



MORPHIC ETHICAL EQUITIES FUND

Monthly Report
May 2023



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	3 Years (p.a.)	ITD (p.a.)
Morphic Ethical Equities Fund ¹	1.55%	3.16%	6.38%	5.09%	7.56%	6.74%
Index ²	1.02%	7.79%	7.05%	11.79%	11.00%	10.47%

* Past Performance is not an indication of future performance.

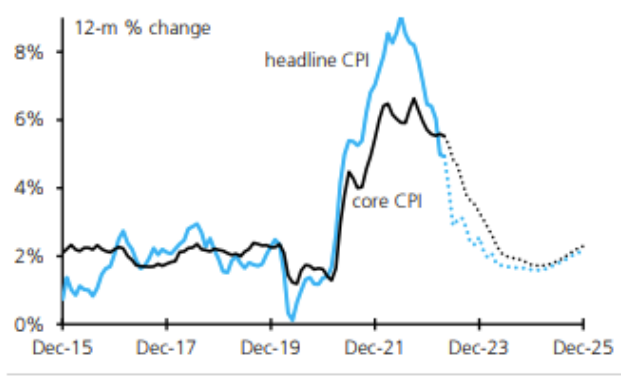
Company Update

The Company appointed Taylor Collison as its broker to begin a buyback of up to 10% of the Company's stock during May. In that time MEC bought back **141,431** shares at an average price of **\$0.93** cents a share. The buy back remains in operation.

Portfolio Commentary

With the March quarter reporting season now in the rear-view mirror (with a decent beat rate relative to expectations again) the focus quickly shifted to the next inflation print and the escalating concerns around the debt ceiling discussions in the US. Inflation remains on investors minds as a continued decline could see the Fed finally pause and provide a path to a potential easing, while stubbornly high prices would result in a higher for longer scenario.

The inflation print released in May showed continued abatement and came in pretty much in line with expectations. That said, the report did show that April rent CPI increased at a slightly faster rate than in March however with asking rents (spot) continuing to decline, this metric should deliver a downward bias going forward. As you can see in the chart below, UBS expects future CPI prints to continue the descent that should lead and confirm our long-held expectation that the Fed and inflation headline risks in 2022 would no longer be a feature in 2023. Considering that inflation in the US has declined 420bps from 9.1% to 4.9% we have seen some heavy lifting to get it under control.



Source: BLS, UBS estimates

Net Tangible Assets (NTA)	
NTA value before tax ³	\$1.1351
NTA value after tax ³	\$1.1586

Investment Returns since inception⁴



In early May, the headline risk baton was passed to the ongoing discussions and horse trading associated with the debt ceiling discussions. The spotlight was triggered by Janet Yellen who wrote to Congress highlighting that the X date could come as early as June 1st. It seems in every "crisis" we need to learn about a new metric or acronym to monitor so we can estimate when the markets could crater. So, we find ourselves on several conference calls learning about the X Date (the day the Treasury runs out of funds to pay its bills and the US defaults on its debt) and potential market implications.

We quickly found out that we could add little value to what the outcome would be and focused our energy on our businesses with conference calls to discuss recent results and their operating outlooks. To be clear, we maintained a keen focus on the debt ceiling proceedings however we held a base case that, like Winston Churchill is credited as saying, "Americans will always do the right thing – after exhausting all the alternatives". This turned out to be the outcome with a deal finally struck at the end of the month, quickly passing through both the House and Senate.

So now we can get back to the seemingly perennial discussion around the upcoming (and most telegraphed) recession. Hard landing, soft landing, no landing – we have no edge on predicting the outcome however do consider that the tightening of financial conditions, coupled with the recent US regional bank stress, should lead to a slowing of economic activity which would impact earnings. We remain steadfast in our approach in identifying and investing in businesses with strong secular or structural growth opportunities. While these companies will not be totally immune from a slowing economy, they should be relatively insulated and come out the other side in an even stronger competitive position.

The Morpic Ethical Equities Fund increased 1.55% net during the month compared to the MSCI World Mid Cap (AUD) Index which increased by 1.02% over the same period.

The portfolio's top three contributors **Advantest Corp., Flex Ltd and PTC Inc added 253bps to performance** while **Chart Industries, Inc, Option Care Health Inc and Bureau Veritas SA detracted 145 bps** during the month.

It feels like we can characterise the world of AI, semiconductors, data growth and compute as pre Nvidia first quarter results and post (similar to pre-pandemic and post-pandemic discussions). Pre Nvidia results the market was aware of ChatGPT (large language networks) and Generative AI. However, it was in the Nvidia result commentary on May 25th that a tectonic shift was signalled, spotlighting the long term opportunity associated with these next generation technologies.

Here are some of the main quotes from the result commentary that we felt provided the most powerful indication of where the compute market may be heading. Note that we have had a 5G and data growth vertical within our portfolio for several years with several companies benefiting from this megatrend. One corollary that is definitely worth calling out is our ownership in Iron Mountain which is a leader in IT asset decommissioning and recycling (you will see this in point 4):

- ✓ The computer industry is going through two simultaneous transitions, accelerated computing and generative AI
- ✓ CPU scaling has slowed, yet computing demand is strong and now with generative AI, supercharged
- ✓ There is \$1 trillion installed in the global data centre infrastructure, based on the general-purpose computing method of the last era. Companies are now racing to deploy accelerated computing for the generative AI era. Over the next decade, most of the world's data centres will be accelerated. The entire world's data centres are moving towards accelerated computing
- ✓ You're seeing the beginning of call it a 10-year transition to basically recycle or reclaim the world's data centres and build it out as accelerated computing. You'll have a pretty dramatic shift in the spend of the data centre from traditional computing, and to accelerated computing
- ✓ The workload is going to be predominantly generative AI. inference is now a major driver of accelerated computing because generative AI is used so capably in so many applications already

Advantest had been rallying early in the month however it was post the Nvidia result that the stock really took off, ending the month up almost 70%. Now if you remember there are two companies in the world with close to 95% combined market share in the system on chip (SoC) testing market (basically testing to make sure the chips in our smartphones, data centres and automobiles don't fail). We estimate Advantest has c80% market share in the high performance compute (HPC) market and is the dominant supplier to Nvidia, hence the strong rally. We did trim a bit post the solid performance and while we have owned the stock for almost 3 ½ years, we see long term capital growth opportunity for us all as investors.

Flex is one of the world's largest contract manufacturers with many secular tailwinds such as solar, electric everything and medical devices driving the stock. We consider that the performance this month is attributable to its data centre capabilities, especially those associated with its recent acquisition of Anord Mardix. Flex has owned the business for almost 2 years now after it bought the company for \$540m in October 2021. Anord Mardix offers an extensive product portfolio of critical power solutions directly tied to data centre operators and one thing is certain, this compute associated with Generative AI is going to require a lot of smart power deployments.

PTC held its first in-person Livework Conference in 4 years and the event was well received. Management highlighted a number of growth levers over the next several years including its ongoing shift to SaaS (significant revenue uplift with higher absolute EBITDA), the synergy benefits associated with its recent ServiceMax acquisition and continued strong growth in Codebeamer which is becoming the defacto operating platform for the automotive manufacturing industry.

Chart Industries is a leading global manufacturer of highly engineered equipment servicing multiple applications in the Energy and Industrial Gas markets. It is recognized as a leader in the clean energy transition by providing technology, equipment and services related to liquefied natural gas (LNG), hydrogen, biogas, carbon capture and water treatment to global customers. Given it has a decent exposure to energy, its share price does correlate to the price of natural gas and oil which were down by 12.4% and 11.3% respectively during May. The weakness came despite several very positive announcements during the month including expanding its partnership with TECO 2030 ASA to include all Howden solutions for ship efficiency and carbon emissions reductions, successfully testing a new liquid hydrogen valve with Crane, collaborating on carbon capture utilization and storage (CCUS) Projects with Koch Engineered Solutions and collaborating with FuelCell Energy on decarbonization and hydrogen technologies.

Option Care Health reported a set of very strong results on the 4th of May with revenues up almost 11% driving EBITDA ahead by over 20%. Management upgraded full year guidance for both revenue and earnings with full year operating cash now expected to come in above \$240m. With a result like that you would have expected Option Care to be in the plus column. What drove the stock down was the concurrent announcement of an all-stock offer for home care company Amedisys. We have owned and profited from Amedisys in the past, know the company well and understand the acquisition rationale. That said, it is a bit of a pivot from its core home infusion business and understandably the market has lobbed an uncertainty discount on the stock. We continue to discuss the merits with Management and have slightly added to the position.

There was really nothing out to explain the weakness in Bureau Veritas this month. It produced a very solid set of results at the end of April and recent discussions with the company highlight that the business is performing in line with expectations, albeit with China re-opening hopes coming in a bit more muted than hoped.

The fund was a bit more active during May as we trimmed Advantest and Cellnex Telecom, added to Aixtron, Azek, Bloom Energy and GFL Environmental while initiating a position in the #1 global provider of factory automation solutions in Japan based Daifuku. We have owned Daifuku in the past and as part of our library we have been watching for an attractive entry point which presented itself following its most recent set of results.

We continue to have differentiated exposure to some pretty powerful long term thematic which should drive long term compounding benefits to us all as investors. These include 5G and the growth in data as Industrial IoT, AI and large language networks such as ChatGPT and next generation applications associated with 5G drive data demand, companies that enable our push to a circular economy, beneficiaries of deglobalisation as well as those helping to improve supply chain efficiency and companies which are levered to the multi trillion dollar spending required for our "Road to Net Zero".



These businesses as well as idiosyncratic opportunities in the fund should provide solid absolute and relative returns over the long term as secular and structural business drivers help mitigate earnings risk in times of economic uncertainty.

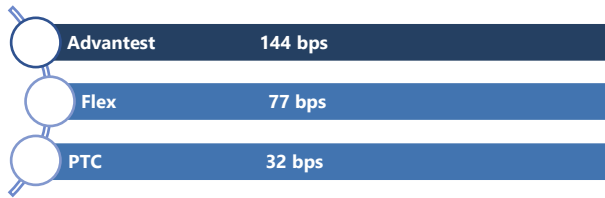
As always, we thank you for your continued support and look forward to providing further updates in the future.

Top 10 Active Positions

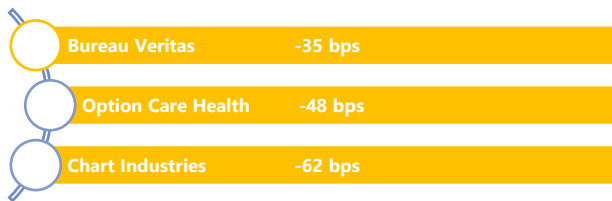
Stocks	Industry	Region	Position Weighting %
Graphic Packaging	Materials	North America	5.17
GFL Environmental	Industrials	North America	5.16
PTC Inc	Information Technology	North America	4.85
GXO Logistics	Industrials	North America	4.38
Cellnex	Communication Services	Europe	4.32
WillScot Mobile Mini	Industrials	North America	4.10
Ciena Corporation	Information Technology	North America	4.03
Flex	Information Technology	North America	4.02
TKH Group	Industrials	Europe	3.80
Option Care	Health Care	North America	3.77

Risk Measures	
Net Exposure ⁵	92.28%
Gross Exposure ⁶	92.29%
VAR ⁷	1.63%
Best Month	9.59%
Worst Month	-8.44%
Average Gain in Up Months	2.66%
Average Loss in Down Months	-2.68%
Annual Volatility	12.59%
Index Volatility	10.95%

Top alpha contributor⁸ (bps)



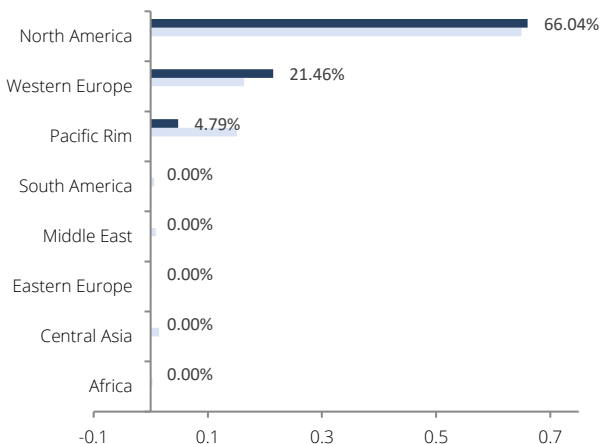
Top alpha detractor⁸ (bps)



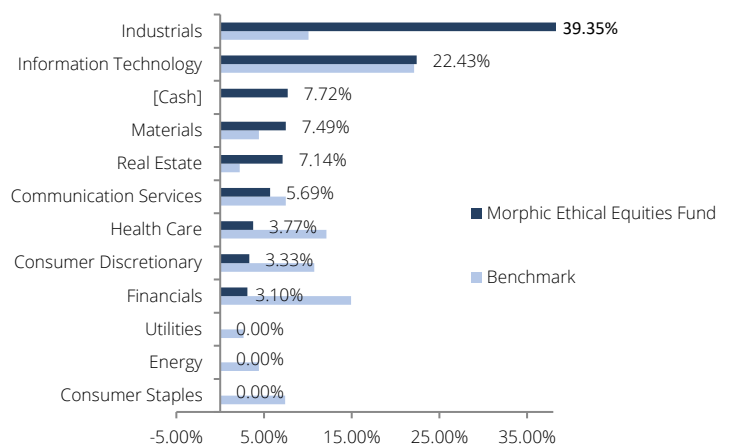
Key Facts

ASX code / share price	MEC / 0.960
Listing Date	3 May 2017
Profit Reserve ⁹	\$0.440
Management Fee	1.25%
Performance Fee ¹⁰	15%
Market Capitalisation	\$51m
Shares Outstanding	53,430,989
Dividend per share ¹¹	\$0.06

Equity Exposure Summary¹² By region



Equity Exposure Summary¹² By sector



Contact us

Morphic Asset Management Pty Ltd

Level 11, 179 Elizabeth St

Sydney 2000

New South Wales

Australia

www.morphicasset.com

Investor Relations

Phone: +61 2 9021 7701

Email: info@ellerstoncapital.com

This communication has been prepared by Morpheic Ethical Equities Fund Limited ("MEC") (ACN 617 345 123) and its Manager, Morpheic Asset Management Pty Ltd ("Morpheic") (ACN 155 937 901) (AFSL 419916). The information contained in this communication is for information purposes only and is not investment or financial product advice and is not intended to be used as the basis for making an investment decision. Please note that, in providing this communication, MEC and Morpheic have not considered the objectives, financial position or needs of any particular recipient. MEC and Morpheic strongly suggest that investors consult a financial advisor prior to making an investment decision. No warranty, express or implied, is made as to the fairness, accuracy, completeness or correctness of the information, opinions and conclusions contained in this communication. To the maximum extent permitted by law, none of MEC, its related bodies corporate, shareholders or respective directors, officers, employees, agents or advisors, nor any other person accepts any liability, including, without limitation, any liability arising out of fault or negligence for any loss arising from the use of information contained in this communication. If this communication includes "forward looking statements", such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of MEC and its officers, employees, agents or associates that may cause actual results to differ materially from those expressed or implied in such statement. Actual results, performance or achievements may vary materially from any projections and forward-looking statements and the assumptions on which those statements are based. MEC and Morpheic assume no obligation to update such information. This communication is not, and does not constitute, an offer to sell or the solicitation, invitation or recommendation to purchase any securities and neither this communication nor anything contained in it forms the basis of any contract or commitment. The Certification Symbol signifies that a product or service offers an investment style that takes into account environmental, social, governance or ethical considerations. The Symbol also signifies that Morpheic Ethical Equities Fund adheres to the strict disclosure practices required under the Responsible Investment Certification Program for the category of Product Provider. The Certification Symbol is a Registered Trade Mark of the Responsible Investment Association Australasia (RIAA). Detailed information about RIAA, the Symbol and Morpheic Ethical Equities Fund's methodology, performance and stock holdings can be found at www.responsibleinvestment.org, together with details about other responsible investment products certified by RIAA. The Responsible Investment Certification Program does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed.

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 NDUJACWF) in AUD; ³ The figures are estimated and unaudited; ⁴ Performance is net of investment management fees, before dividends, company admin costs and taxes. Fund listing on the ASX 3 May 2017. Past performance is not an indication of future performance; ⁵ Includes Equities and Commodities - longs and shorts are netted; ⁶ Includes Equities, Commodities and 10 year equivalent Credit and Bonds - longs and shorts are not netted; ⁷ Based on gross returns since Fund's inception; ⁸ Attribution; relative returns against the Index excluding the effect of hedges; ⁹ The reserve is made up of amounts transferred from current and retained earnings that are preserved for future dividend payments. The payment of franked dividends depends on the rate the Fund realises taxable profits and generates franking credits; ¹⁰ 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; ¹¹ Annual dividend per share. ¹² Exposure Summary charts do not take into account derivative positions.