



Signatory of:



# MORPHIC ETHICAL EQUITIES FUND

## Monthly Report February 2018

### Fund Objective

The Morphic Ethical Equities Fund Limited (the Fund) seeks to provide investors a way to grow their wealth and feel confident they do so without investing in businesses that harm the environment, people, and society.

The Fund excludes direct investments in entities involved in environmental destruction, including coal and uranium mining, oil and gas, intensive animal farming and aquaculture, tobacco and alcohol, armaments, gambling and rainforest and old growth logging.

### Investment returns

	1 Month	3 Months	6 Months	ITD
Morphic Ethical Equities Fund <sup>1</sup>	0.15%	-0.34%	11.66%	9.46%
Index <sup>2</sup>	-0.45%	0.18%	11.02%	10.90%

### Ethical Investing in Focus

March sees International Women's Day, which seems to grow every year in its awareness. Last year it was the [State Street statue in front of the bull in New York](#) that garnered all the attention. Some in the Funds Management industry see gender diversity issues as peripheral. Morphic, as the manager of the Morphic Ethical Equities Fund, sees them as good investing sense. Bank Of America Merrill Lynch in a study this month shows that high ESG scores on board and gender diversity are correlated with better returns for shareholders and lower risk for investors. So whether it is due to good companies hiring more women, or women making a company better, what is clear is that you invest in the opposite at your peril. This is why Morphic continues to work with the companies we own in Asia, who traditionally have even lower portions of women at senior levels, to encourage them to see it as good business practices.

### Portfolio review

The Fund rose 0.15% in February outperforming a falling market. Global markets were down 4.4% in USD terms for the month, but a falling Australian dollar (-4%) offset the Index' fall (-0.5% in AUD).

It was a wild ride in February with markets down 7.6% at one stage, on fears of rising interest rates, which then led to technical selling after some volatility funds experienced heavy losses. Despite the fall, global markets remain +1% for the year. Europe fell the heaviest over the month (-6.1%), along with Asia (-4.9%). Japan was the best performer (-1.5%). Energy was the worst sector globally (-8.6%) and tech hardware (+1.8%) was the only sector with a positive return for the month.

The Fund was able to outperform against this volatile backdrop. Investors Cloud in Japan was our top performer over the month. The Fund added to its position during the market sell-off and reduced it later in the month after the stock rallied over 40%. We were able to meet with the founder on his recent roadshow trip to Australia and we remain very impressed with the business he has built. Nonetheless, at over 30x P/E, up from 16x when we bought it, the market is "baking in" most of the good news.

Macromill in Japan was the second largest contributor over the month. The market has digested the sell down from Bain with remarkable ease thus far. However, valuation is becoming a concern and the position has now been scaled down.

Our largest detractor was our position in Japanese construction company Hazama Ando. After the company reported soft quarterly results and a weak order book, the stock sold off heavily. We have reduced the size but await a one-on-one in Tokyo to decide whether this is transitory or of longer term concern.

### Net Tangible Assets (NTA)

Net tangible asset value before tax <sup>4</sup>	\$ 1.1531
Net tangible asset value after tax <sup>4</sup>	\$ 1.1381

### Key Facts

ASX code / share price	MEC / 1.01
ASX code / option price	MECO / 0.020
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee <sup>3</sup>	15%
Market Capitalisation	\$ 46m
Shares Outstanding	45,479,227
Options Outstanding	43,402,026
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

### Outlook

After a [highly volatile start](#), markets did stabilise and rose over the month from the lows. Our view is that markets trade in a wide band as the competing forces of higher interest rates are globally pushing against a tailwind of rising earnings forecasts.

The median 2018 EPS growth for Asia is currently 17%, suggesting earnings are rising at 1.4% *per month*. If P/E stays constant, a simple calculation suggests markets will rise by 17% this year. Although in the past, this sort of EPS growth and valuation saw Asian markets rise by 24%.

We remain of the view that the tailwind of higher earnings will push markets to new highs later this year. A disorderly bond market is still a risk, although bond investors don't seem worried about it as bond volatility remains low.

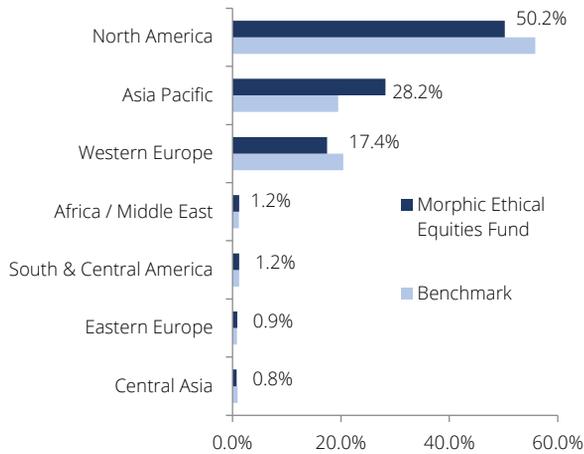
Some hedges are in place, with the Fund long the Yen, as the Yen tends to do well in "risk-off" environments. Reflecting the more constructive stance, the Fund remains fully invested.

## Top 10 Active Positions

Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	4.1%
China Everbright Intl	Environmental & Facilities	Asia Pacific	3.1%
Service Corp	US Deathcare	North America	2.6%
Panalpina	Global Freighters	Europe	(2.4%)
Macromill	Global Research	Asia Pacific	2.2%
Open House	Japanese Homebuilders	Asia Pacific	2.1%
IRB Invt Fund	Indian Infrastructure	Central Asia	1.9%
DSV	Global Freighters	Europe	1.8%
Bank of Internet	US Quality Banks	North America	1.7%
Haseko	Japanese Homebuilders	Asia Pacific	1.4%

Hedge Positions	Risk Limit Utilisation (%) <sup>6</sup>
Long Japanese Yen	1.2%
Short Bonds	0.9%

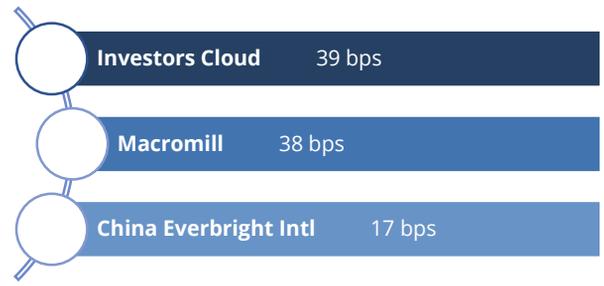
## Equity Exposure Summary By region



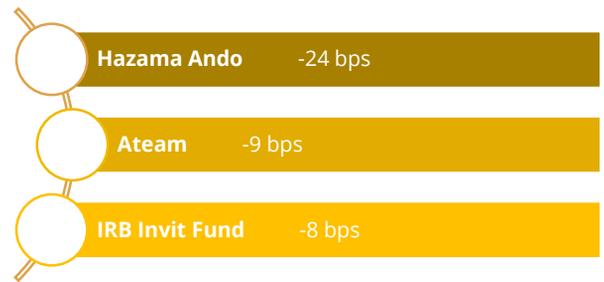
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<sup>1</sup> Performance is net of investment management fees, before company admin costs and taxes; <sup>2</sup> The Index is the MSCI All Countries World Daily Total Return Net Index (Bloomberg code NDUEACWF) in AUD; <sup>3</sup> The Performance Fee is payable annually in respect of the Fund's out-performance of the Index. Performance Fees are only payable when the Fund achieves positive absolute performance and is subject to a high water mark; <sup>4</sup> The figures are unaudited; <sup>5</sup> Attribution; relative returns against the Index excluding the effect of hedges; <sup>6</sup> As a percentage of the Fund's Value at Risk (VaR) Limit; <sup>7</sup> Includes Equities and Commodities - longs and shorts are netted; <sup>8</sup> Includes Equities, Commodities and 10 year equivalent Credit and Bonds - longs and shorts are not netted; <sup>9</sup> VAR is Value at Risk based upon the 95<sup>th</sup> percentile with a 1 day holding period using a 1 year look back.

## Top three alpha contributors<sup>5</sup> (bps)



## Top three alpha detractors<sup>5</sup> (bps)



Risk Measures	
Net Exposure <sup>7</sup>	104%
Gross Exposure <sup>8</sup>	135%
VAR <sup>9</sup>	1.12%

## Equity Exposure Summary By sector

