

Quarterly Report July 2022

Performance ¹	Quarter %	6 months %	1 year %	3 years % p.a	5 years % p.a	Inception % p.a ²
Fund return (net)	3.7	-6.7	-3.5	12.2	14.7	12.4
MSCI World Net Total Return Index (AUD) ³	0.5	-8.5	-4.3	12.3	11.8	10.6
Excess return ⁴	3.2	1.8	0.9	3.4	2.9	1.8

Fund facts

Portfolio managers	Jonas Palmqvist, Jeff Thomson, Trent Masters, Mary Manning, Chris Willcocks.
APIR code	HOW0164AU
Inception date	21 December 2015
Investment objective	To outperform the MSCI World Net Index (AUD).
Management fee	0.75% p.a.
Performance fee	10% of the excess return of the Fund above the Performance Benchmark (MSCI World Net Return Index (AUD)) and only paid if performance is above the Performance Hurdle (Reserve Bank of Australia cash rate target). Any negative or unpaid performance is carried forward to the next period. ¹
Buy/sell spread	+0.25% / -0.25%
Fund size	\$275m
Distributions	Annually at 30 June
Min. Investment	\$10,000
Max. cash position	20%

Fund features

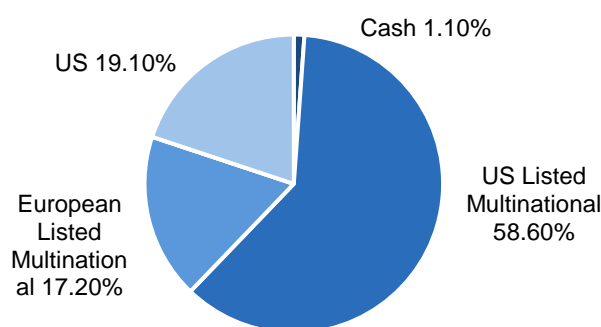
Concentrated: A long only, concentrated portfolio of 25-40 of our best ideas, highly diversified across sectors and regions. A truly global fund consistently exposed to powerful trends reshaping our world.

Discipline: A disciplined process finding quality businesses with strong earnings that are under appreciated by the market. This approach has proven successful across different market cycles.

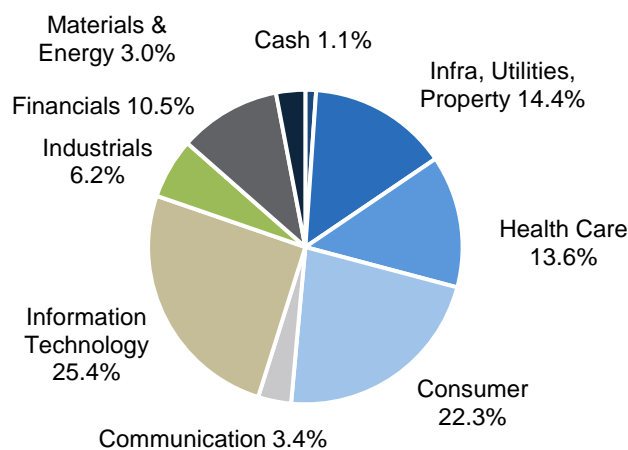
Talent: A united and deeply experienced team of global portfolio managers each with an average of 22 years of financial experience.

Aligned: Alphinity Investment Management is a boutique firm, strongly aligned with its clients' investment objectives and focused solely on growing clients' wealth.

Geographical exposure



Sector exposure



Top 10 positions

Company	Sector	%
Microsoft	Info. Technology	6.1
NextEra Energy	Utilities	6.1
LVMH Moët Henne	Consumer Disc	5.7
American Tower	Real Estate	4.7
Apple	Consumer Disc	4.7
Danaher	Health Care	4.5
Keysight	Info. Technology	4.4
Deutsche Boerse AG	Financials	4.0
ASML	Info. Technology	3.9
UnitedHealth Group	Health Care	3.8
Total		48.0

Data Source: Fidante Partners Limited, 31 July 2022

¹ Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

² The inception date for the Fund is 21 December 2015

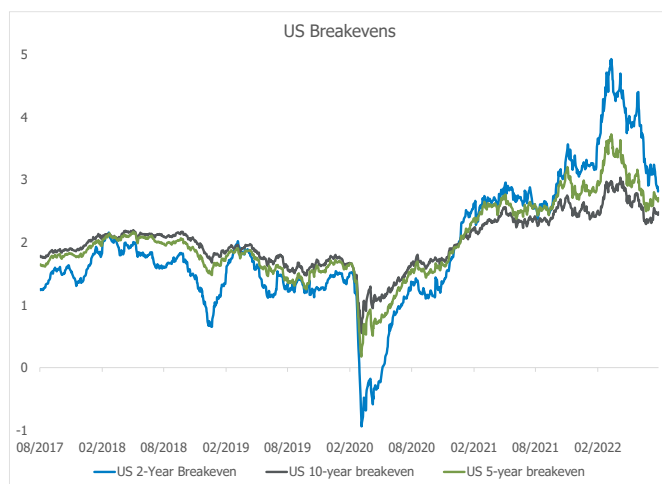
³ From 21 December 2015 to 30 April 2019, the Benchmark was the MSCI World Equity ex Australia (Net) Index. The current index is effective from 1 April 2019.

⁴ Numbers may not add due to rounding

Market comment and outlook

With pessimism among investors at extreme levels, and surveys claiming average cash holdings at 20-year highs, the backdrop was set for a rebound in equities on any hint of positive news. This positive news was somewhat perversely delivered in the form of weaker economic data, with an increasing view that rate hikes could be less aggressive than previously expected. The degree of under-positioning in equities and a 'better than feared' start to earnings season in the US and in Europe, led global stocks up 6.8% in AUD terms. The US S&P 500 index rallied 8% (AUD) in July, largely driven by a sharp rebound in Tech stocks, while European shares relatively underperformed (Euro Stoxx +3.7%) and Asian stocks were among the weakest performers with China's Shanghai Composite falling 5.8% in AUD terms.

Inflation expectations have already fallen sharply



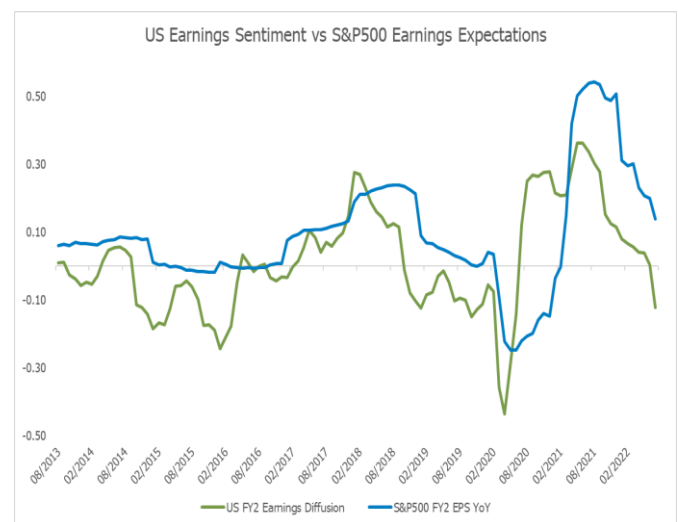
Source: Bloomberg, 31 July 2022

In terms of global sector performance, Consumer Discretionary (+14.3%) and Tech (+12%) were the best performers, while Consumer Services (2.1%) and the more defensive Healthcare (2.2%) and Consumer Staples (2.8%) lagged as a fall in bond yields drove a rotation back into higher growth sectors. With most companies in the US having reported Q2 earnings, earnings have come in 6.1% ahead of expectations, below the previous quarter beat of 7.3% but still better than feared heading into July. Over the past month in aggregate there was a slight upgrade to global FY22 earnings, bearing in mind this is inclusive of Energy which is still experiencing outsized upgrades.

Economic activity continued to deteriorate in most regions, with European manufacturing data (PMI) contracting to 49.4, the steepest decline recorded in Germany. Importantly, forward-looking indicators hinted that deteriorating conditions may still lie ahead.

Composite new orders fell to 46.9 (-3.1 pts) and new export orders also fell to 43.7 (-3 pts), suggesting further slowdown in activity is likely. The US raised rates by 75 basis points as expected, but against the backdrop of sluggish activity, the market was quick to pounce on any language from the Fed suggestive of a pivoting stance to less aggressive hikes going forward. The market also took a large increase in July nonfarm payrolls (+528k vs +250k expected) in its stride, showing resilient performance in the face of stronger print. A slightly lower than expected CPI print for July boosted markets, and despite year-on-year CPI running at 8.5% in the US, any hint of peaking inflation could provide further support.

Earnings Revision Breadth pointing to more downside pressure on earnings expectations



Source: Alphinity, Bloomberg, 31 July 2022

Portfolio comment and outlook

Overall, this is a challenging macro-economic and geopolitical backdrop, and we expect financial markets to remain volatile. The global earnings cycle has also continued to weaken, with negative revisions to forecasts across nearly all sectors and regions. Despite this, analysts still expect a rebound in the second half of the year, with earnings growth seen to recover to over 10% over last year. Based on the reporting season, and our own recent global research trips, we see further downside risks to these market expectations.

One big factor are the continued cost pressures impacting margins across a wide range of sectors, but also likely 'demand destruction' as inflation and higher rates undermine confidence and purchasing power. However, a negative global earnings cycle is not automatically a call on the overall market direction from here.

However, a negative global earnings cycle is not automatically a call on the overall market direction from here. It's worth noting that even after the July rally, market valuations are still noticeably down from the peak, with the 12-month forward p/e multiple for S&P500 having fallen from 23x to 17x.

Valuations have already derated significantly



Source: Alphinity, Bloomberg, 29 July 2022

With risks of negative earnings surprises elevated across the market, we believe having a relatively concentrated portfolio with high conviction ideas will continue to be important for performance. Portfolio changes during July were relatively limited, but with fresh information and insights from the second quarter reporting season, the portfolio has continued to evolve to reflect the changing earnings leadership in the market.

We added L’Oreal to the portfolio during the month, a high-quality growth compounder where the strong second quarter is driving positive earnings upgrades. Within Consumer Staples we continued trimming our position in Nestle after strong performance. We also sold down our holding in Merck, another quality defensive stock which has performed well, and where the earnings case now appears increasingly appreciated by the market. We added to the position in Danaher after its quarterly report quelled fears about a slowdown in demand from biotech clients, and the impact from Chinese lockdowns.

The range of potential macro-outcomes remains wide, and we aim to construct a diversified portfolio of high-quality stocks, with the most reliable and misunderstood earnings outlooks. The companies’ ability to navigate the challenging combination of rising cost inflation and slowing economic growth, strong balance sheets, and reasonable valuations should be key factors in the second half of the year.

What’s on our mind – When the tide recedes

Warren Buffett famously said that only when the tide goes out do you discover who has been swimming naked.

We have been hitting lower tides in recent months as the world of ‘free money’ comes to an end, which is exposing ‘naked’ companies and assets that have crashed.

The low tide is however also highlighting great companies with strong management teams that are suited up to steer their customers – and investors – to safety during these difficult times.

Great management teams can navigate challenging periods like the present and come out stronger on the other side.

There are many examples of best-in-class management teams represented across our Global funds and several management teams that have specifically done a phenomenal job managing the increasing risks. We can commend the teams at McDonalds, PepsiCo, Diageo, and Waste Connections.

In this note, Elfreda Jonker, looks at the lesser-known team at Waste Connections in the USA.

Waste Connections (WCN) - – Pragmatic & differentiated Waste Connections is the 3rd largest solid waste services company in North America. They provide non-hazardous waste collection, transfer, and disposal services to millions of customers across the US and Canada. WCN was founded by the current Chairman and this entrepreneurial culture runs deeply through the organization.

WCN runs a decentralised structure where decisions and PNL responsibility is pushed out of HQ and down into the operating businesses around the country. You often see this type of management structure in Scandinavian capital goods companies, but we rarely see it in the US. If done well, it creates a dynamic and flexible business that can respond rapidly to a changing environment.

With the challenges that the waste companies have faced over the past 6 months, this approach has been a meaningful advantage for Waste Connections. We see the outcomes of this decentralisation through their industry leading margins and cashflow generation.

Please visit our website for the full note: [When the tide recedes - Alphinity](#)

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