

# MORPHIC ETHICAL EQUITIES FUND

Monthly Report  
January 2021



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	3 Years (p.a.)	ITD (p.a.)
Morphic Ethical Equities Fund <sup>1</sup>	8.60%	14.93%	17.13%	14.96%	9.53%	10.12%
Index <sup>2</sup>	0.12%	7.09%	9.59%	2.10%	9.86%	10.95%

\* Past Performance is not an indication of future performance.

## Ethical Investing in Focus

Road, rail, air and marine transportation accounts for over 24% of global CO<sub>2</sub> emissions and roughly 15% of all global emissions. Within the transportation sector, road vehicles account for 72% of global CO<sub>2</sub> emissions. Despite increased awareness, the transportation sector is still the fastest growing source of global emissions.

In response to this challenge, governments are introducing national targets to reduce transport emissions and meet their Nationally Determined Contributions (NDC'S) under the Paris Climate Agreement. In particular the EU is targeting a 60% reduction in GHG emissions compared to 1990 levels by 2050. The EU recognises electric vehicle (EV) market development and adoption as a key pillar to achieving this target. While in the US, the recent inauguration of President Biden has already seen the weaker auto emissions policies of the Trump administration be reversed.

### Portfolio review

Anyone hoping that 2021 would be a little less eventful than 2020 was quickly brought back to our current reality as the retail vigilantes, primarily driven by "swarm traders" of WallStreetBets, drove one of the largest de-grossing periods on record. According to the Economist, retail investors made up a tenth of trading volumes in 2019 and by January this year their share had risen to a quarter. This de-grossing impacted confidence in global stock markets, primarily in the last week of January with markets turning in a relatively subdued performance during the month.

The Morphic Ethical Equities Fund increased 8.6% net during the month outperforming the benchmark which increased by 0.1% over the same period.

In light of the Fund's recent performance, going forward, we will provide you with the profit reserve on a monthly basis. As at the end of January 2021, the Fund's profit reserve was 23.6 cents per share<sup>3</sup>. 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.

The portfolio's top three contributors Bed Bath and Beyond, Tencent Music Entertainment and Option Care Health added 513bps to performance while Tempur Sealy, Alstom and New Oriental Education & Technology detracted 53bps. The Fund had 9 portfolio companies reporting quarterly results or trading updates in January.

Bed Bath and Beyond is a new position in the Fund premised on relatively new CEO, Mark Tritton, turning around a business which has been historically mis-managed inside a very large addressable market. Rightsizing and investing in the existing store fleet, focusing on an omni-channel strategy, exiting non-core businesses and re-energising its buybuyBABY franchise will drive significant operating leverage and cash flow over the coming years. The stock got caught up in the retail frenzy during January increasing from \$18 to just under \$53 at the peak, pulling forward the entirety of our forward expectations into one month. We took advantage of the run and booked our entire initial cost position as profits and are now looking to add to the position as fundamental value is better reflected in the price.

## Net Tangible Assets (NTA)

NTA value before tax <sup>3</sup>	\$ 1.3483
NTA value after tax <sup>3</sup>	\$ 1.2646

## Investment Returns since inception<sup>4</sup>



Past Performance is not an indication of future performance.

Groupe SEB is one of the largest small domestic appliance and cookware companies globally owning strong brands such as Tefal and Moulinex. In its Q4 and FY20 sales update the company announced full year organic revenues down 3.8% compared with negative 5-6% guidance while earnings were upgraded by >10% as Europe performed better than expected. The resilience of its globally integrated manufacturing footprint was evidenced in the result.

Our regional US Banks, Comerica and Webster, both reported as expected with past provisioning proving to be very conservative as loan books remain healthy, although growth still remains elusive. The banking system is awash with excess deposits, currently invested in low yielding short duration assets, which provides significant optionality for the group.

## STOCK IN FOCUS: Sensata (ST US, \$8.3bn Market Cap)



Sensata Technologies is a world leader and early innovator in mission-critical sensors and controls designed to make the world cleaner, safer and more efficient. Sensors are the fundamental building blocks for electrification, autonomy and smart, connected products in connecting the physical to the digital world. Sensata aims to be a leading provider of mission-critical sensor-rich hardware and software solutions to help customers transition to an Electrified future.

Its corporate name is literally derived from the latin word sensate or "those gifted with sense" while its logo also spells Sensata in braille. It is involved in four key megatrends which will shape its business and earnings growth over the next decade:



### Clean & Efficient

Sensata sensors are being used to make more efficient industrial pumps, improve fuel efficiency in cars and heavy off-road vehicles and more.



### Electrification

As electric vehicles rise in popularity and demand, they require sensors to monitor and optimize everything from battery systems to thermal management systems.



### Autonomy

Sensata is developing sensors that will enable light passenger cars, off-road vehicles and material handling equipment to operate autonomously.



### Smart & Connected

Sensata is developing smart, connected sensors that enable actionable insights for commercial vehicle operators.

Source: Sensata Corporate Website

Its end markets are dominated by auto and heavy duty/off road vehicles and with its highly customised and differentiated solutions it provides customers with better on-board diagnostics to address global regulatory mandates for cleaner and more efficient vehicles, safety and performance as they move to greater vehicle electrification and longer-term greater autonomy of global fleets.

On the back of increasing complexity of vehicles and subsequent sensor demand, Sensata benefits from increased sensor content per vehicle and, over the long term, typically outgrows its end global auto market by 400-600bps and by 600-800bps in the heavy vehicle/off road category. In its recently reported FY20 results, Sensata delivered market outgrowth above its target ranges for both heavy vehicle off-road and automotive coming in at 880bps and 690bps, respectively.

With the global auto market down almost 21% in 2020 and Heavy Vehicle down by 18.0%, the business is set up for some very strong growth over the coming years. Management indicated its EV-related revenue represented approximately 5% of its automotive end market, as compared to EVs representing approximately 3% of vehicles manufactured globally. It is confident that it can grow along with the accelerated growth of EVs especially when considering it has closed new electrification business with many of the largest and most innovative automotive OEMs around the globe. It has existing business or design-wins on future EVs with nearly every automotive OEM with an announced EV launch.

We believe that the global supply chains will continue to take time in recalibrating post the Covid-19 shutdown and therefore elongate the recovery cycle for Sensata's end markets. Management expects global automotive to rebound 13.0% this year with heavy vehicle to recover by 6.0% and when you couple its outgrowth characteristics, we should see FY21 revenues expand by close to 16.0% with EPS up by almost 50%. This is an early cycle play on the recovery and therefore we would expect solid growth over the next couple of years as well.

At the time of writing, Sensata is trading at \$52.85 which represents a forward PE of 13.1x, EV/EBITDA of 9.5x, >6% FCF yield. We consider that Sensata offers one of the cheapest, highest quality investing opportunities for those looking for exposure to global megatrends underpinned sustainability and increasingly stringent environmental regulations.

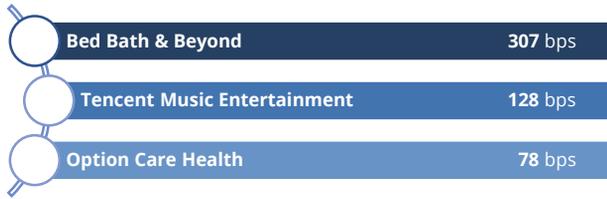
In the interest of keeping you updated on the performance and positioning of your holding in the Fund, we are hosting an investment update on Tuesday 16th February 2021 at 10am AEDT, for which you can register [here](#).

## Top 10 Active Positions

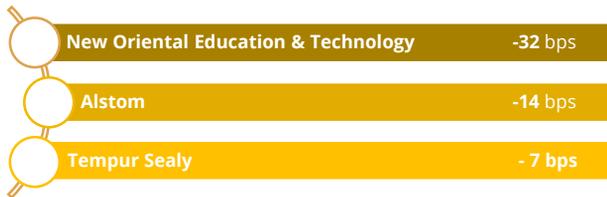
Stocks (Shorts)	Industry	Region	Position Weighting
PTC	Information Technology	North America	5.2%
Techtronic Industries	Industrials	Asia Pacific	4.4%
Flex	Information Technology	North America	4.1%
Bureau Veritas	Industrials	Europe	3.9%
Option Care Health	Health Care	North America	3.9%
SEB	Consumer Discretionary	Europe	3.8%
Sensata Technologies	Industrials	North America	3.7%
Cellnex Telecom	Communication Services	Europe	3.6%
Alstom	Industrials	Europe	3.5%
Tempur Sealy	Consumer Discretionary	North America	3.5%

Risk Measures	
Net Exposure <sup>5</sup>	89.87%
Gross Exposure <sup>6</sup>	94.44%
VAR <sup>7</sup>	2.13%
Best Month	8.60%
Worst Month	-6.49%
Average Gain in Up Months	2.34%
Average Loss in Down Months	-2.13%
Annual Volatility	9.94%
Index Volatility	10.86%

## Top three alpha contributors<sup>8</sup> (bps)



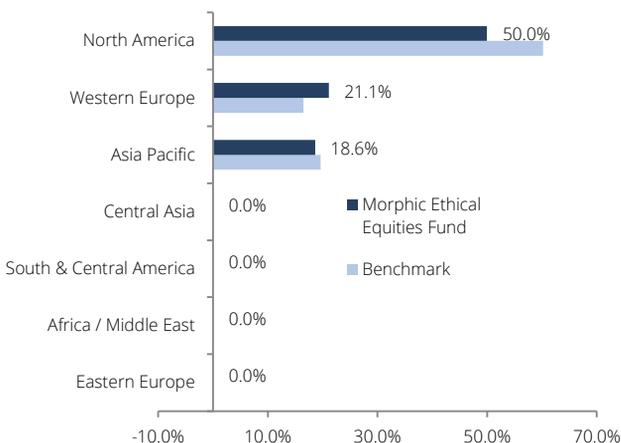
## Top three alpha detractors<sup>8</sup> (bps)



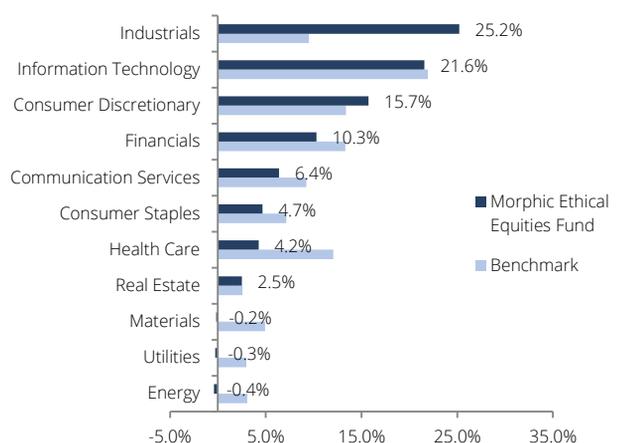
## Key Facts

ASX code / share price	MEC / 1.03
Listing Date	3 May 2017
Profit Reserve <sup>9</sup>	\$ 0.236
Management Fee	1.25%
Performance Fee <sup>10</sup>	15%
Market Capitalisation	\$ 55m
Shares Outstanding	52,953,469
Dividend per share <sup>11</sup>	\$ 0.025

## Equity Exposure Summary By region



## Equity Exposure Summary By sector



## Contact us

### Morphic Asset Management Pty Ltd

Level 11, 179 Elizabeth St

Sydney 2000

New South Wales

Australia

[www.morphicasset.com](http://www.morphicasset.com)

### Investor Relations

Phone: +61 2 9021 7701

Email: [info@ellerstoncapital.com](mailto: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](http://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.

<sup>1</sup> Performance is net of investment management fees, before company admin costs and taxes; <sup>2</sup> The Index is the MSCI All Countries World Daily Total Return Net Index (Bloomberg code NDUEACWF) in AUD; <sup>3</sup> The figures are estimated and unaudited; <sup>4</sup> 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; <sup>5</sup> Includes Equities and Commodities - longs and shorts are netted; <sup>6</sup> Includes Equities, Commodities and 10 year equivalent Credit and Bonds - longs and shorts are not netted; <sup>7</sup> Based on gross returns since Fund's inception; <sup>8</sup> Attribution; relative returns against the Index excluding the effect of hedges; <sup>9</sup> 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; <sup>10</sup> 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; <sup>11</sup> Annual dividend per share.