EthicalPartners
FUNDS MANAGEMENT
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FEBRUARY 2020

Ethical Partners Australian Share Fund		
As at 29 February, 2020	**Unit price**	**APIR code**
Investor Class	$0.9584	EPF9951AU
Class A	$0.9582	EPF9964AU
Class B	$0.9604	EPF3813AU
Class E	$0.9613	-

Relative performance since inception vs S&P/ASX 300 Accum p.a (9 Aug '18): -6.63% (after fees)

To the clients of Ethical Partners and their advisors:

During February 2020 the Ethical Partners Australian Share Fund returned -6.89% versus the S&P/ASX 300 Accumulation Index of -7.76%, outperforming the market by 0.88% (after fees). Over the last quarter the Fund benefitted from underweight positions in Property and Materials. Key detractors over the last quarter included an overweight position in both Financials and Consumer Discretionary an underweight position in Healthcare.

Investor class	**1 Month %**	**3 Months %**	**6 Months %**	**Since Inception (annualised %)**
Fund (after fees)	-6.89	-6.17	-3.61	-0.25
S&P/ASX 300 Accum	-7.76	-5.22	-0.71	6.38
Excess	0.88	-0.96	-2.90	-6.63

Ethical Partners' investment process continues to be focused on investing in sound businesses at conservative valuations. As a consequence of this around 40% of the companies currently in the portfolio have net cash balance sheets (or close to), all are producing solid cash flows and all are conservatively valued on an earnings (not sales) multiple or have a valuation based on hard assets. **As a result we have not had to change the way we think about stocks or our portfolio positioning in response to equities markets selling off.**

Owning interests in well run businesses that produce solid cash flows has stood the portfolio in good stead. It means that we have options during market volatility and are not holding companies that rely on equities markets to be orderly for them to be well financed. Knowing our companies well means that we can selectively add to existing positions or find new holdings during market volatility.

During 1H20 reporting season we observed that stocks with low expectations and lower valuations generally outperformed those with high expectations and higher valuations. As usual we did our assessment of what the team got right and what we got wrong during results season. Of the approximately 30 companies that reported we were satisfied with the business performance in eighty percent of companies and twenty percent were below expectations. Eleven companies increased the dividend from last year and eighteen companies held or dropped the dividend year on year.

Some examples of stocks with low expectations versus high expectations are below:

1. Examples of low expectations and low valuations that outperformed post result: Nick Scali, GWA, JB HiFi (not owned), Suncorp, Smart Group, Webjet, IAG, Brambles, Medibank, Lend Lease, Commonwealth Bank, Janus Henderson, National Australia Bank (underweight).

2. Examples of stocks with high expectations, expensive valuations, and had rallied into result and subsequently underperformed (the Fund does not own any of these stocks): Altium, Pro Medicus, Wisetech, Coles, Wesfarmers, Reliance, Treasury Wines, Cochlear, Audinate, Blackmores, Appen, Nearmap. Market expectations were ahead of what these companies could actually achieve.

Markets sold off heavily in the last week of the month with technology stocks in particular underperforming. A feature of the market move was that equities fell at the same time as global interest rates fell, indicating that this measure will no longer solely support high valuations. The current downturn has the potential to redefine risk as a wider measure including balance sheet and refinancing risk.

The stock market is currently reacting to an economic slowdown precipitated by the global reaction to a new virus. But it is the build-up of risk tolerance and excess in the financial system, partly driven by central bank negative interest rate policies, that is now being unwound. Some of the signs that we were nearing the top of the cycle were:

- Value / growth pricing was the widest for twenty years. We have written about this a number of times last year. Market expectations were for no changes. As growth slows across the board we expect PE's will again converge.

- The ASX unveiled the Technology sub index on 21 February 2020. It covers companies with a combined $96bn of market cap but $1.4bn of historical Net Profit. The introduction of this index reminded us of the Entrepreneurial Investors sub index introduced in 1987 (included companies like Bond Corp and Qintex - with the index later retired in the mid 1990's) and the Asian companies sub index launched in the mid 1990's to tap into the ASX's listing of fast growing companies linked to the Asian Tigers countries. Unfortunately the timing was just prior to the 1997 Asian financial crisis and the index was also later retired.

- Berkshire Hathaway has generally underperformed in exuberant markets and did so again in calendar year 2019. Its book value growth versus the market performance was its worst at -19.5% for first time since 2009 (-23.8%) and before that 1999 (-40.9%).

- There has been a large build up in BBB and leveraged loans in the US and these have been diced up and distributed through Collateralised Loan Obligations to various funds. We expect that this will be a looming issue for markets as the debt expires.

- Low interest rates were unanimously expected to persist but we questioned how much upside still existed in equities re-rating from already high valuations. Lower for longer rates may not always be supportive of markets especially when expectations get ahead of company performance.

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With markets now facing a different risk profile, balance sheet and earnings are becoming more important than low rates and growth, in our view. With the portfolio positioned in companies with strong balance sheets, good cash flows and reasonable valuations we continue to look for good opportunities amidst lower prices. Through last week of February we became a net buyer of stocks in a ratio of almost 2:1 (buy/sell). We found stock specific opportunities in high quality industrials and cyclicals that had been oversold, in our view..

Nathan Parkin
Investment Director

Matt Nacard
Chief Executive Officer