EthicalPartners
FUNDS MANAGEMENT

Ethical Partners Australian Share Fund

DECEMBER 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 31/12/20	$0.9405	$0.9388	$0.9422	$0.9325	$0.9445
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 December 2020 the Fund returned 2.11% versus the S&P/ASX 300 Accumulation Index of 1.32%, outperforming the market by 0.79% (after fees). Overweight positions in Renewable Energy and Transition Commodities and an underweight position in Healthcare contributed to relative performance while an overweight position in Food Products and an underweight position in Information Technology detracted from relative performance.

Globally, fiscal policy is now the primary source of stimulus as monetary policy has been exhausted with near zero interest rates. This has led to massive increases in government debt as extreme measures were used in 2020 to combat COVID-19. US government debt to GDP for example is now the highest since WWII, a point from where interest rates started to rise, coinciding with the increase in financial leverage.

Despite central banks' record-low interest rate policies, there has been a steady upward movement of the key US 10 year bond yield since August 2020. And equity markets have also risen, driven by a broader sample of stocks, contrasting the narrow markets of the last few years.

Through the end of 2020 stock valuations remain relatively high, reflecting low interest rates, but speculative activity is rampant in some parts of the market and can be seen globally in penny stocks, which is spilling over to other unprofitable companies, particularly in technology related areas. But despite this activity, or partly because of it, share prices of slower growing and higher cash flow companies remain near multi-year lows. The gap between the highest rated companies and the lowest rated companies is the widest on record.

(…continued over)

SIGNIFICANT HOLDINGS

- Bega Cheese
- Bluescope Steel
- Commonwealth Bank
- Graincorp
- IGO Limited
- Insurance Australia Group
- Meridian Energy
- SCA Property Group
- TPG Telecom
- United Malt Group

Performance as at 31 December, 2020

INVESTOR CLASS	1 MONTH %	3 MONTHS %	6 MONTHS %	12 MONTHS %	SINCE INCEPTION (ANNUALISED %)
Fund (after fees)	2.11	17.52	14.77	-5.00	-0.45
S&P/ASX 300 Accum	1.32	13.79	13.73	1.73	6.30
Excess	0.79	3.73	1.04	-6.73	-6.75

The conundrum facing investors today is that interest rates remain at absolute low levels but the direction of rates is up. The consequence of this has begun to be felt in financial markets in the last six months and capital flows data suggests that it is accelerating, making it harder to ignore for investors not positioned for a change. In our view the shift has four main effects, in this order:

1) Firstly, those companies that are exposed to cyclical forces rally as future economic growth is perceived to have improved;

2) Secondly, the rising 10 year benchmark interest rate has the effect of depressing the value of future cash flows and negatively affecting equity values. This is especially true for companies that have negative cash flow today because all the perceived value is in the anticipated but yet unseen future business value. Critically these companies depend on external and ongoing market support to make it through near term loss scenarios;

3) Thirdly, companies that are highly geared may face higher financing costs as they roll debt maturities. Low volatility businesses like toll roads and other infrastructure have higher volatility capital structures when they are highly geared;

4) Lastly, investors return to seeking out companies that produce strong cash flows and have less speculative business models. Companies capable of paying a reasonable and current year yield out of cash earnings are relatively more attractive in this environment.

While these changes take place in markets there is no change to Ethical Partners' investment philosophy or process or the way we invest, always using low debt, strong operating cash flow and reasonable and observable valuation as minimum investment requirements.

Our view is that the relative safety in Australian equities is to own companies with lower debt (not as exposed to rising rates) that are recovering from an earnings low point, companies that may be attractive targets for consolidation and those with exposure to a stronger USD (as we enter a period where world debt risks are on the rise). Our preferred exposures are in the Supermarket, Food, Insurance, Industrial and Transition Commodities sectors.

ESG AND ENGAGEMENT COMMENTARY

Lithium is an essential mineral for the growth of renewable energy and the path to net-zero emissions. Renewable energy is an important investment theme at Ethical Partners, and an important part of our portfolio's impact on SDG 7. Therefore, we believe that IGO's recent acquisition of the non-controlling stake in the Tianqi Lithium JV (including the Greenbushes Lithium mine and the Lithium Hydroxide plant at Kwinana) is a very positive step in its strategy to transition "to a leader in the clean energy metal space", and along with its exposure to copper, cobalt and nickel (as well as a current strategic review of the gold assets) positions it well as a pure-play miner of clean energy minerals.

It is also an area that provides a powerful opportunity for growth. A recent report from the World Bank projects that the production of minerals such as graphite, lithium and cobalt could increase by nearly 500% to 2050 to meet the growing demands of clean energy technologies. It also estimates that 3 billion tons of minerals and metals will be needed to deploy these technologies. Morgan Stanley has also projected that electric/hybrid vehicles will account for about 30 per cent of all vehicle sales by 2025, as compared with just 1 per cent in 2016, which will fuel a growth in global demand for lithium of 8 to 11% each year from 2017.

It is important to note however, that despite lithium playing a key role in transitioning to a net-zero future, it is still critical to consider lithium's own ESG issues. Therefore, Ethical Partners is also happy to see that Roskill's sustainability analysis shows the Greenbushes mine will have one of the lowest CO2 footprints of its hard-rock peers. Furthermore, its location in Australia gives us comfort around the labour and human rights issues that regularly affect the mining sector, including in transition metals (more than half of the global lithium reserves are found in countries like Bolivia, Chile and Argentina that have comparatively weak social and environmental standards). IGO has noted that it sources its four clean metals from "the tier one jurisdiction of Western Australia" and has committed that it would be "delivered to the highest ESG standards". We further note that Australia scores very well on the Transparency International Index, an important part of our (Ethical Partners Operational Risk Assessment) EPORA screening tool for Country Risk, and that we have had positive interactions with IGO about its commitment to sustainability.

IGO Limited has been a significant positive contributor to the Fund's performance.

(…continued over)

SECTOR EXPOSURE, DECEMBER 2020