

MORPHIC ETHICAL EQUITIES FUND

Monthly Report May 2018



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	0.33%	1.59%	1.25%	8.87%	10.34%
Index ²	-0.11%	1.87%	2.06%	10.03%	11.98%

Ethical Investing in Focus

The Fund has a substantial short position in the Coca-Cola bottler in Australia, Coca-Cola Amatil. Over the course of the month, Morphic has engaged with both the Chairman and the Head of Sustainability.

The Manager has expressed its views that the company is not doing enough to alleviate the effects of sugar on obesity, particularly in the poorer parts of Asia Pacific, where it has operations. Answers explaining their failure have thus far been unsatisfactory. Morphic is working to raise the awareness of this failure and will be updating investors in due course.

Portfolio review

The Fund rose 0.3% in May, ahead of global markets (-0.1%). Global markets fell -0.2% in USD terms, with a small increase in the Australian dollar proving the difference.

May saw markets rise only to then fall back, unable to break definitively in either direction. The politics of Italy dominated the headlines as investors feared the new coalition in Italy would reignite the Euro crisis of 2012.

Unsurprisingly, Europe was the worst performing market over the month (-4.0%). Emerging Markets continued to underperform (-3.8%) and the US market performed the best (2.2%).

The largest contributor for the month was the long-held position in Open House. Open House reported another set of excellent quarterly earnings, beating guidance. More importantly, they issued guidance for the coming year that is substantially ahead of market expectations. The Fund remains holders, but to reduce market risk, the Manager has started shorting Iida Group, which has rallied back since the short was closed in December. The Manager believes Iida remains an inferior business to Open House.

The biggest detractor for the month was the position in Japanese market research company Macromill. Taking into consideration the impact of Yen weakness and a recent acquisition, recently reported quarterly results were unexpectedly weak and management indicated that meeting their full-year guidance will be challenging. The Fund's risk management framework resulted in a reduction of the position.

Net Tangible Assets (NTA)

Net tangible asset value before tax ³	\$ 1.1679
Net tangible asset value after tax ³	\$ 1.1487

Key Facts

ASX code / share price	MEC / 1.03
ASX code / option price	MECO / 0.009
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee ⁴	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

The manifestation of market fears has shifted from Trump and Trade, to Italy and whether the European project is under threat. Italian bond yield spreads have surged, raising the cost of funding the country's debt.

"Markets tend to overestimate the short-term impact and underestimate the long-term impact". The coming months are likely to be less eventful than priced, but the size of Italy means that Greek-style negotiations are unlikely to end the same way.

The other macroeconomic trend of note since February has been the resurgent USD, driven by higher US interest rate expectations. One side effect has been the weaker performance of emerging markets in USD terms. The confluence of Italian uncertainty and a slight change in tone from the US Federal Reserve has seen US interest rate expectations fall which should be supportive of the Fund's regional positioning in Asia from here.

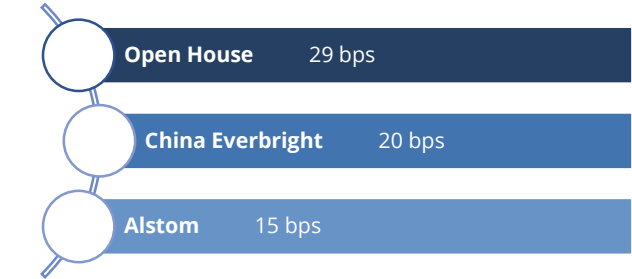
The Fund increased its exposure to Japan and Hong Kong over the course of the month. Reflective of the view that outcomes are balanced here, the Fund has minimal foreign exchange hedging currently in place.

Top 10 Active Positions

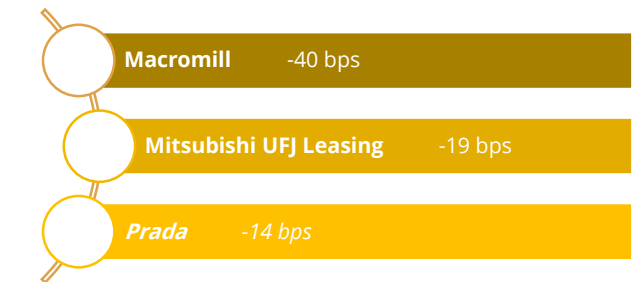
Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	4.4%
China Everbright Intl	Environmental & Facilities	Asia Pacific	3.2%
Service Corp	US Deathcare	North America	3.1%
Open House	Japanese Homebuilders	Asia Pacific	3.0%
Haseko	Japanese Homebuilders	Asia Pacific	3.0%
Western Alliance	US Quality Banks	North America	2.7%
Coca-Cola Amatil	Beverages	Asia Pacific	(2.1%)
Eagle Bancorp	US Quality Banks	North America	2.0%
Iress	Software services	Asia Pacific	(1.9%)
New York Community Bancorp	US Quality Banks	North America	(1.9%)

Hedge Positions	Risk Limit Utilisation (%) ⁶
Long EM Puts	0.2%

Top three alpha contributors⁵ (bps)

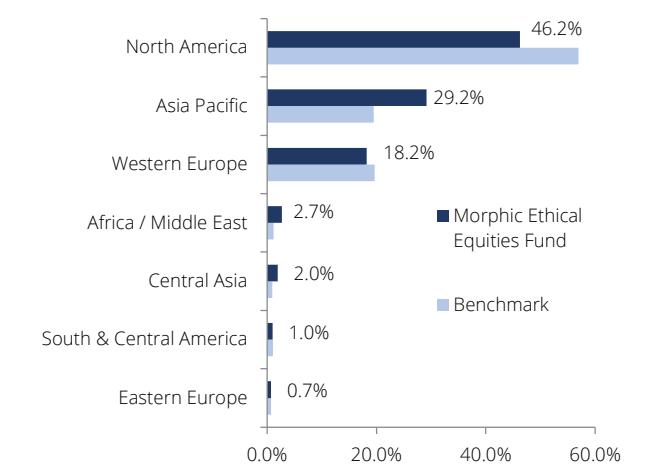


Top three alpha detractors⁵ (bps)

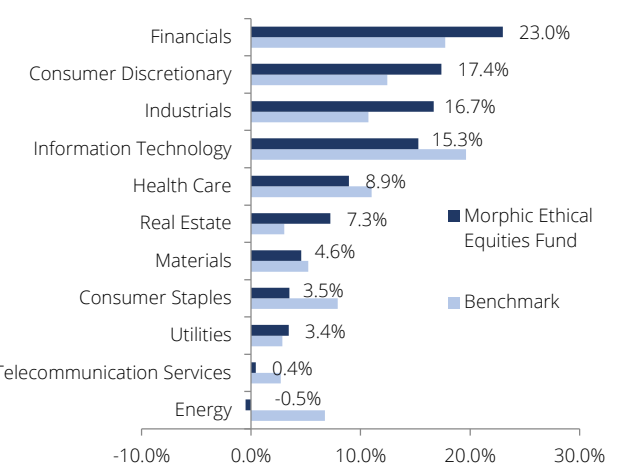


Risk Measures	
Net Exposure ⁷	100%
Gross Exposure ⁸	136%
VAR ⁹	1.08%

Equity Exposure Summary By region



Equity Exposure Summary By sector



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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 NDUACWCF) 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.