6/3/19 – Boyd to SIRA Committee

Hi all
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A note about SIRA's investment with Australian Ethical Investments: A question was raised at the last meeting about whether we should move more quickly to exchange all of our interest-bearing funds (currently with St George in a term deposit) for the Balanced Fund at AEI. It's a good question but my response is that it is now more than 10 years since the GFC, so looking at the investment performance of AEI, or any fund, over the last decade will probably look quite a bit better than what we can expect in the next few years. As business cycles are often around 10 years, and as other factors affect the world economy and Australia's economy, we may find that a slower shift from interest-bearing to fund investment is a more cautious approach. However, I'm not especially worried about recessions and market corrections because our investment is for the medium and long term.

AEI prepare investment reviews from time to time and they are very informative. I'd encourage people to read them for your own and for SIRA's benefit. Here is the latest one;

"The global backdrop

2018 was a tough year for global share markets. The US stock market as measured by the S&P 500 index was down 4.4%, in Asia the Hong Kong Hang Seng index declined 13.6%, and in Australia the S&P/ASX 200 fell 2.8%.

Investors were optimistic at the start of the year following a strong surge in global share markets during the last quarter of 2017. This rally continued in January supported by a positive global economic picture: economic growth was looking strong across both developed and emerging markets, inflation figures in the US were starting to look healthy, employment rates were improving and US companies were releasing encouraging earnings results. The US market continued to rally spurred on by President Donald Trump's corporate tax cuts. However, concerns about inflated asset prices and rising interest rates threatened to undermine what otherwise seemed to be a reasonably positive global economic scenario. By the end of January markets took their first tumble of the year, and after a brief recovery they fell again in March. While strong economic data and a positive earnings outlook supported a further rally throughout the middle of the year, it all unravelled in the last few months of 2018. In fact, the final month of the year was the worst December for the US stock market since 1931!

So why did share markets take a dive in late 2018? The main thing investors were (and continue to be) worried about is whether the US economy will be able to maintain its current growth trajectory throughout a period of rising interest rates. More broadly, investors are nervous about the potential impact of a US slowdown on the global economy amid the backdrop of US/China trade tensions and the continuing uncertainty created by Britain's exit from Europe (known as 'Brexit').

Looking closer to home

In Australia we also faced a number of domestic issues that weighed on the minds of investors. The Royal Commission took its toll on the big four banks which returned an average of -10%. AMP, which we divested from in May following adverse findings by the Royal Commission, lost half of its value throughout 2018. The banks were further impacted by the persistent decline in house prices and the falling demand for new loans, particularly in the major cities. Between the decline in housing, poor wages growth and the slowdown in demand from China, the prospects of a near-term rate hike by the Reserve Bank of Australia seemed to dissipate as the stability of the economy was increasingly questioned.

Our performance

While our ethical investment process leads us to differ significantly from the rest of the market, our portfolios are nonetheless subject to the movements of the broader market. As such, our best performing fund over the 2018 calendar year was the Fixed Interest Fund which delivered a return of 4.0% for our wholesale investors. On a relative basis our funds performed in line with the broader market. The exceptions were our Emerging Companies Fund (which posted strong outperformance over the fund's benchmark, the Small Industrials

Accumulation Index) and our International Shares Fund (which underperformed the market as measured by the MSCI World Index ex-Australia).

The utilities sector was one of our strongest performers in 2018. This was largely thanks to the dominance of renewable energy companies in this part of our portfolio (which is a direct result of the application of our Ethical Charter). Some of our strong performers included Meridian Energy (which returned 31%) and Mercury NZ (up 20% over the year). While annual global emissions continued to rise in 2018 it was also the year when a record number of renewable power stations were accredited. Even more encouragingly, the Clean Energy Regulator says Australia's uptake of solar panels has been the fastest in the world.

Another notable name is Nearmap which returned 122% over the year. Nearmap is an Australian tech company that offers high resolution aerial imagery, coupled with 3D datasets for commercial use. This technology provides significant efficiency and capability to businesses and government agencies, allowing them to make more informed and data rich decisions.

Resmed is another standout, up 47% for the year. Resmed is a medical device company that provides masks and other devices to assist people with sleep-related breathing disorders such as sleep apnoea and chronic obstructive pulmonary disease. The growth in share price was due to an improved valuation rating relative to other major Australian listed device companies as the company continued to show strong growth year-on-year.

In the education sector, G8 Education returned 16% over the calendar year. G8 is one of the largest childcare providers in Australia, operating centres in both Australia and Singapore. The stock benefited from improved market conditions following changes to the childcare government subsidy.

The largest detractor from relative performance in the international shares portfolio was not holding Amazon which delivered a return of +42.7% over the year. We have assessed the company and it doesn't meet our ethical criteria due to poor working conditions of its employees. Of greatest concern is the company's tendency to micro-manage its workers by subjecting them to increasing surveillance and measuring their performance with reference to prescriptive metrics, leaving very little room for worker autonomy (which is considered important for wellbeing and satisfaction). Another issue is poor supply chain management, a metric on which we have assessed Amazon as being below average in the electronics industry.

On the positive side of the ledger, our investment in Microsoft was the largest contributor to relative performance with the stock delivering a return of 33.5% over the year. Microsoft overtook Apple during 2018 to become the world's largest company by market capitalisation. It is assessed to meet our ethical criteria for the way in which its products and services contribute to business efficiency and help organisations and individuals pursue their objectives, including in the areas of communication, education and leisure.

Please remember that when considering financial returns, past performance is not indicative of future performance.

<u>New investments in 2018</u>

As Australian Ethical has grown as a business we have been able to expand the scope of our funds giving our investors access to a broader range of asset classes. During 2018 we added unlisted infrastructure and unlisted healthcare property investments to our Balanced Fund as well as a number of our Superannuation Fund investment options. Towards the end of December 2017 we made our first investment in the Dexus Healthcare Wholesale Property Fund (HWPF), which is close to completing construction of a private hospital in Adelaide and will begin construction of a new healthcare 'hub' in Sydney in 2019. In June 2018 we made a commitment to invest in the Morrison & Co Growth Infrastructure Fund (MGIF) which aims to benefit from growing global trends such as decarbonisation, increased connectivity and water and food scarcity. MGIF will look to make investments in renewable energy infrastructure, water and waste management solutions, datacentres, and the latest in telecommunications infrastructure. Both HWPF and MGIF integrate environmental, social and governance (ESG) considerations into their investment processes. In addition, our co-investment with the Clean Energy Finance Corporation in these funds will drive HWPF and MGIF to be industry leading in sustainability and energy efficiency."