EthicalPartners
FUNDS MANAGEMENT
Suite 3, L4, 130 Pitt St, Sydney, NSW 2000
Ph: 02 8999 1228 www.ethicalpartners.com.au

**ETHICAL PARTNERS FUNDS MANAGEMENT**

**NOVEMBER 2019**

| **Ethical Partners Australian Share Fund** | | |
|---|---|---|
| **As at 30 November, 2019** | **Unit price** | **APIR code** |
| Investor Class | $1.0453 | EPF9951AU |
| Class A | $1.0428 | - |
| Class B | $1.0459 | EPF3813AU |
| Class E | $1.0477 | - |

Relative performance since inception vs S&P/ASX 300 Accum p.a (9 Aug '18): -7.46% (after fees)

**To the clients of Ethical Partners and their advisors:**

During November 2019 the Ethical Partners Australian Share Fund returned 3.65% versus the S&P/ASX 300 Accumulation Index of 3.18%, outperforming the market by 0.47% (after fees). Over the last quarter the Fund benefitted from overweight positions in both Packaging and Construction Materials and an underweight position in Real Estate. Key detractors over the last quarter included an underweight position in Health care and Energy and an overweight position in Consumer Staples.

| **Investor class** | **1 Month %** | **3 Months %** | **6 Months %** | **Since Inception (annualised %)** |
|---|---|---|---|---|
| Fund (after fees) | 3.65 | 2.73 | 3.32 | 4.67 |
| S&P/ASX 300 Accum | 3.18 | 4.75 | 9.25 | 12.14 |
| Excess | 0.47 | -2.02 | -5.94 | -7.46 |

We have often written about the Fund being positioned very differently to the broader market (S&P/ASX 300 Index). The returns achieved in November and the individual stock contributions below highlight that the Fund can achieve returns but in quite different stocks to what might make up overall market returns. In a strong month the Fund achieved better than market returns while not owning the largest two contributors to market returns (CSL Limited and BHP Limited). Instead the Fund's largest contributors during the month were Graincorp, GWA Group, CSR and Janus Henderson. We continue to have large active positions across the Fund as well as have active engagement with companies (see Westpac below).

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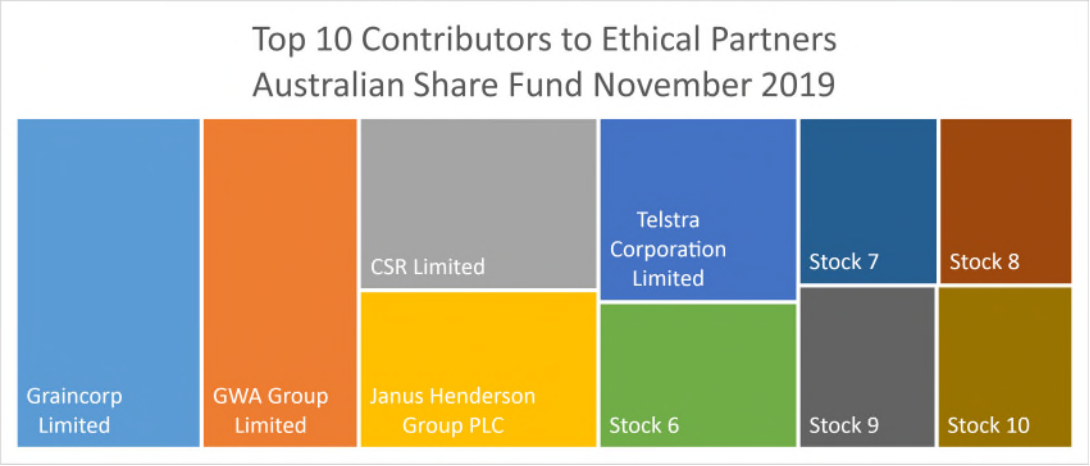


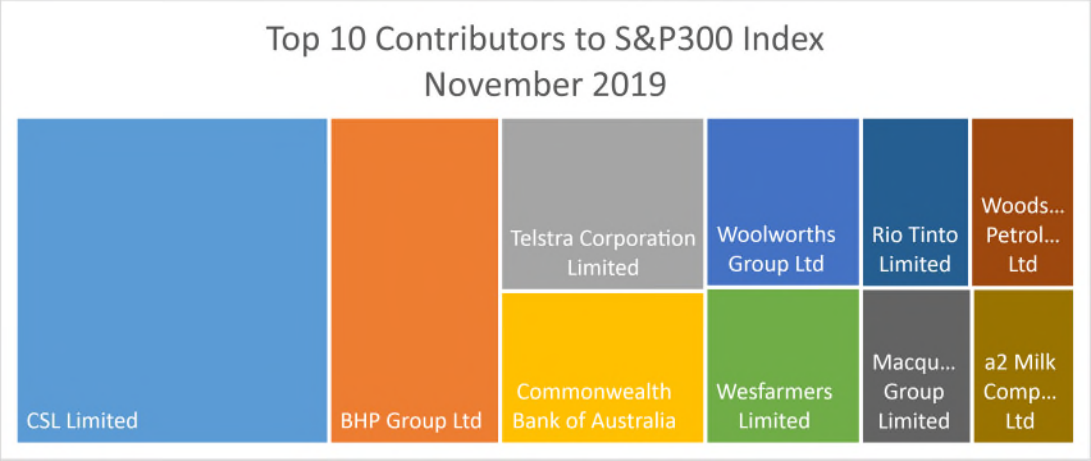


Our research effort and US trip

Our research effort continues to be based on a rigorous company visit schedule and the team at Ethical Partners has done over 300 individual company meetings this calendar year. This includes overseas trips to assess Australian company operations directly and in early November our Senior Analyst, Andrew Wilson visited North America, meeting with management teams to discuss a wide range of topics such as operating conditions, competitor dynamics, product opportunities and sustainability risks and initiatives.

Companies he met included subsidiaries of Australian listed companies, peer companies to provide an industry read through, and finally, some of the large US financial businesses, for example Wells Fargo and American Express, to gain some insights on the overall health of the US corporate and consumer landscape.

On 9 flights over 9 days to visit 6 cities, Andrew covered locations ranging from San Francisco, Portland, Seattle, Montana, New York, Atlanta and finally Houston to name a few. Our trips are always specific and targeted and we met with 18 different management teams and industry contacts, across Agriculture, Outdoor apparel, Healthcare, Travel, Financial Services, Transport, Consumer Staples and Building Materials. One such example was a meeting with a subsidiary of a listed business in our portfolio who said we were only the second investor to visit this year and were personally driven around by the CEO to inspect key assets. We gained valuable insights from this

meeting around a set of assets which are in the process of being demerged and in our view remained significantly under-valued by the market.

Another example was travelling via two separate flights to get to a remote town about 4500 feet above sea level, to meet with one of the fastest growing apparel companies in North America who are now the top ranked hiking shoe in REI. The 15 minute walk from the hotel to the office off Main Street risked frost bite (-15 Degrees Celsius). To put this small town in context the Uber driver who picked Andrew up from the airport the night before, by coincidence, just happened to be the same Uber driver the next day.

It is common practice for the investment community to focus their time on conferences and investor days when travelling abroad, whilst these can be informative and have an important role, we get significantly more value and enjoyment from spending time with a company outside of such events, and understand what truly makes them tick. We feel meeting management teams on their own turf, combined with choosing to focus on “off the beaten track” companies and cities, provides our investment team and ultimately our clients with genuinely differentiated insights that can have many years of shelf-life. In that vein, this trip further cemented our beliefs providing actionable insights and more significantly we gained a longer term understanding of key business drivers and risks for our holdings.

Our positioning, engagement and advocacy at Westpac

Westpac was the second largest contributor to relative returns during the month given the Fund had a large underweight position and the stock underperformed the market by -13.4%. The Fund has had a large underweight position in Westpac since May 2019. We had this view because we felt that the company would need to raise capital at some point and/or cut the dividend given the level of capital the bank held versus expected levels and likely additional regulatory requirements. Management and the Board had been slow to act in our view but eventually raised $2bn from institutions and also cut the dividend in November. Additionally AUSTRAC released a Statement of Claim in mid-November alleging Westpac had not reported around 20 million international transactions and had not monitored suspicious transactions properly for the known risks involved with child exploitation back as far as 2016.

Ethical Partners’ view is that matters concerning poor company practices and subsequent reputational risk can have a material financial impact. The assessment of how a business treats people and human rights is an important part of our EPORA (Ethical Partners Operational Risk Assessment) process and these recent allegations clearly indicate there may have been a lack of attention to these issues within the corporate culture of Westpac. We were extremely disappointed to see the content of the allegations and have engaged with the company and also made public our views around executives being held accountable. We feel that the CEO’s resignation, the early retirement of the Chairman as well as the Head of the Risk and Compliance Committee not standing for re-election at the AGM were appropriate changes.

A key aspect of our engagement with companies and banks in particular has been to advocate for better behaviour. Where Ethical Partners can see progress we are happy to retain a shareholding. Where we see a pattern of slow actions to remedy alleged and actual breaches it is a serious consideration for our ongoing holdings.

In addition to the clear ethical considerations, financially we see the allegations as a risk. While there are four large banks in Australia and they have all, at times, treated customers with contempt, Westpac is potentially an easy avoid for customers currently looking for banking services in a market with largely homogeneous products. Deposit and mortgage flows can move relatively easily to other

banks causing potential volume impacts. And the public outrage that might result in market share losses was on display the company's AGM.

During the month Ethical Partners further reduced its position in Westpac on these concerns. We will continue to review our stance on Westpac but we feel the first steps might have been made in changing the culture, albeit there is significant disruption at the organisation in the short term. The Fund currently has an overweight position in ANZ and Commonwealth Bank based on our view that these two organisations were; early to change the culture and early to change the leadership, respectively and are attractively valued.

Nathan Parkin
*Investment Director*

Matt Nacard
*Chief Executive Officer*