

MORPHIC ETHICAL EQUITIES FUND

Monthly Report
October 2020



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 | 0.20% | 1.91% | 8.51% | 7.40% | 5.31% | 6.57% |
| Index ² | -0.42% | 2.33% | 5.92% | 2.90% | 8.65% | 9.62% |

* Past Performance is not an indication of future performance.

Ethical Investing in Focus

On Sept 23rd the Governor of California announced that by 2035, all new cars and passenger trucks sold in the State are to be zero-emission vehicles as it looks to drastically reduce demand for fossil fuel in California's fight against climate change. The Governor indicated that Transportation currently accounts for more than 50 percent of California's Greenhouse Gas Emissions

California is leading the nation in this effort with New Jersey and New York also providing strong commitments in addressing the defining issue of our time, climate change. There are 15 countries globally that have already committed to phase out gasoline-powered cars and we believe many more will follow as the world recognises the need for climate action.

Portfolio review

The Fund rose 0.2% in October, outperforming global markets which fell 0.4% in AUD terms. Leading up to the early November US Elections, global equity markets were generally weak during the month with the S&P 500 and Nasdaq down 2.7% and 2.3% respectively while increasing Covid-19 cases in Europe saw the French and German markets down by 4.4% and 9.4%.

Most of the US election noise is now (hopefully) behind us and while the players at the top have changed, it looks likely that the political gridlock of a divided government will remain in place. While this does reduce the potential for aggressive fiscal stimulus, it also takes aggressive Democratic tax policy changes off the table in the near term. The growth and economic recovery narrative has not changed and we consider strong fiscal measures remain a matter of when and not if.

The portfolio's top three contributors Tencent, LiveRamp and New Oriental Education & Technology Group added 97bps to performance while Alstom, NEC Corp and Fujitsu detracted 94bps. We had a very busy month with 15 companies reporting quarterly results or trading updates, some of which we include below:

Fujitsu is a beneficiary of medium-term digitalisation trends at the corporate and government level. Fujitsu 2Q results disappointed the market after a strong 1Q as a result of a delay in project deployment related to the Covid-19 pandemic. Management did however reiterate their full year guidance as they look to deploy resources to high growth areas and focus on operational efficiencies. Despite weakness in IT spending during the quarter, Fujitsu, as well as some of their key competitors have held their full-year guidance which suggests a strong 2H.

Groupe SEB is the global leader in small domestic equipment which covers both cookware and small electric appliances owning strong brands such as Tefal and Moulinex. It delivered 4.4% like for like Q3 revenue growth which was ahead of market expectations and marked a strong turnaround from the negative 12.6% performance of the first half. Its consumer business of cookware and small domestic appliances grew 10% as it benefits from the favourable trends of "homemade over processed" and "Health and Wellness".

Net Tangible Assets (NTA)

| | |
|-----------------------------------|-----------|
| NTA value before tax ³ | \$ 1.1899 |
| NTA value after tax ³ | \$ 1.1584 |

Investment Returns since inception⁴



Past Performance is not an indication of future performance.

Sensata (ST) is a global leader in sensor technology and sensor-based solutions used in mission critical applications underpinned by megatrends such as vehicle electrification, smart and connected fleets, clean, efficient and autonomous vehicles. ST upgraded Q3 guidance in September however reported numbers exceeded this guide by quite a margin with EBIT of \$155m well ahead of its \$132-\$142m guide. The business continues to grow faster than its underlying auto and heavy vehicle end markets which are under extreme pressure as demand for its emission, electrification and safety related sensor technology continues to provide increased content per vehicle.

STOCK IN FOCUS: Bureau Veritas (BVI FP, €9.0bn Market Cap)



We are excited to launch the “Stock in Focus” series, a monthly update on one of our top holdings. We start with Bureau Veritas (BVI), a global leader in the €200bn testing, inspection and certification (TIC) market which is being driven by its client’s needs to reduce risk and improve performance through BVI’s expertise in quality, safety, health, environment and social responsibility. Its stated mission is to reduce risk, improve its clients’ performance and help them innovate to meet society’s challenges with confidence. As a business to business to society service company it establishes an unbiased, independent relationship of trust between consumers, governments and businesses.

The business generated about €5.1bn of revenue and over €600m of FCF last year with operations around the globe and in many diverse industries. It has dominant market share in ensuring safety at sea through ship and offshore platform classification services, ensuring the safety, reliability and integrity of industrial assets throughout their life cycle and providing assurance that property assets and infrastructure in service or under construction are safe, energy efficient and comply with applicable regulations. It also has #2 or #3 positions in certifying standards compliance of large companies, testing and certifying consumer products and improving transparency of the commodity supply chain.

In its last conference call Management highlighted 3 megatrends providing considerable opportunities and all driven by sustainability. With its global testing, inspection and certification capabilities it can fully support energy players transition to renewables, ensure quality, safety and traceability of products sourced through fragmenting supply chains and lastly as the leader in building and infrastructure, the European Green Deal will deliver revenue opportunities associated with green buildings, sustainable mobility and clean energy.



Source: BVI Q3 Trading Update Presentation

Like many companies, results in the first half of 2020 will be atypical and with approximately 17% of revenues from China, BVI felt the global pandemic early in the piece with group revenues down 11% in the half. BVI released its third quarter trading update near the end of October and provided an encouraging turnaround in organic revenue growth which was down 4.4% compared with market expectations for a decline greater than 8%. Additionally, it “upgraded” its base case scenario to a slow and gradual recovery from its previous base case of a muted recovery which subsequently resulted in market upgrades to earnings.

At the time of writing, BVI is trading at €20.98 which represents a nice uplift from when we entered the stock following its first half result which was weaker than expected causing the stock to decline double digits. The business is currently trading on about 10x forward EBITDA which is a 5-point discount to its listed comparables and 20-30% discount to its recent history.

We consider that BVI represents compelling value and is well placed in an environment of increasing supply chain complexity, heightened regulations and increasing business risk associated with safety and reliability of products and services.

Top 10 Active Positions

| Stocks (Shorts) | Industry | Region | Position Weighting |
|------------------------|------------------------|---------------|--------------------|
| Fujitsu | Information Technology | Asia Pacific | 3.8% |
| Assurant Inc | Financials | North America | 3.7% |
| Keysight Technologies | Information Technology | North America | 3.7% |
| New Oriental Education | Consumer Discretionary | Asia Pacific | 3.6% |
| Cellnex | Telecom | Europe | 3.4% |
| Tempur Sealy | Consumer Discretionary | North America | 3.1% |
| Bureau Veritas | Industrials | Europe | 3.1% |
| Sensata Technologies | Industrials | North America | 3.0% |
| Anritsu | Information Technology | Asia Pacific | 3.0% |
| Groupe SEB | Consumer Discretionary | Europe | 2.9% |

| Risk Measures | |
|-----------------------------|--------|
| Net Exposure ⁵ | 94% |
| Gross Exposure ⁶ | 99% |
| VAR ⁷ | 2.03% |
| Best Month | 5.51% |
| Worst Month | -6.49% |
| Average Gain in Up Months | 2.06% |
| Average Loss in Down Months | -2.13% |
| Annual Volatility | 9.16% |
| Index Volatility | 10.72% |

| Hedge Positions | Risk Limit Utilisation (%) ⁹ |
|-----------------|---|
| None | |

Top three alpha contributors¹⁰ (bps)

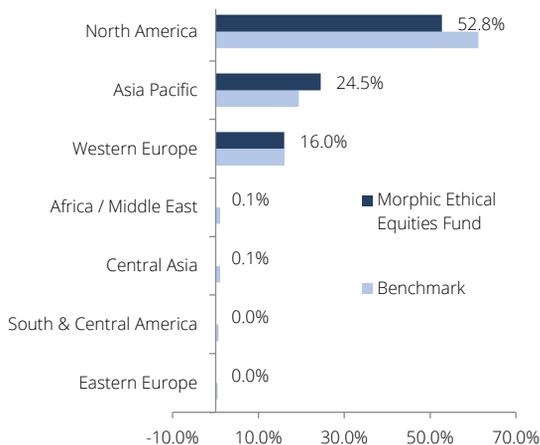


Top three alpha detractors¹⁰ (bps)

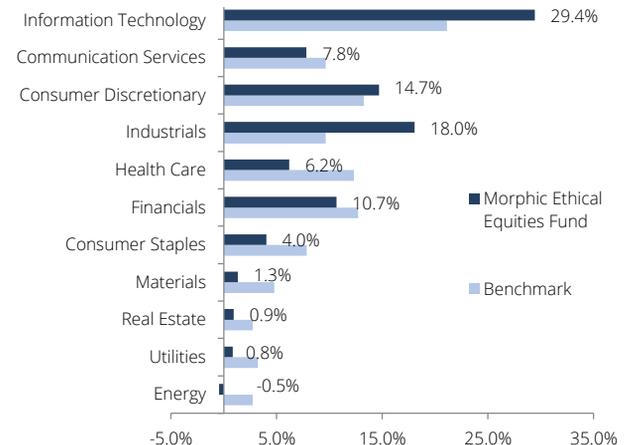


| Key Facts | |
|----------------------------------|------------|
| ASX code / share price | MEC / 1.01 |
| Listing Date | 3 May 2017 |
| Management Fee | 1.25% |
| Performance Fee ¹¹ | 15% |
| Market Capitalisation | \$ 53m |
| Shares Outstanding | 52,859,147 |
| Dividend per share ¹² | \$ 0.02 |

Equity Exposure Summary By region



Equity Exposure Summary 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 As a percentage of the Fund's Value at Risk (VaR) Limit; ⁹ As a percentage of the Fund's Value at Risk (VaR) Limit; ¹⁰ Attribution; relative returns against the Index excluding the effect of hedges; ¹¹ 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; ¹² Annual dividend per share.