EthicalPartners
FUNDS MANAGEMENT

Ethical Partners Australian Share Fund

SEPTEMBER 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 30/9/20	$0.8003	$0.7984	$0.8011	$0.7948	$0.8022
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
Nathan Parkin

CEO
Matt Nacard

CONTACT US
Suite 3, Level 4,
130 Pitt Street
Sydney NSW 2000
02 8999 1228
investors@ethicalpartners.com.au
www.ethicalpartners.com.au
Link to PDS

MONTHLY COMMENTARY

During September 2020 the Fund returned -3.40% versus the S&P/ASX 300 Accumulation Index of -3.60%, outperforming by 0.20% (after fees). Overweight positions in Insurance stocks and an underweight position in Construction stocks and Healthcare detracted from performance while overweight positions in Industrials (specifically Building Products) and underweight positions in Information Technology and Energy contributed to performance.

After a strong August (+3.05%) the Australian market retreated in September (-3.60%) led down by Financials, Energy and Consumer Staples. Australian and US based stock indexes had their worst month since March 2020 with the US based NASDAQ tech index leading the way down (-5.16%). Prior to September the NASDAQ had rallied over 78% since the March 2020 low while the Australian market was up approximately 33% over the same time.

In late August 2020 the US Federal Reserve officially relaxed its inflation target of 2% saying that it may let inflation run above that level into the future, before it next raises interest rates. Last time the Fed raised interest rates (four times in 2018) it was precisely to combat the prospect of future inflation amidst a tightening labour market. And while markets initially interpreted the Fed's new policy as meaning bond yields will stay lower for longer, this new policy is stimulatory and means that long bond yields can start to rise without inflation. Why? Because without the Fed being on watch for a specific level of inflation, and being willing to pre-empt it, markets will now have to be more vigilant.

While the Fed's new policy is a necessary, but not sufficient condition to actually achieve inflation, coupling it with global economies in the midst of re-opening and the largest-stimulus-ever working its way through financial systems, the risk of inflation has indeed risen.

SIGNIFICANT HOLDINGS

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

Performance as at 30 September, 2020

INVESTOR CLASS	1 MONTH %	3 MONTHS %	6 MONTHS %	SINCE INCEPTION (ANNUALISED %)
Fund (after fees)	-3.40	-2.34	7.05	-7.71
S&P/ASX 300 Accum	-3.60	-0.06	16.73	0.82
Excess	+0.20	-2.28	-9.67	-8.53

Accordingly, longer term US bond yields have increased since the Fed's change in policy. Any prolonged change in the perceived trajectory of rates could result in a change to the stocks leading the market. The last few years has been somewhat of a one way street running towards lower rates for longer which has helped the valuations of unprofitable tech, profitable tech, growth and some commodities. It has been unkind to most other stocks. With these issues in mind we have revisited our analysis of our current portfolio positioning. While we build the portfolio on a stock by stock basis and we analyse the risks and opportunities of each company individually we find it useful to summarise some of the factors that the portfolio is exposed to, below:

Characteristic	% Fund	% Market	% Active
Bond Proxies *	11.9	14.6	-2.7% underweight
Cyclicals (ex Banks) **	36.2	39.0**	-2.8% underweight
Defensives/Staples ^	49.3	28.8	+20.5% overweight
Resources/Commodities	4.8	20.0	-15.2% underweight (predominantly Iron Ore)
High Dividend Yield (+4.0%)	25.2	34.9	-9.7% underweight
Small Cap exposure	35.3	12.7	+22.6% overweight

** REITS, Telstra, Utilities, Airports, Toll Roads*

*** Market is Industrials, Materials, Consumer Discretionary, Energy*

^ Consumer Staples, Healthcare, Insurance, Telcos, Utilities, ASX, Brambles

The portfolio remains underweight Bond Proxies but significantly less underweight than one year ago. While the portfolio is underweight iron ore we have a high exposure to Cyclicals that are experiencing low cycle earnings such as base metals, steel making and aviation. Over the past year we have almost doubled our exposure to Defensives/Staples. Interestingly the proportion of both the Market and the portfolio with a High Dividend (we now use 4.0% as a cut-off vs 4.5% one year ago) has declined significantly over the past year as companies have experienced lower revenue and cut payout ratios. Consistent with last year we retain a large overweight position to Small Caps, mainly industrials.

ESG COMMENTARY

Mirvac: Sustainability leader

During the month we met with the Mirvac sustainability team. Mirvac continues to be an ESG leader in our view and it is a company where over time the market will continue to assign a higher rating to the stock as a result. Sustainability "is" the business at Mirvac. It isn't an afterthought or a set of strategies added on to the core business strategy. The company's sustainability positioning statement of *"Reimagine Urban Life"* is particularly interesting given COVID19. We asked if it was time to "reimagine" Reimagine Urban Life given the changing lifestyle trends of work from home, less time in cities, preference for landed houses over apartments and so on during and post COVID19. The short answer was no, which we think is the right approach. People will return to the CBDs; while office markets will be in downturn in the near term, COVID19 has merely accelerated a down-cycle that had already commenced. Mirvac's Masterplanned Communities business is well positioned and while apartments will be slower to launch and sell, there is a need for high quality product and Mirvac is well placed to provide it over the medium term.

Meanwhile Mirvac is taking the opportunity to progress its "*Planet Positive: Waste and Materials"* strategy which is targeting zero waste to landfill by 2030. Its recycling rate has been 60%+ and 95%+ for construction. However it became apparent progress was not sufficient to get the company to 100%. It had two choices 1) Halve development waste and/or 2) Procure 25% recycled content. A recent trial at its Willoughby project, considerable progress in waste management was shown and cost savings were also identified. At Tullamore in Melbourne Mirvac also launched a trial which saw four houses built using prefabricated wall and floor panels. Its aim was to save time, cost, reduce waste and maintain quality and safety levels. Our first question was whether you can tell the difference between fully built on site product and pre-fab product. We are assured that you cannot. The prefab program was over 20% faster than a traditional build, labour hours reduced by over 10% and waste onsite reduced by 50%. We see few reasons why this can't be rolled out more widely which will both reduce project costs as well as reduce waste.

Mirvac has also set itself a target of "net carbon positive" by 2030. It recently reduced its carbon emissions by 65% by changing to renewable energy for 70% of its office portfolio and 80% of its retail assets. We understand the net dollar cost impact was negligible. This is clearly just step one. Mirvac is also "designing out" fossil fuels in its new office developments. We like the focus on its genuine attempts to reduce its carbon footprint, not just acquiring offsets.

Overall, the thoughtful way Mirvac approaches sustainability permeates throughout the organisation. We value the stock at $2.50 and the Fund continues to hold an overweight position.

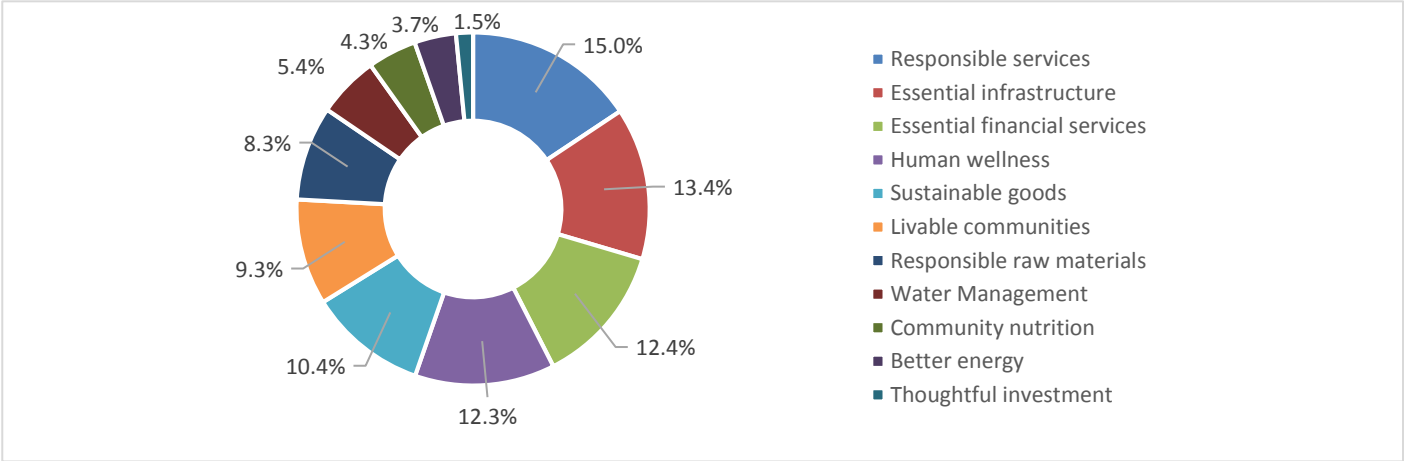
(…continued over)

EthicalPartners
FUNDS MANAGEMENT

Australia's great stimulus opportunity…lost?

We recently wrote an article laying out what we see as an excellent green stimulus opportunity, assuming Australian Governments will continue to look for ways to reflate the economy. We noted that significant stimulus spent in the right areas provides $11bn in net benefits, 100,000 jobs, minimises Australia's climate change impact, and minimises pollution levels. (For the full article click HERE). Credit Suisse estimates that the recent Australian Budget committed $10.1bn to the "Green Recovery". The Australian Government has committed to a "multi modal" approach which includes metro train upgrades, improving walking, bus interchange and cycling infrastructure. Unfortunately there was more focus on promoting gas as a transition fuel than investing in additional renewable energy. This approach appeared to upset almost everyone except large corporate gas users. Labor's response to the Budget was putting forward the spending of $20bn toward modernising the electricity grid to allow Australia to adapt to changing energy markets and further progress the transition to renewables. The Fund does not invest in fossil fuel producers but does hold Meridian Energy, a renewable energy provider well positioned for the market's renewable energy transition.

SECTOR EXPOSURE, SEPTEMBER 2020



PRI Principles for Responsible Investment

Zenith Investment Partners Recommended