



Signatory of:



# MORPHIC ETHICAL EQUITIES FUND

## Monthly Report June 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	1 Year	ITD (p.a.)
Morphic Ethical Equities Fund <sup>1</sup>	-0.39%	0.37%	3.42%	11.54%	9.21%
Index <sup>2</sup>	1.85%	4.37%	5.40%	14.95%	12.86%

### Ethical Investing in Focus

After several private engagements with Japanese holding Haseko, the decision was made to publicise our proposals to management as to how we can work with them for the market to fully appreciate the quality of their business. This decision was not taken lightly but we believe it to be the best way forward from here for management and the public to see the potential in this business.

Morphic remains a shareholder and is pleased to see changes on Haseko's board with the addition of the first female board member. The full letter is [here](#) along with some [press coverage](#).

### Portfolio review

The Fund fell -0.4% in June, trailing global markets for the month (1.9%). Global markets fell -0.7% in USD terms, with a decent fall in the Australian dollar providing a cushion for Australian investors.

If May was characterised by a lack of direction, June was about "divergence". President Trump's trade rhetoric and increasing "tit for tat" replies from China and Europe dominated headlines and markets. US markets were up 0.5%, but in contrast Emerging Markets (-4.6%), Asia Ex-Japan (-4.1%) and Japan (-2.6%) all suffered sizeable losses for the month.

The largest detractor for the month was our position in China Everbright. Stock specific news was minimal, but like many of our holdings in Asia, the stock was caught up in the China selloff (-10%) and dropped 16% over the month. The stock was stopped out to prevent further losses. The Manager is of the view that this is not stock specific and will actively consider re-entering after the stop-loss "cooling off" period.

On the positive side, a large contributor was China Water Affairs. The company reported earnings post the end of the month, which were well ahead of consensus expectations, with the stock outperforming into those results. The company increased the dividend and announced an additional special dividend. The Manager has done several calls with management now, along with one-on-one meetings in Beijing and Tokyo, and we still believe this stock is under-appreciated by the market, trading on 10x P/E with good growth prospects.

### Net Tangible Assets (NTA)

Net tangible asset value before tax <sup>3</sup>	\$ 1.1624
Net tangible asset value after tax <sup>3</sup>	\$ 1.1456

### Key Facts

ASX code / share price	MEC / 1.035
ASX code / option price	MECO / 0.001
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee <sup>4</sup>	15%
Market Capitalisation	\$ 47m
Shares Outstanding	45,479,227
Options Outstanding	43,402,026
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

### Outlook

There is a fine line between conviction and stubbornness, and one must always try to adapt views to reality. The Fund had consistently positioned in 2018 for the view that looking through "Trump tirades" was the optimal course of action. Market price action, particularly in our area of focus, Asia, over the last three months has not supported this view.

Reflective of adapting to this reality, cash levels were raised, with the net exposure decreased towards the end of the month. It appears Chinese credit growth is slowing in the background and global growth indicators continue to slow outside the USA – and this is before any tariffs come in.

For now, though, we don't see the bear market beginning just yet. A flattening yield curve and widening credit spreads from low levels tend to be normal late cycle behaviour in which equities perform well.

Long USD and JPY exposure were increased over the month. More discussion on our outlook is to follow in the Half Yearly report to investors, which will be published later this month.

## Top 10 Active Positions

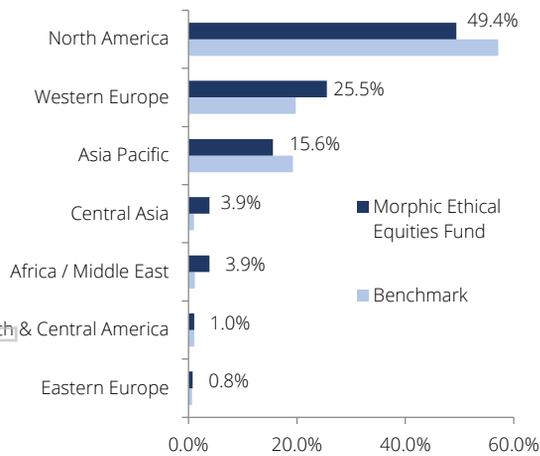
Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	5.0%
Open House	Japanese Homebuilders	Asia Pacific	3.2%
Haseko	Japanese Homebuilders	Asia Pacific	3.1%
Western Alliance	US Quality Banks	North America	3.0%
Tokyo Century	Japanese Leasing Companies	Asia Pacific	(2.7%)
Service Corp	US Deathcare	North America	2.6%
Mitsubishi UFJ Lease & Finance	Japanese Leasing Companies	Asia Pacific	2.6%
Coca-Cola Amatil	Beverages	Asia Pacific	(2.5%)
Eagle Bancorp	US Quality Banks	North America	2.4%
lida	Japanese Homebuilders	Asia Pacific	(2.2%)

## Hedge Positions

## Risk Limit Utilisation (%)<sup>6</sup>

Long Bonds	1.6%
Short AUD vs USD, EUR and JPY	1.2%

## Equity Exposure Summary By region



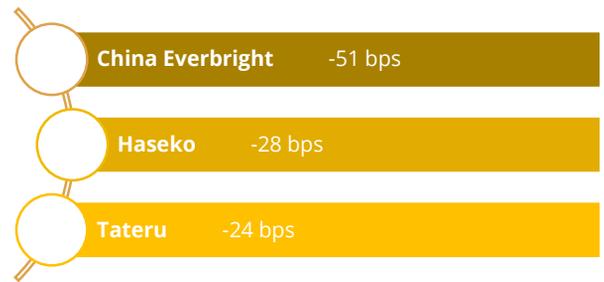
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<sup>1</sup> Performance is net of investment management fees, before company admin costs and taxes; <sup>2</sup> The Index is the MSCI All Countries World Daily Total Return Net Index (Bloomberg code NDUACWCF) in AUD; <sup>3</sup> The figures are unaudited; <sup>4</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>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>	81%
Gross Exposure <sup>8</sup>	144%
VAR <sup>9</sup>	0.98%

## Equity Exposure Summary By sector

