.2

*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 2021.

[^]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 13 51 53 during Sydney business hours.

Quarterly Report – December 2021

Alphinity Concentrated Australian Share Fund

Market outlook

As we say goodbye to 2021 the broader market themes remain the same: to what extent will economic growth slow in 2022, how much will monetary conditions around the world be tightened and what role will this and other iterations of Covid play in influencing both of the above? Slower growth and higher interest rates don't necessarily mean that equity markets cannot move higher in 2022 but as the starting point for valuations is relatively high, the market's tolerance of disappointment is surely limited.

While too early to be definitive, we see more risk that Central Banks have left it too late in "removing the punchbowl" and, as a consequence, might need to lift rates at a faster clip than the market anticipates, than we see risks to economic and corporate earnings growth. However, a careful balancing act will be required by the world's central bankers in order to rein in inflation without jeopardising growth in the process. Where Covid will take us is anybody's guess but the limited increase in hospitalisation rates so far despite the surge in infections is clearly encouraging. And even if governments and the general public are yet to fully learn to live with Covid it appears that the equity market is becoming increasingly comfortable in doing so.

Other events to consider is how China's economy progresses and the upcoming Australian election. It is interesting to note that while China's slowdown in the second half of 2021, which was partly policy driven and partly unintended, has been more severe than in the rest of the world, the Chinese Government is now taking noticeable steps to support growth through monetary easing. This is occurring at the same time authorities in the Western world are starting to tighten. Equity markets are as always forward looking and pro-growth policy settings in China should be supportive for Australia's commodity-leveraged share market.

An election tends to be an event that slows economic activity for the month or two leading in before things get moving again. With neither party likely to hold back on spending promises and an Opposition likely to avoid pursuing controversial policy agendas after the backlash it suffered at the 2019 election, it's hard to see that the election itself will be a major factor in determining equity market returns in 2022.

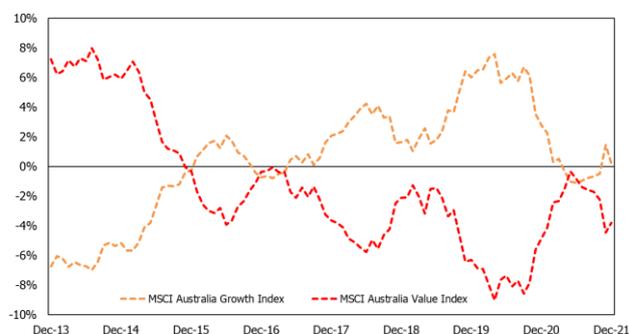
Top five active overweight positions as at 31 Dec 2021	Index weight %	Active weight %
BHP Group Limited	5.8	4.6
Macquarie Group Ltd	3.4	4.0
National Australia Bank Limited	4.5	3.8
Goodman Group	2.1	2.9
Aristocrat Leisure Limited	1.4	2.6

Portfolio Outlook

As active managers, our experience is that being discriminating in the companies we invest in and making incremental portfolio changes at the appropriate time can add considerably to returns relative to the "buy everything and hold" strategy adopted by index investors. This is demonstrated by the returns in excess of the benchmark that our Funds have delivered over the history of the company.

Following a year of pleasing returns, especially for cyclical stocks, and with some cracks emerging in the trend of relentless outperformance of expensive growth stocks, a well-diversified portfolio like ours with a firm quality and/or defensive bias seems like a good place to start the new year.

As we look into 2022, we will of course be mindful of macro events such as those described above but our primary focus will remain on owning individual companies with their own performance drivers as, in our experience, these tend to have a more reliable ability to add value than trying to get the big-picture issues right. By not tying ourselves to a growth or value style, too, we aim to avoid long periods of underperformance when that style is out of favour. The chart below shows the relative performance of growth and value stocks and you will observe that cycles can go on for years.



January is usually a quiet news period for domestic companies, most of the time any big moves that take place will be generated by developments offshore. The interim reporting season in February however will be an important time when we get more detailed information about how the companies we own, or are considering owning, have performed; what management is thinking about the coming period; what competitors are saying and so on. We will be testing the theses of all our positions and making adjustments as necessary.

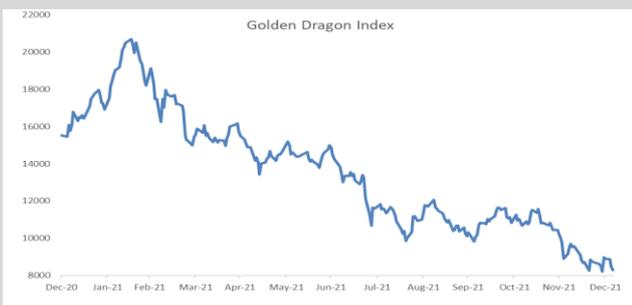
Asset allocation	31 Dec 2021 %	Range %
Securities	98.1	90-100
Cash	1.9	0-10

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BTW

We are often critical of media reporting on financial markets. On the evening TV news, for instance, helpful context is rarely given: “\$100 billion wiped off the share market”, when that represents a very small fraction of its total value. Or when modest moves in a company’s share price are often described with hyperbole unjustified by the magnitude of the change. A company is said to have “plunged” or something similar when its shares had fallen by 2 or 3%. That’s not a plunge: this is a plunge!



The US stock market finished the year at all-time highs but the NASDAQ Golden Dragon China Index, a hundred or so US-listed companies based in or primarily exposed to China, is down 60% from its February peak. What’s been going on? As always, it is a number of things. In the final months of the Trump presidency there was a push among an anti-China cabal to stop Chinese companies from accessing the deep, liquid US capital markets. Part of this was purely political, trying to deny China’s inexorable rise, but there were also some valid concerns around the quality of financial accounts and differences in audit standards that meant US investors were not always fully aware of the true financial situation of these companies. Apparently Chinese data laws will not allow the financial quality control demanded of US companies.



There were also some things China did to make investors nervous. First there was the disappearance in 2020 of Alibaba founder Jack Ma, which we reported on recently; then came the Didi debacle in June, when China’s Uber-equivalent raised more than \$US4 billion of capital and listed on Nasdaq without the proper approval of the Chinese government. China promptly banned Didi’s local app. People who had bought Didi shares were justifiably annoyed and the spectre of sovereign risk was raised. Didi’s \$US14 shares halved immediately and were trading below \$5 by year end.

Then there was the education shambles. That same month the Chinese government abruptly declared that companies

providing childhood education services needed to become non-profits. It was pitched as an effort to reduce the cost of child-rearing and encourage people to have more children, but however a huge issue for investors who had provided many billions of dollars of capital to fund companies providing education services. Companies like New Oriental and TAL Education Group lost more than 90% of their value over the year.

August saw a further blow to China-related tech stocks when the government cracked down on gaming, a move apparently designed to protect children’s mental and physical health. Gaming addiction is a troubling issue in China, with more than 30 percent of Chinese children reportedly affected. The new restrictions were that children under 18 can only play online games on Fridays and Saturdays between 8pm and 9pm and on public holidays. Maybe we don’t have the same degree of gaming addiction here, but could you imagine trying to enforce such rules on Aussie kids?! Despite the good intentions, gaming stocks fell sharply.

Then of course there was Evergrande, the large Chinese apartment developer which we reported on in October; it was still teetering on the brink at year end. Being listed in Hong Kong it is not part of the Golden Dragon Index but the uncertainty hit the values of anything vaguely related to Chinese property and increased general distrust around all China-exposed companies.

Former Chinese premier Deng Xiaoping supposedly said, back in the 1970s, “To be rich is glorious.” However, it has also become a bit dangerous to be rich in China, there is an active government campaign to discourage ostentatious behaviour. In December internet celebrity Huang Wei, who does live-streamed videos to sell products or services received a big fine. She had tens of millions of followers and was hugely successful until authorities accused her of evading taxes and fined her about \$A300m. She humbly apologised but that didn’t stop her online presence, something that took her many years to generate, being erased the day before she was due to hold a huge cosmetics promotion. Some say the Party is “killing the chicken to scare the monkeys” – i.e. taking out a minor player to show that no one is out of reach.

The uber-wealthy class in China also had a tough year in 2021 with the ten biggest tech billionaires losing more than \$A100 billion according to some reports. The biggest individual loser was agri-tech company Pinduoduo’s Colin Huang whose net worth fell a massive \$A60 billion in 2021. He’s hardly on struggle street, however, with \$30 billion or so remaining. \$30 bill might be enough for you and me but in those echelons the number is more of a scorecard than anything else, so the shame and loss of face is probably more significant than any actual loss.

Travellers' Tales

One of the challenges of working in an organisation with such great cultural diversity is that, especially this time of year, people tend to want to go overseas to see family. That was particularly the case in 2021 after two years of inward and outward restrictions. So a number of Alphinites braved Omicron and headed offshore in December.

First to go was Andrey who headed to geopolitical hotspots Russia and Ukraine early in the month. He reported pleasant travel conditions – not many people in the airports and on planes – but was a little disappointed that the spa in the first class lounge in Dubai was closed (a first world problem!). In Moscow there were few signs of mask-wearing on the Metro as fines for non-compliance were not being enforced.



Stuart went to visit his in-laws in London a few days before Christmas. Also flying via Dubai his plane was packed but, despite testing negative before departure, he ended up being confined to quarters for much of the time after receiving a positive PCR test on arrival at Heathrow. He experienced no symptoms at all and was released after the obligatory seven days, returning home in January with no after effects.

Stephane headed to Covid hotspot Brussels, where even the [hippos](#) in the zoo have had it. He left Sydney just after Christmas and observed a degree of caution being shown→ by duty free shoppers during a stopover in Dubai. Perhaps it would have been best if he'd followed suit though as a week into his trip he received a positive RAT, curtailing his plans despite feeling physically well.

Johan headed for Sweden via Austria the week after Christmas and he too picked up the bug, spending his first few days isolated from the family he had gone half way around the world to see. He had no noticeable symptoms at the time of writing though. We are grateful and encouraged however that our three globe-trotting positives, all (relatively) young, (relatively) fit and (relatively) without underlying health conditions, have suffered either no or only mild symptoms. If that's the worst Omicron can do, it's not that bad. Of course we know it can be a lot worse so we don't take it that lightly. But with a 75% hit rate we can't help concluding that it might be best to leave international travel for a while. Sorry about that Qantas!

Whatever privations our colleagues have been through, however, it can't have been worse than the experience of US pre-school teacher Marisa Fotieo. Part-way through her Icelandair flight from Chicago to Reykjavik on December 21 she felt unwell and took a Covid test. Showing positive, she made the noble decision to isolate herself for the rest of the journey from the other 150 or so passengers in one of the plane's toilets. She made a Tiktok video of her



experience which soon racked millions of views. We've all been in those cramped aircraft toilets and a few minutes is about the maximum tolerance most people would have. Marisa was in there for five hours, comforted only by a supply of food and drinks from flight attendants. She deserves a medal.

For further information, please contact:

Fidante Partners Investor Services | p: 13 51 53 | e: info@fidante.com.au | w: www.fidante.com.au

Fidante Partners Adviser Services | p: 1800 195 853 | e: bdm@fidante.com.au | w: www.fidante.com.au

Alphinity Investment Management | w: www.alphinity.com.au