

MORPHIC ETHICAL EQUITIES FUND

Monthly Report
January 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	ITD
Morphic Ethical Equities Fund ¹	2.05%	2.15%	9.30%
Index ²	2.04%	3.61%	11.40%

Ethical Investing in Focus

This month sees the launch of our Morphic ESG Long/Short Hedge fund, developed in partnership with our European distribution partners, Trium, to be sold to European clients. The innovative fund will be one of the world's first ESG compliant hedge funds and offers a version of the Morphic funds into Europe in a European compliant fund. If you are interested please contact us to see if you are eligible to invest (open to wholesale Australian investors only at this stage).

Whilst Morphic focuses its investing efforts on investing clients' money into suitable shares, one interesting piece of news flow over the month that we thought worth bringing to your attention was some evidence that adding a focus on environment, social and governance issues [added value to bond investors as well](#). We see this as further evidence that ESG has a positive effect on both investors returns, no matter the asset class.

Portfolio review

The Fund rose 2.05% in January, slightly outperforming the benchmark.

Global markets were up 5.6% in USD terms for the month, but offsetting this the Australian dollar rose strongly, up 3% again last month. This was the third strongest start to a year in over 30 years. Emerging Markets were the strongest region, up 8.3%, continuing their trend from 2017. USA (+5.6%) was in line, with Japan (+4.6%) the slight laggard. Banks (+8.3%) and other cyclical led, with utilities (-0.6%) suffering from rising interest rates. All returns above are in USD terms to allow comparisons.

Our long-held position in Bank of Internet was the largest contributor as it benefitted from both the buying of banks and good stock specific news. The company's results for 2017 showed the business continues to improve, with margins remaining high and charge-offs low. Even after this move, the stock has not re-rated to where it was before a series of short-selling 'hit pieces' published over the last few years, suggesting further upside. We have trimmed but remain holders.

Cosmos, the short leg of our Japanese drugstore pairs trade composed of long Kusuri No Aoki and short Cosmos was the second largest contributor. Cosmos reported results suggesting falling profitability in its key markets and future capital expenditure. After Cosmos fell heavily on the announcement, we closed the position.

Our largest detractor for the month was our short position in Prada. The stock rose strongly on the back of a general rally in Asian stocks combined with the hope that sales and margins improve in line with reported peers. We cut our position and will await to see how trading conditions evolve.

Outlook

Whilst as a general rule we keep the performance report to what happens in the relevant month, the post-month end moves in markets do warrant some comment. We have written a [blog for investors](#) outlining our views of what is taking place and our thoughts on how we manage through this.

In December, [we wrote](#) that it would be "interesting" to observe how bonds react to improving data. January saw them start to price in the better real world and it seems bonds got their answer – moving to 2.9% or 50bps in a month was too much.

The real world and its "shadows" that are financial markets have a close relationship over long periods of time. In a world of fewer active managers, one cost is lower diversity of buyers. The financial world is more "brittle" than it was before. Whether this is what regulators intended is another matter. We saw this in August 2015 and in 2010. We would argue this is the same again. But the real world is robust for now and we remain of the view that markets will adjust to reflect the real world, not the other way around.

Key Facts

ASX code / share price	MEC / 1.08
ASX code / option price	MECO / 0.023
Listing Date	3 May 2017
Management Fee	1.25%
Performance Fee ³	15%
Market Capitalisation	\$ 49m
Shares Outstanding	45,479,227
Options Outstanding	43,402,026
Options Exercise price	\$ 1.10
Options Expire	30 November 2018

Net Tangible Assets (NTA)

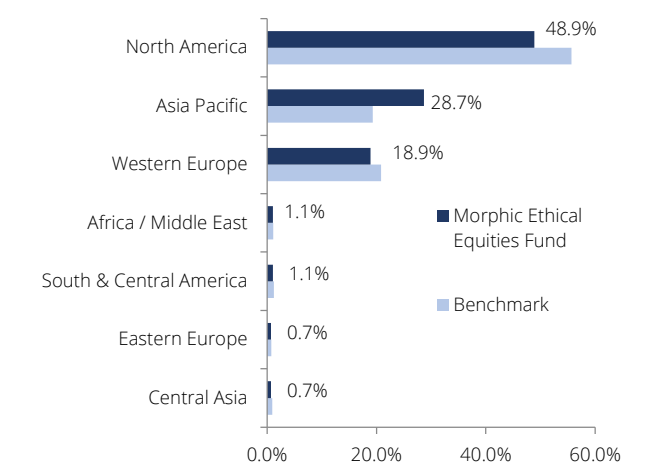
Net tangible asset value before tax ⁴	\$ 1.1530
Net tangible asset value after tax ⁴	\$ 1.1380

Top 10 Active Positions

Stocks (Shorts)	Theme	Region	Position Weighting
Alstom	Global Rail	Europe	4.1%
China Everbright Intl	Environmental & Facilities	Asia Pacific	2.9%
Wells Fargo	US Quality Banks	North America	(2.8%)
Macromill	Global Research	Asia Pacific	2.8%
Service Corp	US Deathcare	North America	2.7%
Hazama Ando	Engineering & Construction	Asia Pacific	2.7%
Western Alliance	US Quality Banks	North America	2.6%
Panalpina	Global Freighters	Europe	(2.4%)
Ateam	Japanese E-Commerce	Asia Pacific	2.0%
Bank of the Ozarks	US Quality Banks	North America	2.0%

Hedge Positions	Risk Limit Utilisation (%) ⁶
Short Bonds	0.6%
Long AUD	0.5%
Long Japanese Yen	0.4%

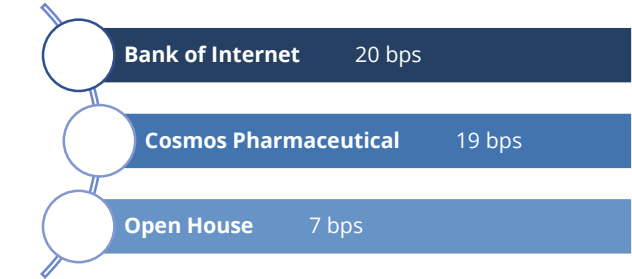
Equity Exposure Summary By region



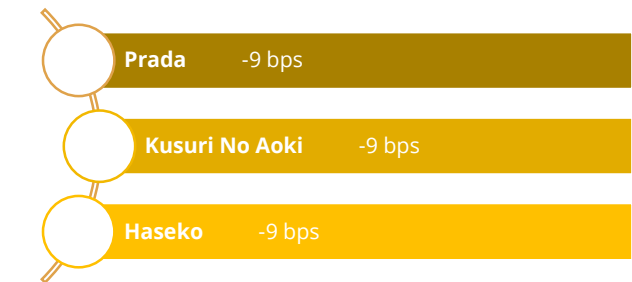
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¹ Performance is net of investment management fees, before company admin costs and taxes; ² The Index is the MSCI All Countries World Daily Total Return Net Index (Bloomberg code NDUEACWF) in AUD; ³ The Performance Fee is payable annually in respect 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 alpha contributors⁵ (bps)



Top three alpha detractors⁵ (bps)



Risk Measures	
Net Exposure ⁷	102%
Gross Exposure ⁸	126%
VAR ⁹	0.98%

Equity Exposure Summary By sector

