A proud founder of: Climate Action 100+

Signatory of: PRI Principles for Responsible Investment

MORPHIC ETHICAL EQUITIES FUND

Monthly Report
September 2023

Fund Objective

The Morphic Ethical Equities Fund Limited (MEC) 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.

MEC 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.)
MEC[1]	-5.78%	-2.86%	3.96%	18.75%	6.94%	6.80%
Index[2]	-3.80%	-0.37%	6.43%	20.34%	10.70%	10.33%

* Past Performance is not an indication of future performance.

Performance Summary

MEC decreased -5.78% net during the month compared to the MSCI All Countries World Daily Total Return Net Index which fell by -3.80% over the same period.

For the calendar year to date, MEC appreciated 15.78% with the underlying benchmark increasing 15.64%.

Market Commentary

The portfolio's top three contributors were Daifuku, Rentokil and Willscot Mobile Mini which added 22bps. Meanwhile, Radnet, Montrose Environment and Unity Software detracted 126bps during the month. We discuss these stocks in greater detail in the 'Portfolio Commentary' section.

Global markets pulled back during September on concerns that central banks, most notably the US Federal Reserve (Fed), may raise interest rates further. Although the Fed kept policy rates on hold at 22-year highs of 5.25-5.50% during September, it left the door open for another rate hike later this year. Fed officials also indicated that rates could stay higher for longer throughout 2024 than they had previously anticipated. Confirmation of potential further upside in interest rates led to a spike in US 10-year yields to 17-year highs of 4.8%.

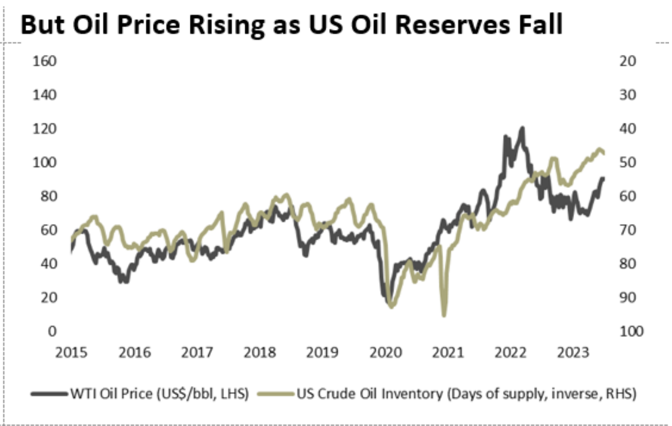
Interestingly, the jump in yields have (thus far) not been driven by a rise in inflation expectations. This is despite a 20% increase in oil prices over the past 3 months driven by low inventories in the US and supply cuts from major oil producers such as Saudi Arabia. Another risk to the near-term inflation outlook in the US is the impact on wages from a still tight labour market and the outcome of strikes by unionised workers across the auto industry. Finally, the rollout of new stimulus measures in China over the past month could also lead to improved demand, particularly for commodities in the coming months. These factors combined could trigger another wave of inflation and again put upward pressure on interest rates globally. This in turn could take the US economy a step closer towards the most anticipated recession in history.

Net Tangible Assets (NTA)	
NTA value before tax[3]	$1.1118
NTA value after tax[3]	$1.1299

Investment Returns since inception[4]

Whilst the debate on whether the Fed has done enough to tame inflation rages on, rising bond yields nonetheless are typically negative for valuations of long duration assets such as real estate, utilities, healthcare and growth companies. Indeed, the S&P500 utilities, healthcare, real estate and growth indices fell on average 5.4% during September. Even the "Magnificent 7" (Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA and Tesla) dropped 5.6% on average over the past month.

Source: Bloomberg



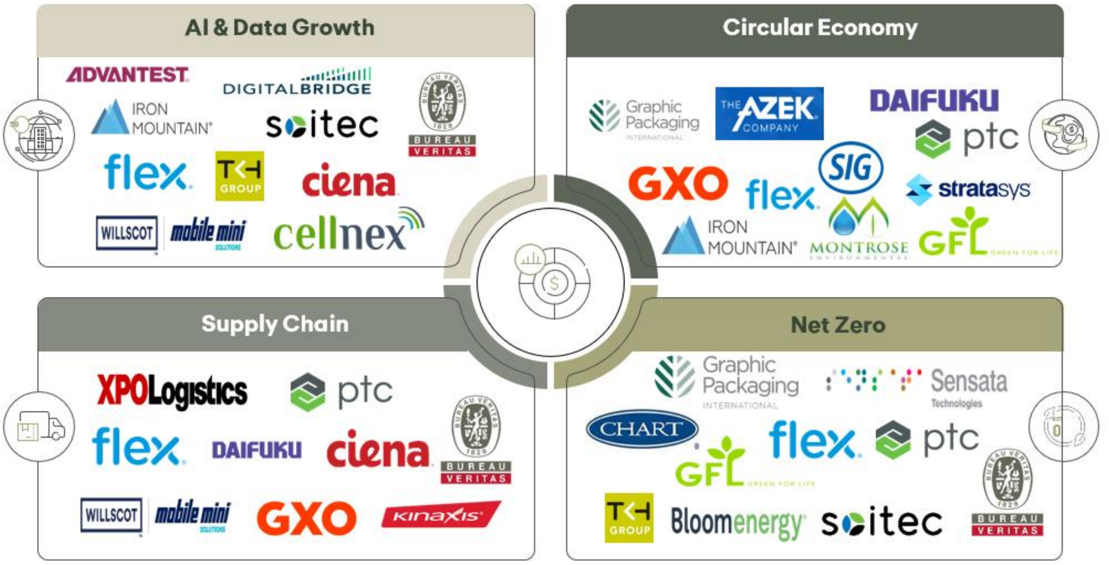
Source: Bloomberg, US EIA

Portfolio discussion

At Ellerston, we do not make investment decisions based on economic forecasts. But as Howard Marks famously put it, "you can't predict, but you can prepare" for potential risks on the horizon. In an environment where inflation could still surprise on the upside and rates remain higher for longer leading to an economic recession, we believe that investing in quality businesses with excellent business models, solid balance sheets and cash flows, whilst operating in attractive end markets and trading on reasonable valuations will help to mitigate downside risk.

As regular readers will know, we continue to have differentiated exposures to powerful long term thematics that should drive long term compounding benefits for 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 de-globalisation, as well as those helping to improve supply chain efficiency; and
- Companies which are levered to the multi trillion-dollar spending required for the "Road to Net Zero".



Source: Ellerston Capital

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 drivers help mitigate earnings risk in times of economic uncertainty.

Portfolio Commentary

Turning back to September performance, key contributors for the month were:

Daifuku (+0.10%) is the global leader in providing automated material handling solutions for customers around the world while also providing cleanroom line systems primarily in semiconductor and flat panel display applications. There was no company specific news during the month however it looks to have recovered some of the relatively weak share price performance during August.

Rentokil (+0.06%) is the world's largest hygiene and pest control company. The company's share price was resilient during the month reflecting the nature of its business model as a provider of 'essential services'. This along with solid management execution has allowed the company to compound earnings at ~12% CAGR over the past 10 years. Going forward, the company is guiding to organic revenue growth of at least 5% per annum along with acquisitions and further margin expansion should drive low teens earnings growth.

Willscot Mobile Mini (+0.06%) is the largest provider of modular offices in North America. Willscot's share price recovered slightly after it was sold off in August on concerns around retail demand and non-residential construction activity. This was despite the company posting EBITDA growth of 25% in 2Q2023 driven by 11% revenue growth and commendable margin expansion (+500bps yoy). We expect the upcoming large scale infrastructure projects and long-term tailwinds from onshoring/reshoring to help offset near term concerns.

Conversely, the major detractors during September were:

Radnet (-0.52%) is the largest, independent diagnostic imaging service provider in U.S with 363 imaging locations. The stock was weighed down during the month by some profit taking after a 77% rally year to date in 2023. Management however provided an update at a broker conference where they highlighted Radnet's competitive advantages in capturing a larger slice of its US$100bn total addressable market which is driven by a rapidly ageing population. This includes building out its AI screening solutions and further industry consolidation. The company trades on 10x EV/EBITDA and we forecast ~10% EBITDA CAGR over the next 3 years.

Montrose Environmental (-0.38%) is a US based environmental services company providing a diverse range of innovative solutions to help clients and communities meet their environmental needs and goals to address the world's environmental challenges. There was no material catalyst to explain the share price weakness in September. We continue to view Montrose's services as essential in helping customers adapt to an environmentally conscious and rapidly changing business backdrop. In the near term, regulatory developments relating to per- and poly fluoroalkyl substances (PFAS) particularly in the US could drive increased testing and remediation work for Montrose.

Unity Software (-0.36%) is a name that we initiated a position in during the month. It is a 3D software game engine developer and is a market leader in the mobile games space. Unity's share price was sold off following an announcement that from 1 January 2024, it would increase the subscription fee for games developed using its engine that meet certain revenue and install thresholds. Whilst this new pricing strategy could add ~10-15% to EBITDA, there are market concerns around potential longer-term attrition and market share losses, particularly with small, independent game developers. We however believe that Unity has a unique service offering which has allowed it to achieve ~70% market in the mobile games space. As such, we do not expect the price increases to materially impact Unity's business model.

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 %
GFL Environmental	Industrials	North America	6.28
PTC Inc	Information Technology	North America	5.17
Option Care	Health Care	North America	4.36
WillScot Mobile Mini	Industrials	North America	4.34
GXO Logistics	Industrials	North America	4.18
Cellnex	Communication Services	Europe	4.17
Rentokil Initial	Industrials	Europe	3.98
Chart Industries	Industrials	North America	3.86
Graphic Packaging	Materials	North America	3.73
Digital Bridge	Real Estate	North America	3.61

Risk Measures	
Net Exposure[5]	96.57%
Gross Exposure[6]	96.57%
VAR[7]	1.58%
Best Month	9.59%
Worst Month	-8.44%
Average Gain in Up Months	2.67%
Average Loss in Down Months	-2.78%
Annual Volatility	12.69%
Index Volatility	10.86%

Top contributor[8] (bps)

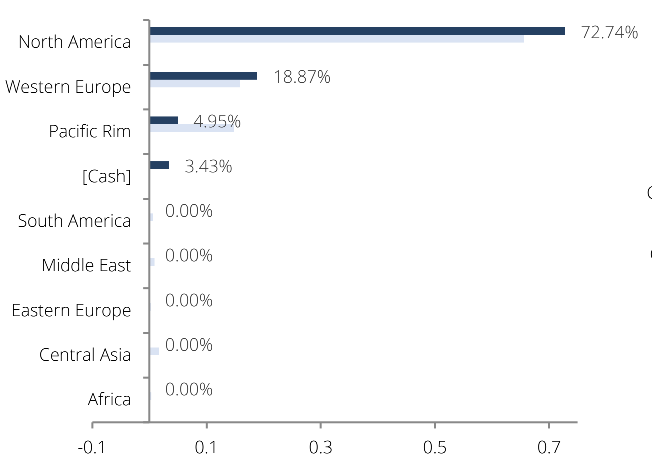
Daifuku	10 bps
Rentokil	6 bps
WillScott	6 bps

Top detractor[8] (bps)

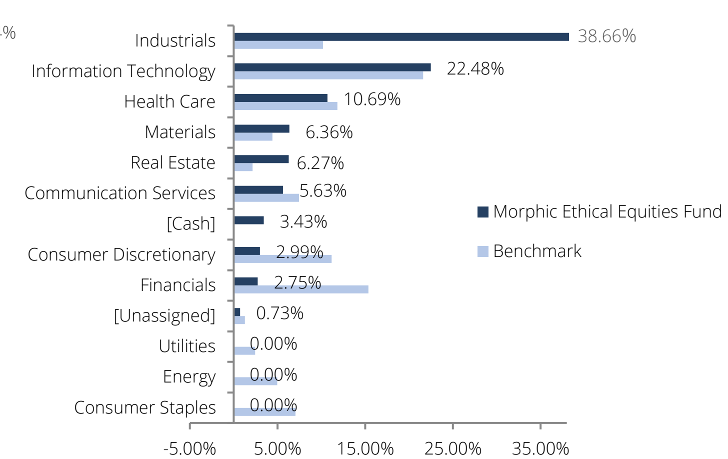
RedNet	-52 bps
Montrose	-38 bps
Unity	-36 bps

Key Facts	
ASX code / share price	MEC / 1.020
Listing Date	3 May 2017
Profit Reserve[9]	$0.480
Management Fee	1.25%
Performance Fee[10]	15%
Market Capitalisation	$52m
Shares Outstanding	51,148,678
Dividend per share[11]	$0.14

Equity Exposure Summary[12] By region



Equity Exposure Summary[12] 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 NDUEACWF) 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] Contribution; absolute returns against 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 MEC realises taxable profits and generates franking credits; [10] The Performance Fee is payable annually in respect of MEC's out-performance of the Index. Performance Fees are only payable when MEC 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.