

# Morphic Ethical Equities Fund Limited – June 2017

## Performance Report

The Fund fell 2.8% in June, global markets were flat in USD, but a strong Australian Dollar saw markets down 2.5% in AUD. Since inception (May 3<sup>rd</sup> 2017), the Fund is down 0.7%.

## Market Recap

In June global markets consolidated gains after their strong run so far this calendar year (the fourth best first half-year return for the index since its inception in 1988), with the broad market up 0.3% in US Dollar terms. A brisk rally in the Australian Dollar over the month was the cause of absolute losses for the Fund. The Fund's mandated negative screens added value over the month as the oil price fell.

For the month, Financials were the standout sector, up 4.6%, with defensive sectors such as staples (-2.4%) the worst as they suffered from the bond market sell-off. The sell-off in bonds began with comments from the ECB and other central banks that alluded to the end of monetary easing outside the USA as they see stronger economic growth.

## Portfolio Review

Underperformance came from an unwind in previous winners in Asian stocks and short positions in global fund managers. Short positions as a whole were detractors. Offsetting these losses were gains in US and Japanese stocks and gains from hedges.

Our best contributor was [Japanese market researcher Macromill](#). We bought it following its relisting in Tokyo after several years in private ownership. The firm is a world leader in the fast growing field of getting instant digital feedback on consumer behaviour.

A good bounce from US hospital firm HCA also contributed to the long side. As feared, the US Senate did table draft legislation which would strip 22 million people of health insurance, but investors are sceptical about the prospects for its enactment. HCA is a well-run, lowly priced company, with steady growth prospects. However given the volatile political environment, we have trimmed the position so we can buy back into any further round of panic in the next few months.

The big detractors this month came from Pakistan, where the whole market fell following a brief round of euphoria about its promotion to emerging market status. The fall was exacerbated by political tension caused by a judicial enquiry into the Prime Ministers naming in the Panama Papers. Our contrarian view is that investors should take comfort from the impressively robust legal process underway and the respect all parties are showing for it. Even if there is a change of PM, we anticipate the largely reformist direction of the government will remain intact.

## Fund Objective

The Morhic 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.

## Performance

Name	Fund <sup>1</sup>	Index <sup>2</sup>
1 Month	-2.78%	-2.51%
Since Inception (p.a.)	-0.70%	0.10%

## Key Facts

ASX code / share price	MEC / 1.11
ASX code / option price	MECO / 0.033
Listing Date	03 May 2017
Management Fee	1.25%
Performance Fee <sup>3</sup>	15%
Market Capitalisation	\$50m
Shares Outstanding	44,850,627
Options Outstanding	44,030,626
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

## Net Tangible Assets (NTA)

Net tangible asset value before tax <sup>4</sup>	\$ 1.0536
Net tangible asset value after tax <sup>4</sup>	\$ 1.0674

## Top 10 Holdings

Long Stocks (Shorts)	Theme	Region	Weighting
Power Grid	Indian Infrastructure	Central Asia	3.7%
Alstom	Global Rail	Europe	3.2%
<i>Panalpina</i>	Global Freighters	Europe	-3.0%
<i>Wells Fargo</i>	US Quality Banks	North America	-3.0%
SES	Global Satellite	Europe	2.8%
D.G. Khan Cement	Pakistan Infrastructure	Central Asia	2.7%
Samsung Electronics	Global Tech	Asia Pacific	2.5%
Service Corp	US Deathcare	North America	2.5%
Macromill	Global Research	Asia Pacific	2.2%
DSV	Global Freighters	Europe	2.1%

We also suffered from a further derating for Indian power sector financier; Rural Electrification Corp. Management has recently reiterated multi-year guidance of 20% plus loan growth and steady margins, meaning the stock is very cheap on 5x 2017/18 earnings.

## Outlook

June saw a number of central banks move to a less accommodating monetary policy stance, including the US Federal Reserve, which reiterated its guidance for more rate hikes and a start to the shrinking of its balance sheet.

While the US economy and stock market look resilient enough to absorb this, there must be some doubt about the capacity of a still feeble Europe (other than Germany) to cope with a similar process as the European Central Bank is suggesting. We are pleased that for once Japan looks as though it will resist making what we feel would likely be a policy error.

Tighter global monetary conditions may be tough for emerging markets, so we have trimmed our overweight. [A recent trip to Japan](#) confirmed our growing enthusiasm for prospects there, particularly sectors that can benefit from what we feel will be a surprising pick up in real wages. Being underweight the US is the funding source.

Our view last month that the outlook in Australia is starting to look precarious proved premature as unexpected gains in commodities and house prices put a floor under the currency. However, we doubt the Australian Dollar can rise much more. Our main hedge is to rising interest rates and the weakening of the Japanese Yen.

## Ethical Investing

In June, Goldman Sachs announced that MEC's top holding, Power Grid, would be added to their GS SUSTAIN Global Focus List. Launched in 2007 at the UN Global Compact Leaders' Summit, GS SUSTAIN aims to be at the forefront of integrating environmental, social and governance criteria into the fundamental analysis of companies, and bringing greater investor attention to the importance of ESG factors in identifying companies best placed to manage 21st-century business risks.

Power Grid is instrumental in implementing India's commitment to renewable energy, via the "green corridor" connecting new energy sources to the large cities of India.

*Jack Lowenstein, Chad Slater, Geoff Wood, James Tayler, Nadeem Ali, Irene Kardasis, Cameron Halkett, Lucina Martin, Daniel Hayman*

## Hedge Positions

Name	Risk Limit Utilisation (%)*
Short Yen vs. Euro	1.0%
Short Global Bonds	0.6%
Long French Bonds vs. Germany	0.3%
Long Copper	0.2%
Long AUD	0.2%

\* As a percentage of the Fund's Value at Risk (VaR) Limit

## Risk Measures

Net Exposure <sup>5</sup>	101%
Gross Exposure <sup>6</sup>	160%
VAR <sup>7</sup>	1.01%

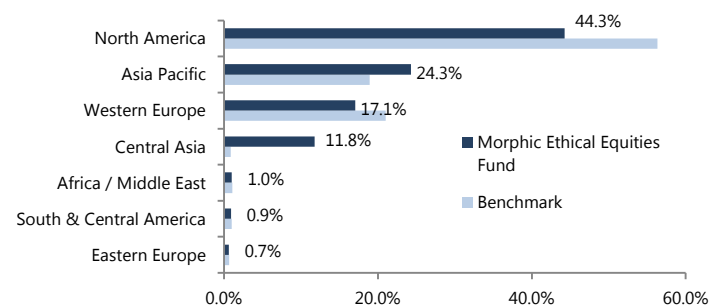
## Top 5 Contributors<sup>8</sup> (bps)

Macromill	30	D.G. Khan Cement	-36
HCA Healthcare	16	Rural Electrification	-30
Service Corp	11	Wells Fargo	-21
Kusuri no Aoki	10	Platinum Asset Mgmt.	-20
Western Alliance	9	SES	-19

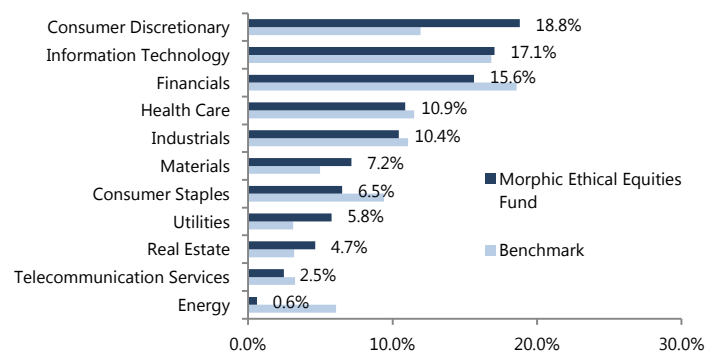
## Top 5 Detractors<sup>8</sup> (bps)

## By Region

## 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 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> 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> 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; <sup>8</sup> Attribution; relative returns against the Index excluding the effect of hedges.