EthicalPartners
FUNDS MANAGEMENT
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ETHICAL PARTNERS FUNDS MANAGEMENT

JUNE 2020

Ethical Partners Australian Share Fund		
As at 30th June, 2020	**Unit price (cum)**	**APIR code**
Investor Class	$0.8294	EPF9951AU
Class A	$0.8298	EPF9964AU
Class B	$0.8320	EPF3813AU
Class C	$0.8341	ETL8683AU
Class E	$0.8297	-

Relative performance since inception vs S&P/ASX 300 Accum p.a (9 Aug '18): -8.49% (after fees)

To the clients of Ethical Partners and their advisors:

Financial year 2020 marked a difficult period of performance for the Fund during the following three phases of the market:

1) Firstly the Fund underperformed through 2019 which turned out to be the last year in a decade long bull market for stocks.
2) Q120 saw markets correct in an aggressive sell off ignited by COVID-19. The Fund outperformed the weak market due to large holdings in companies with sound fundamentals and conservative valuations, until the market bottomed on 23 March.

Q220 saw a forceful market rally based on central bank intervention and liquidity being injected into the financial system by governments. Highly indebted companies and stocks with no earnings have done better than other stocks during this rally. Despite the Fund investing available cash during the market weakness and also supporting 11 different companies in new capital raisings at attractive prices, the Fund underperformed this period.

Investor class	**1 Month %**	**3 Months %**	**6 Months %**	**Since Inception (annualised %)**
Fund (after fees)	-0.59	9.62	-17.23	-7.54
S&P/ASX 300 Accum	2.43	16.79	-10.55	0.95
Excess	-3.02	-7.17	-6.68	-8.49

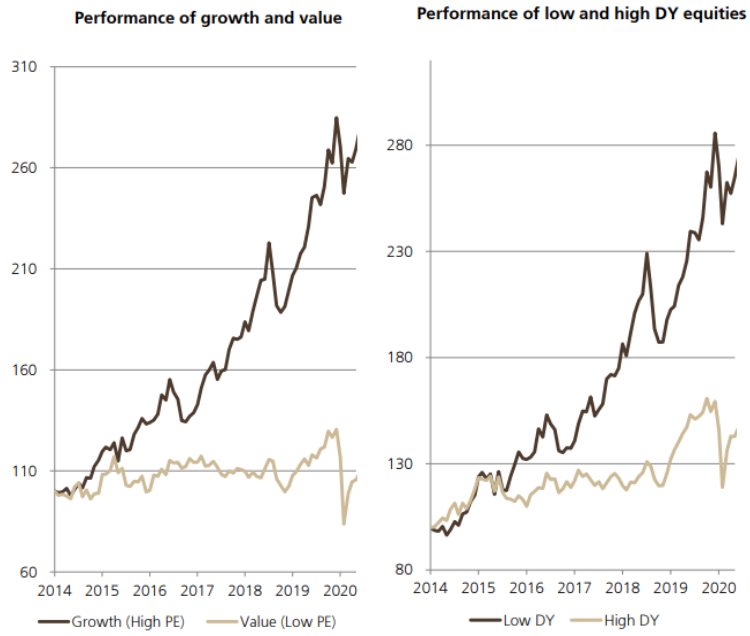
The Fund finished the financial year in the disappointing position of having underperformed in a down market. Importantly though, this includes a period where the market rallied for nine months of the financial year and saw weakness in only a three month period, ie: not long enough for the defensive characteristics of our portfolio to be fully realised.

During 2020 we reassessed the outlook for every stock held as well as performing a thorough reassessment of their balance sheet position and available liquidity assuming the COVID-19 related downturn persists for some time. This has led to a number of companies being sold or positions reduced with capital being reinvested in less cyclical businesses with strong asset backing where valuation has become attractive with the market weakness. What has been surprising is the ease at which we have been able to sell those positions where we no longer want exposure into the market

strength. Being more conservatively run companies, many of our new positions have not outperformed the market recovery to date but we believe they are well positioned.

It is evident that COVID-19 shutdowns will be rolling and unpredictable and that small businesses especially will not be able to maintain employment consistent with current levels once JobKeeper is scaled back. The transfer of individuals from JobKeeper to JobSeeker will add to reported unemployment levels (over and above the Federal Treasurer's adjusted 13.3% estimate). Businesses that have benefitted from government stimulus payments will find it hard to comp current revenue growth numbers next year. The share price reactions to strong results over the April to June period for stocks in the consumer electronics, furniture, fashion and services sectors show diminishing gains, ie: stocks had already rallied hard and it will take another period of stronger trading results for them to go much higher.

Looking at the broader stock market there are two distinct sections and the bull market has existed in relatively few stocks. The first section of the market is exuberant and greedy capital speculating on the ultimate value of tech companies and big data, like Afterpay in Australia and Tesla in the USA. The other is ordinary companies that perform the usual but unexciting services like insurance, agriculture, telecommunications and leasing out shop or office space. The latter has had sobering performance over the last few years. These two market sections for Australia can be seen below, firstly in the growth stock vs value stock chart and secondly in the low dividend yield vs high dividend yield chart.



Source: UBS

Companies that have paid out higher dividends have lagged in share price appreciation as they typically do not grow as fast or have the potential to reinvest in as many opportunities for further growth. But whether these so called opportunities turn out to be good investments remains to be seen. When companies pay out a good yield it means that the cash earnings (if indeed there are any) ends up in the hands of the investor and potentially not squandered away on dud projects. Dividend yield remains a preference of ours and we believe that it will again become a valuable attribute for investors over time.

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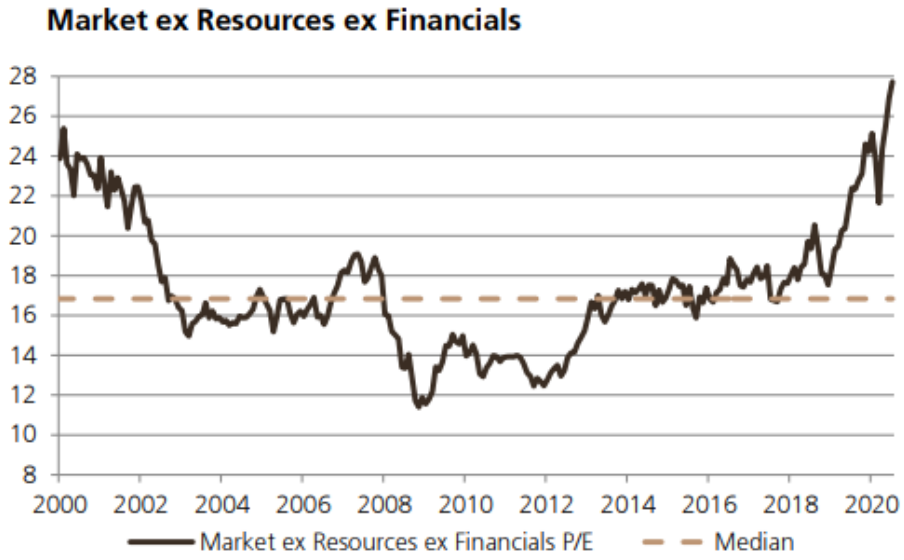
Company valuations remain lofty and analysts unsure of the future. The range of potential earnings outcomes predicted by the analyst community in Australia is showing the widest range of possible outcomes in a decade. Valuations have also risen since COVID-19 hit.



Source: UBS

We have been surprised by the willingness of the public to spend government stimulus and superannuation balances, aimed at supporting the economy over the medium term, on fashion, homewares and hardware. Whichever way you turn however employment or more precisely unemployment is the key to companies reporting future profit growth. So while government stimulus has driven short term results for some stocks we can already see signs of businesses acknowledging that there is going to now be a gap between the end of JobKeeper and the end of rising unemployment. In this environment our view is that the best opportunities to invest today exist in the ordinary companies that are performing the usual but unexciting services in our economy.

Our portfolios are invested in companies with real assets that are proven through the cycle profit and dividend generators, with reasonable valuations and we remain comfortable being invested amidst a range of economic outcomes that may eventuate.

Yours sincerely,

Nathan Parkin
Investment Director

Matt Nacard
Chief Executive Officer

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