

# Ethical Partners Australian Share Fund

JULY 2020

Ethical Partners Funds Management is a boutique Australian fund manager which is fully owned by its staff. We have a dual focus on performance and investing ethically over the long term. Our approach directly manages risk for our clients, provides the ability to invest in line with your values and actively advocates for change. Investors in the Fund invest alongside the owners and managers of Ethical Partners.



INVESTOR CLASS		CLASS A	CLASS B	CLASS C	CLASS E
Unit Price 31/7/20	\$0.7959	\$0.7938	\$0.7963	\$0.7899	\$0.7968
APIR code	EPF9951AU	EPF9964AU	EPF3813AU	ETL8683AU	-

**INCEPTION DATE**  
8 August 2018

**BENCHMARK**  
S&P/ASX 300 Accum. Index

**UNIT PRICING**  
Daily

**DISTRIBUTIONS**  
Every six months

**BUY/SELL SPREAD**  
0.20%

**MANAGEMENT FEE (PDS)**  
0.95%

**PERFORMANCE FEE (PDS)**  
15% of outperformance

**MINIMUM INVESTMENT**  
\$25,000

**INVESTMENT DIRECTOR**  
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[Link to PDS](#)

This newsletter is intended for wholesale and institutional investors only

## MONTHLY COMMENTARY

### Market and sector news

The last quarter has been the best of times for unprofitable but growing companies and the worst of times for value managers and others trying to buy equities with any margin of safety. Speculative activity in markets has been driven by excess central bank liquidity and real yields moving to -100bps, pushing risk assets higher, the valuations of technology companies up to levels not seen before and gold to all-time highs at around \$2,000 USD per ounce.

For some consumer discretionary companies in Australia the April to July 2020 period has been the best comparative sales growth they have ever experienced coupled with the lowest level of (particularly labour and rent) expenses relative to sales. Profits have been soaring. The underlying performance of the Australian economy however is poor and we are now in recession but Australian consumers' cash flow is materially higher than before COVID-19. Australian household incomes including wages and government benefits, according to data from Commonwealth Bank have been boosted by 12%-18% in the period from April to August 2020. Coupled with around \$40bn of Superannuation withdrawals, many households are net better off (from a cash flow perspective) than pre COVID-19. This has driven an extraordinary increase in consumer discretionary spending.

### Market's short term focus

As market participants tried to work out the effects of COVID-19, they have become obsessed with more and more short term data. Based on the volume of emails we receive on this it has been one of the most powerful drivers of share prices over the past quarter. The market is obsessed with how economies potentially open up and granular data showing anything from peoples' movements, road traffic and public transport usage, mall visits, office tower lift movements or web site visits is updated daily and aimed at trying to work out individuals' new post-COVID behaviours, locations and habits. Despite this we are keeping our focus on the medium term fundamentals of businesses.

## SIGNIFICANT HOLDINGS

Bega Cheese	Meridian Energy
Commonwealth Bank	NIB Holdings
Graincorp	SCA Property Group
Insurance Australia Group	TPG Telecom
Medibank Private	United Malt Group

### Performance as at 31 July, 2020

INVESTOR CLASS	1 MONTH %	3 MONTHS %	6 MONTHS %	SINCE INCEPTION (ANNUALISED %)
Fund (after fees)	-2.88	1.84	-21.74	-8.59
S&P/ASX 300 Accum	0.60	7.77	-14.20	1.22
Excess	-3.48	-5.94	-7.54	-9.81

### Looking longer term

While some of our stocks have done very well in the last quarter our portfolios did not fully capture the market move to the upside more broadly as we have been unwilling to believe that the current profit results are sustainable. And while the market is capitalising the extraordinary period of government handouts, we have been selling our remaining positions in companies that will struggle to cycle the results that are currently being reported. We felt this would serve our clients best over the medium term. The companies we have built and maintained large positions in include those that are not reporting stellar results today but those with strong franchises that are creating provisions in the current environment that will create stronger results in the future when those provisions unwind, such as stocks in the insurance sector. Also as Australia and New Zealand go back into various stages of lockdown we are starting to see the market focus back on medium term fundamentals including balance sheet and debt. At the depths of the market in March our investment process added significant value due to holdings in lowly geared and resilient companies but it has been a detractor since then. We expect this will see a return to adding value in the future.

### Valuation gap significant

The gap between our funds' PE and the market (ex-Resources and Financials) PE has opened up over the past few months to the widest since we began. This is a result of a general upward re-rating of the industrials and us being underweight four of the bubbles that have emerged since COVID-19 hit: Gold, Tech, Iron Ore and Consumer Discretionary. These four sectors make up around 28% of the market cap of the S&P/ASX 300 index and have outperformed over the last quarter. Growth expectations are high going forward for these sectors. Much of the portfolio resides in stocks with low profit growth expectations but the market environment of the last few years has not been favourable for these stocks. There are however some early signs that profit growth expectations for more expensive stocks are not being met and they are seeing subsequent falls in their share prices. Should this continue the prospect for stocks with low expectations going forward could be changing and our portfolio's prospects improved.

## ESG COMMENTARY

### Now fossil fuel free

The Fund has always excluded all coal and coal seam gas. However markets evolve and it has become increasingly clear that all fossil fuels provide sub-optimal climate-oriented outcomes and stranded asset risk is becoming more prevalent. Regulators and investors now expect that all companies are to be accountable in addressing their impact on climate change. It has also become clear that renewable energy is an increasingly viable alternative to gas generated energy and we expect development in battery technology to accelerate. The recent Australian Energy Market Operator 2020 Integrated System Plan makes it clear that in its view, based on certain assumptions, in the future it will be very difficult for new gas generation to be able to compete with batteries for 2-4 hours of firm supply. As such the Fund now excludes all fossil fuel producers from its investable universe. We have not had to make any changes to the portfolio in order for it to be fossil fuel free.

### 2020 Engagement Report is evidence of a busy 12 months

Our inaugural Engagement Report has been released providing a summary of how we have addressed ESG issues with companies since the inception of the Fund. We have raised over 300 ESG issues with companies using data and research from over 600 sources. This includes collaboration with 17 different NGOs, Advocacy Groups and Policy Groups. After we research and understand a company and it passes our operational risk analysis (EPORA), we exclude those that are deemed high risk from an ESG perspective (due to the nature of the goods or services the company produces, country risk, human rights risk or human rights related risks) and then identify leaders (positive screening). Engagement with the company comes next. Exactly how we do this and the results can be found in the report [HERE](#).

### We voted for 100% of human rights and environmental resolutions

We take our voting responsibilities seriously and assess each company resolution at AGMs or EGMs very carefully. In 2019/20 we voted in favour of 100% of human rights and environmental resolutions.

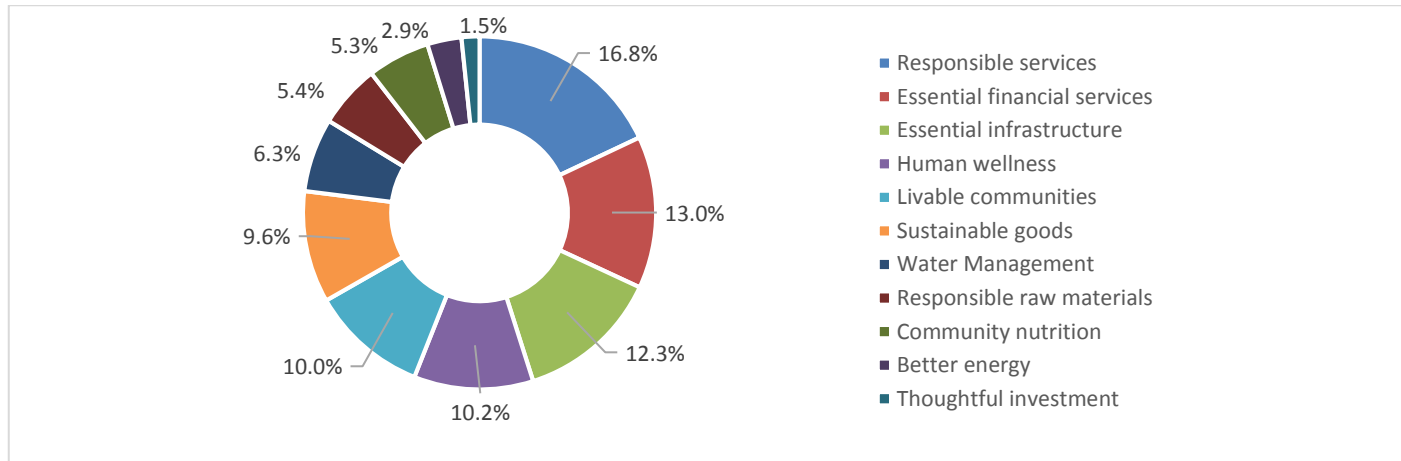
### Tax a key area of focus

Now more than ever, governments need revenue from taxation to fund essential services. Tax avoidance and offshore secrecy all divert potential revenue sources. We recently partnered with Publish What You Pay Australia to publish a report which calls on the Australian Government to introduce legislation requiring project-by-project level reporting of tax affairs for all ASX listed extractive companies operating in or from Australia. Similar laws are already in place in the UK, EU, Switzerland, Norway and Canada. While the Fund is underweight resources and doesn't own companies in the sector with a controversial position on tax, we do see read throughs for other owned sectors. Link to full report [HERE](#).

### If the country is paying, companies must support the country

During the current reporting season we have been pleased with the level of COVID-related assistance disclosure. We are of the view that if a company is receiving significant Government assistance, they have an obligation to "pay-back" this assistance by treating their staff well. This could be via flexible and paid leave, better working conditions and maintenance of current employment levels. While Wesfarmers (owned by the Fund) isn't necessarily a beneficiary of significant direct assistance, clearly it has indirectly benefitted from Government stimulus and hence its recent announcement that it will continue to pay staff during the current Victorian lockdown is to be applauded. Additionally we think that Government assistance should not be used for buy backs or to positively impact senior executive remuneration (STIs or LTIs).

## SECTOR EXPOSURE



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