

MORPHIC ETHICAL EQUITIES FUND

Monthly Report
October 2017



Signatory of:



Fund Objective

The Morpic 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	ITD p.a.
Morphic Ethical Equities Fund ¹	5.51%	9.05%	7.00%
Index ²	4.46%	8.75%	7.52%

Ethical Investing in Focus

Last month, the Fund initiated a position in China Everbright International (CEI). CEI is an attractively priced Hong Kong listed company which operates waste-to-energy plants in China. Like developed countries, China is trying to reduce its reliance on landfill. There is growing awareness that landfill causes environmentally damaging emissions and water pollution. CEI's incineration plants are a better environmental solution by taking the waste for electricity generation. The company also operates biomass-to-energy and water treatment.

Chinese environmentally related stocks are starting to get renewed attention after the Communist Party Congress re-emphasised the need for the country to focus on cleaning up pollution. CEI has also recently announced an increase in their dividend payout, a key validation of improving cash flows.

Portfolio review

The Fund consolidated on its September gains, outperforming the market by 1.05% with a return of 5.51%. Global markets were up 2% in USD terms and a falling AUD was a tailwind.

Long stock selection was again the primary driver of outperformance over the month. Market neutral pairs were a positive contributor and hedging decisions were a small detractor.

The largest contributor for the month was Japanese advertising business, Macromill. [We have written before about this stock](#) and as time post-IPO has passed, more analysts have picked up coverage. After surging by more than 30% in October, we have trimmed our position on two grounds: firstly, while the stock still has upside, it isn't as cheap as it was; and secondly, private equity firm Bain, which sold in the IPO, is now out of lock-up on the stock, and with the price well above IPO levels, seems likely to monetise more of its investment.

The second largest contributor was Japanese construction firm, Hazama Ando, which is relatively large (US\$1.5bn market cap) but has hardly any sell-side coverage. The stock trades at a PER of less than 8x. We see further gains if it just closes the valuation gap with its peer, Kumagai Gumi, which has broad broker coverage and trades on a still cheap PER of 9x.

One of the largest detractors came from French satellite operator SES Group. We often talk about our stop loss rules being a good circuit breaker for calls that aren't working. So it proved here when we were stopped out during the month. Soon afterwards, the stock reported weak results and downgraded its outlook, with our rules having protected investors from worse losses.

Outlook

We wrote about [our Q4 outlook](#) recently. Our view is 'onwards and upwards until Christmas'. It has been a good year already, but it is worth noting that for the last 30 years, on average, two-thirds of equity returns occur between October 12th and December 31st.

Global trends in economic data are good and also broadly based rather than being just driven by China or the US. 'Animal spirits', as measured by consumer confidence, are at their highest in 17 years.

Perhaps the biggest thing to fear is the lack of fear itself. Often things go wrong when so little is priced in, but trying to predict an unknown event at an unknown point for an unknown outcome is tough. We prefer to adapt to new news quickly when it arrives.

Hedges remain minimal. Our aim is to give investors the highest level of upside participation in this old but still bull market. That said, the Fund has some cheap insurance for a December pick up in volatility. It also has some protection against the market pricing faster US interest rate hikes to reflect the good data.

Key Facts

ASX code / share price	MEC / 1.09
ASX code / option price	MECO / 0.016
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee ³	15%
Market Capitalisation	\$ 50m
Shares Outstanding	45,466,227
Options Outstanding	43,415,026
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

Net Tangible Assets (NTA)

Net tangible asset value before tax ⁴	\$ 1.1326
Net tangible asset value after tax ⁴	\$ 1.1236

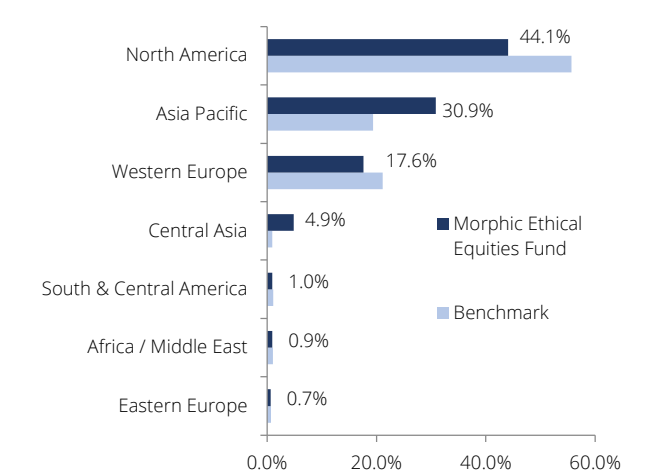
Top 10 Holdings

Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	3.8%
Service Corp	US Deathcare	North America	3.0%
Samsung Electronics	Global Tech	Asia Pacific	3.0%
Ateam	Japanese E-Commerce	Asia Pacific	2.9%
Western Alliance	US Quality Banks	North America	2.6%
Open House	Japanese Homebuilders	Asia Pacific	2.4%
Iida Group	Japanese Homebuilders	Asia Pacific	(2.2%)
Wells Fargo	US Quality Banks	North America	(2.1%)
Macromill	Global Research	Asia Pacific	2.0%
Hazama Ando	Japanese Homebuilders	Asia Pacific	2.0%

Hedge Positions

Name	Risk Limit Utilisation (%) ⁶
Short 10Y US Bonds	1.0%
Short Euro Long Yen	0.6%
US Curve Flattening	0.3%
Long Volatility (VIX)	0.1%

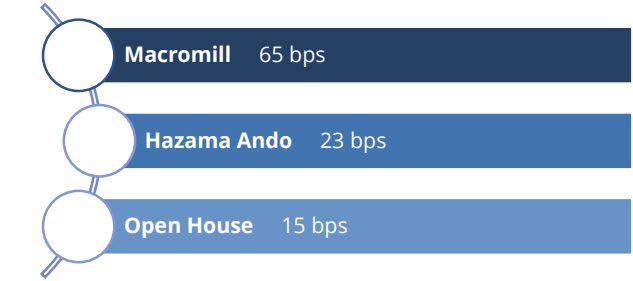
Equity Exposure Summary By region



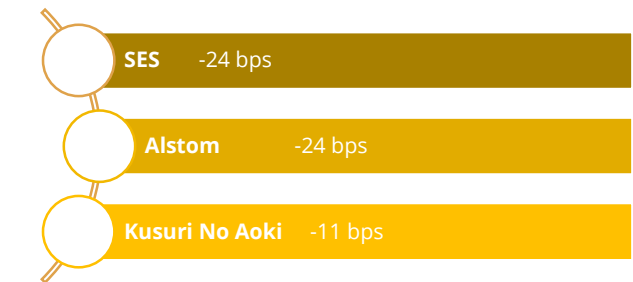
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¹ Performance is net of investment management fees, before company admin costs and taxes; ² The Index is the MSCI All Countries World Daily Total Return Net Index (Bloomberg code NDUEACWF) in AUD; ³ The Performance Fee is payable annually in respect 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; ⁴ The figures are unaudited; 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.

Top three contributors⁵ (bps)



Top three detractors⁵ (bps)



Risk Measures	
Net Exposure ⁷	103%
Gross Exposure ⁸	157%
VAR ⁹	1.06%

Equity Exposure Summary By sector

