

MORPHIC ETHICAL EQUITIES FUND

Monthly Report
August 2018



A proud founder of:



Signatory of:



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	1 Year	ITD (p.a.)
Morphic Ethical Equities Fund ¹	2.84%	3.19%	4.83%	17.05%	10.90%
Index ²	3.60%	8.04%	10.06%	22.19%	16.16%

Ethical Investing in Focus

Responsible Investing continues to gain momentum amongst Australian investors. According to the Responsible Investment Association Australasia (RIAA) more than half of all professionally managed assets systematically consider Environmental, Social and Governance (ESG) as well as ethical factors across their portfolios.

RIAA's 2018 report found that \$866 billion was managed as responsible investments at the end of 2017, representing a 39% growth from 2016, with ESG factors positively impacting portfolio performance and serving as the greatest driver of its growth. With ESG considerations fully integrated into our investment process and with a high level of transparency, Morphic is proud to be a leader of this movement with our Funds available to Australian investors certified as ethical investments by RIAA.

Portfolio review

The Fund rose 2.8% in August, trailing global markets for the month (3.6%). Global markets were up 0.6% in USD terms, with a significant fall in the Australian dollar providing the difference.

Despite continuing uncertainty surrounding trade wars, a strong US earnings season supported a rally in the US (+3.1%), and Tech stocks bounced globally. In contrast, cyclical regions (Emerging Markets and Asia Pac ex-Japan) and old world cyclical sectors (Energy and Materials) underperformed the global index as investors showed a preference for earnings stable assets. Europe (-3.1%) was the worst performing region in August, followed by Emerging Markets (-2.9%) which was impacted by currency weakness as Turkey (-29.0%), Brazil (-12.0%) and South Africa (-10.1%), all contributed negatively.

The largest detractor for the month was our position in Indian Bank. Q1 results disappointed investors at the beginning of the month and the share price slid from the top to the bottom of its near-term trading range. The Rupee has been weak all year and weakened a further 3.5% in August. Ordinarily gentle increases in interest rates would be welcomed by Banks and their investors but with the currency weakness comes the perception that rising interest rates may have to be more aggressive to prevent further weakness, and that the consequences for the economic and thus credit cycle may be unpleasant.

The Fund's largest contributor was the long-held position in North America's largest provider of funeral and cemetery services, Service Corporation. Year-to-date the share price had suffered the headwind of a 25% de-rating in PER terms even though EPS continued to grow by circa 15%. Q2 results, reported at the end of August, were more profitable than expected and this was a catalyst for a strong rebound in the share price.

Net Tangible Assets (NTA)

Net tangible asset value before tax ³	\$ 1.1907
Net tangible asset value after tax ³	\$ 1.1671

Key Facts

ASX code / share price	MEC / 1.040
ASX code / option price	MECO / 0.002
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee ⁴	15%
Market Capitalisation	\$ 47m
Shares Outstanding	45,524,927
Options Outstanding	43,382,026
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

Outlook

Concerns about Emerging Markets remain at the forefront of investors' minds – be it about tariffs or a rising US dollar – as it has been for over six months now. Investors have taken the view that this is a US-centric expansion, with winners (US large cap tech) and losers (everyone else), as opposed to a more generic risk-off environment.

Given the Fund has a focus on Asian as well as small and mid-cap stocks, this continues to present a headwind. Risk has been reduced in the Fund through less stocks and smaller sizing, combined with hedging out some regional and currency risk for some positions in India and Hong Kong.

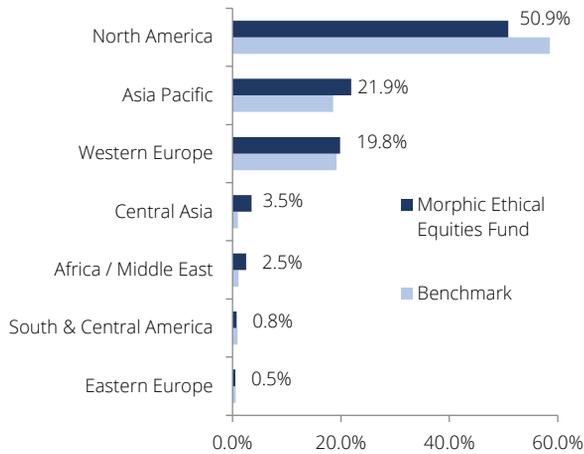
Yet relative to US stocks, Asian stocks are as cheap as they have been in 15 years on many valuation metrics. We remain of the view that medium term, the value opportunities remain in this region.

Top 10 Active Positions

Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	4.8%
Service Corp	US Deathcare	North America	3.1%
Open House	Japanese Homebuilders	Asia Pacific	2.5%
Indian Bank	Indian Quality Banks	Central Asia	1.8%
China Water Affairs	Chinese Water Utilities	Asia Pacific	1.7%
Bank Leumi	Israeli Quality Banks	Middle East	1.6%
Kering	Luxury Retailers	Europe	1.4%
<i>lida</i>	<i>Japanese Homebuilders</i>	<i>Asia Pacific</i>	<i>(1.4%)</i>
Rural Electrification	Indian Infrastructure	Central Asia	1.4%
China Everbright Intl	Environmental & Facilities	Asia Pacific	1.3%

Hedge Positions	Risk Limit Utilisation (%) ⁶
Short US Bonds	0.6%
Short AUD vs USD and JPY	0.4%

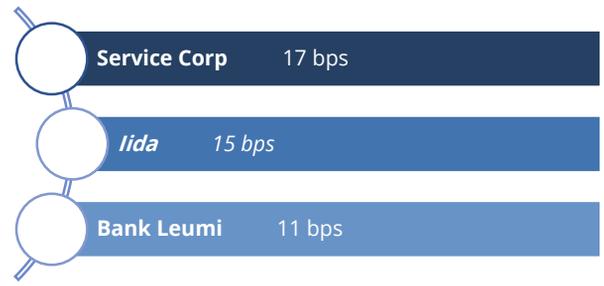
Equity Exposure Summary By region



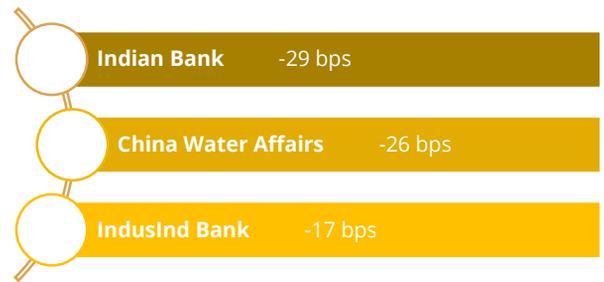
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¹ Performance is net of investment management fees, before company admin costs and taxes; ² The Index is the MSCI All Countries World Daily Total Return Net Index (Bloomberg code NDUWACWF) in AUD; ³ The figures are unaudited; ⁴ The Performance Fee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

Top three alpha contributors⁵ (bps)



Top three alpha detractors⁵ (bps)



Risk Measures	
Net Exposure ⁷	103%
Gross Exposure ⁸	123%
VAR ⁹	1.10%

Equity Exposure Summary By sector

