



# MORPHIC ETHICAL EQUITIES FUND

Monthly Report  
October 2018

AsiaHedge  
2018 Finalist  
"New Fund of  
the Year"



A proud founder of:  
Climate Action 100+

Signatory of:  
PRI Principles for Responsible Investment

## 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	CYTD	ITD (p.a.)
Morphic Ethical Equities Fund <sup>1</sup>	-5.41%	-3.82%	-3.18%	0.20%	4.83%
Index <sup>2</sup>	-5.56%	-1.78%	2.31%	5.99%	10.24%

## Ethical Investing in Focus

Integrating Environmental, social and governance (ESG) factors into long-term stock selections is a well analysed and discussed technique, as they provide vital insights into future performance and valuation of companies. However, there is less discussion of whether using ESG signals can be applied to shorting strategies. Morphic believes that ESG data for shorting purposes can add alpha to a fund's performance and can also be used as a signal of market sentiment regarding ESG risks to companies. Chad Slater shares his thoughts on ESG signals in shorting for the [Sustainability Report](#).

In November, the Morphic team will be travelling across Australia, to meet investors and discuss investment themes and the outlook for global markets. Our Australian tour will end in Sydney where we will also hold the Morphic Ethical Equities Fund's AGM. You can get your ticket for the November luncheons [here](#).

## Portfolio review

The Fund fell 5.4% in October, outperforming global markets which fell 7.6% in USD terms, experiencing the largest monthly fall in more than six years.

The October sell-off was broad with all regions falling at least 7.0%. As is often the case in a sell-off, the US fell the least (-7.0%) while Asia-Pac ex-Japan (-10.3%) and Emerging Markets (-8.8%) fell the most. Europe (-7.7%) and Japan (-8.5%) slightly underperformed the global aggregate.

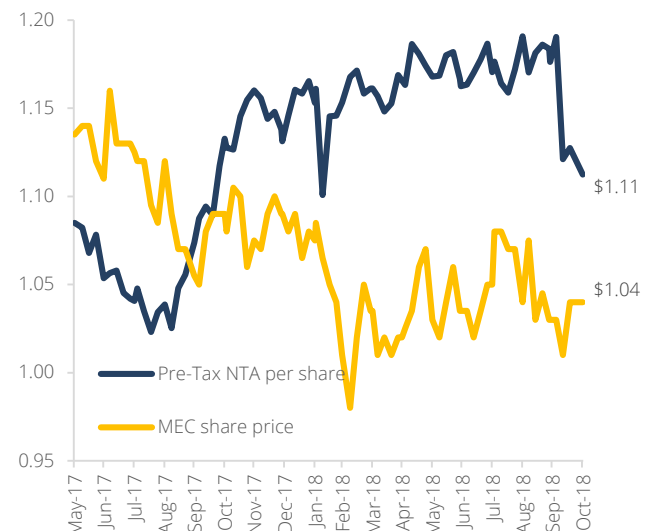
The largest detractor for the month was our long-held position in Japanese property developer Open House which was stopped out towards the end of the month. Open House fell after one broker increased his profit estimates for the current financial year, but cut them severely for the following year. We are sceptical about this, but the market reaction meant our stop loss risk rules forced us to close out the position, and corresponding short positions in property developers Iida and Daito Trust.

On the positive side, the Fund's largest contributor was the position in Rural Electrification. Rural Electrification rose as the market recognised that recent liquidity concerns about Indian private sector consumer facing non-bank financial companies were irrelevant to it. Rural Electrification's business model consists of borrowing long term to lend state government bodies to build transmission and distribution infrastructure in the poorest parts of the country.

## Net Tangible Assets (NTA)

NTA value before tax <sup>3</sup>	\$ 1.1123
NTA value after tax <sup>3</sup>	\$ 1.0998

## MEC share price and Pre-tax NTA performance<sup>4</sup>



## Outlook

Our optimism for October proved to be misplaced, though portfolio risk management enabled the Fund to enter early November rebound fully invested. With the US mid-term elections having concluded, the market has resumed its "risk-on" stance this month.

Of note in last month's sell-down was the fact that Emerging Markets did not significantly underperform the US market. Taken with the stubborn refusal of foreign exchange markets to go along with equities, in combination with credit spreads, it thus far seems to be an equity specific event. We feel the seasonality of markets discussed last month could reassert itself into year-end as oversold markets rebound. Yet caution is in order as lead indicators of growth and earnings are slowing.

Given the inability of the USD to rally in the risk-off phase, some of the USD hedges have been removed. The Fund remains largely invested on the belief that markets rebound from here now that the uncertainty of the mid-term elections has passed. We believe the lead is likely to come from non-US markets.

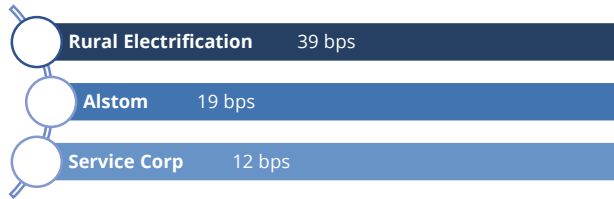
## Top 10 Active Positions

Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	3.5%
China Everbright Intl	Environmental & Facilities	Asia Pacific	3.2%
Bank Leumi	Israeli Quality Banks	Middle East	2.3%
Service Corp	US Deathcare	North America	2.3%
China Water Affairs	Chinese Water Utilities	Asia Pacific	2.2%
Rural Electrification	Indian Infrastructure	Central Asia	2.1%
Haseko	Japanese Homebuilders	Asia Pacific	1.8%
Power Grid	Indian Infrastructure	Central Asia	1.4%
Axos Financial	US Quality Banks	North America	1.2%
Tsuruha Holdings	Japanese Drugstores	Asia Pacific	1.0%

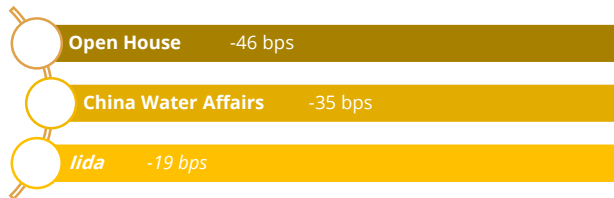
Risk Measures	
Net Exposure <sup>5</sup>	100%
Gross Exposure <sup>6</sup>	110%
VAR <sup>7</sup>	1.20%
Upside Capture <sup>8</sup>	66%
Downside Capture <sup>8</sup>	86%
Best Month	5.51%
Worst Month	-5.41%
Average Gain in Up Months	1.92%
Average Loss in Down Months	-1.93%
Annual Volatility	8.78%
Index Volatility	8.71%

Hedge Positions	Risk Limit Utilisation (%) <sup>9</sup>
Long JPY, CNH and AUD volatility	0.17%

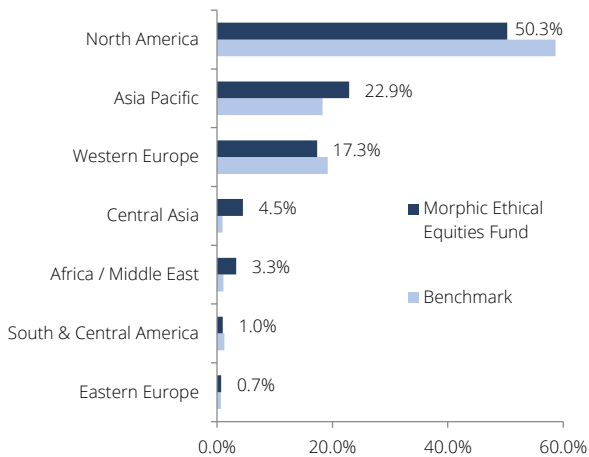
## Top three alpha contributors<sup>10</sup> (bps)



## Top three alpha detractors<sup>10</sup> (bps)

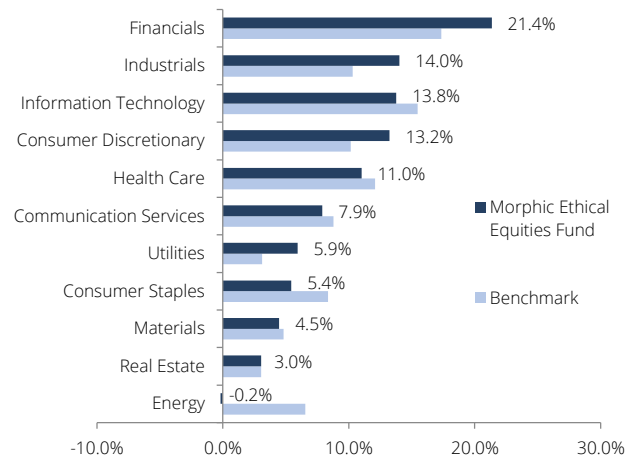


## Equity Exposure Summary By region



Key Facts	
ASX code / share price	MEC / 1.040
ASX code / option price	MECO / 0.001
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee <sup>11</sup>	15%
Market Capitalisation	\$ 47m
Shares Outstanding	45,529,927
Options Outstanding	43,377,026
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

## Equity Exposure Summary By sector



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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 figures are unaudited; <sup>4</sup> The pre-tax net tangible asset value is after the deduction of fees and costs. Fund listing on the ASX 3 May 2017. Past performance is not an indication of future performance; <sup>5</sup> Includes Equities and Commodities - longs and shorts are netted; <sup>6</sup> Includes Equities, Commodities and 10 year equivalent Credit and Bonds - longs and shorts are not netted; <sup>7</sup> Based on gross returns since Fund's inception; <sup>8</sup> As a percentage of the Fund's Value at Risk (VaR) Limit; <sup>9</sup> As a percentage of the Fund's Value at Risk (VaR) Limit; <sup>10</sup> Attribution; relative returns against the Index excluding the effect of hedges; <sup>11</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.