

15 May 2024

ASX Limited
ASX Market Announcements Office
SYDNEY NSW 2000

Intelligent Investor Ethical Share Fund (Managed Fund) (the “Fund”)

ASX Code: INES

CHANGE OF INVESTMENT STRATEGY

InvestSMART Funds Management Ltd, as the responsible entity of the Fund, hereby provides notice that it will amend the Fund’s investment strategy, with effect from 1 July 2024, to allow up to 30% of the net asset value to be held in global ethical shares listed on international exchanges.

Further information about the rationale for the change of investment strategy from the portfolio manager is set out in the attached letter.

Yours faithfully

Catherine Teo
Company Secretary

About the Intelligent Investor Ethical Share Fund (Managed Fund)

The Intelligent Investor Ethical Share Fund is an active ETF and is focused on investing in undervalued stocks chosen on Environmental, Social and Governance (ESG) factors and financial criteria to achieve medium to long-term capital growth. Please contact Mitchell Datson with any questions 1300 880 160.

ACN 067 751 759 AFSL 246441

Dear Investor,

Why we're making changes to the *Intelligent Investor Ethical Share Fund (Managed Fund)*

It's been nearly 5 years since we launched the *Intelligent Investor Ethical Share Fund* (the Fund). The rationale for its launch was based on results of the ethical screening of nearly 500 buy recommendations made over nearly 20 years by our flagship subscription service, *The Intelligent Investor*.

There was an almost +5% per annum difference between recommendations that would've passed our ethical screen compared to those that wouldn't.

The secret sauce was quality. When we applied our value investing approach to high quality businesses, preferably run by founders, our results were excellent.

When we sacrificed quality, as expressed through financial metrics like lower returns on equity, our results were mediocre. That in turn fed portfolio turnover, rendering after-tax returns even worse.

The inferior group had the occasional big winner but that didn't compensate for the lack of quality over the long run.

Quality focus helps us beat the market

The results since inception tell the story. The Fund has beaten the market by nearly 3% per annum, assisted by a focus on quality. The Fund is jammed with the ASX's best businesses, including healthcare companies **CSL**, **ResMed** and **Sonic Healthcare** and monopolies like **Sydney Airport** and **Auckland Airport**.

We have also profited from hidden gems like **Uniti Wireless**, **RPM Global**, **MA Financial** and **Audinate**, which has performed sensationally. We aim to maintain this performance over the long term.

Unfortunately, that is getting harder for two reasons. First, the already small number of high-quality ASX-listed businesses that pass our ethical filter is shrinking. **Uniti Wireless** and **Sydney Airport** were our largest holdings when they were taken over and delisted. Private equity is also having an impact.

Second, the growing dominance of index funds is bidding up the price of quality growth stocks, particularly those with strong ethical credentials. Even yesterday's heroes like **Commonwealth Bank** are trading at ridiculous levels.

If we were satisfied with average returns this wouldn't be an issue. We are not. In recent months, we have examined ways to offset these effects to help maintain our performance track record.

Addressing the shrinking pool

The first option we considered was increasing the position sizes of our holdings. We discounted this due to the increased risk it entails. With larger positions, bad luck or a few miscalculations amplify underperformance from which recovery could take years.

Nor is this approach practical. Strict ASX liquidity rules governing our Fund restricts investments in too many small companies, which are often our best ideas.

The second was to sacrifice quality. As explained above, this makes no sense and contradicts the Fund's ethos. It was not a realistic possibility.

Holding more cash and remaining patient, our last option, was more feasible. Unfortunately, it could entail holding more cash for many years. This is not what you pay us for and there is also a fine line between patience and market timing. We do not want to cross it.

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Holding cash for extended periods can mean you don't take the risks you should, or the performance drag of high cash levels forces you into dumb decisions. Neither are appealing.

Going international

We think there is a better way. On 1 July 2024, the Fund's Product Disclosure Statement will change to allow us to invest up to 30% of the Fund in overseas-listed stocks, chiefly in the US. Some of these will be stocks we already own in the *Intelligent Investor Select Value Share Fund*.

Adding a handful of the world's best ethical businesses to the portfolio requires little extra work and potentially increases the return of the Fund while reducing the risks. This is what successful investing is all about.

Most importantly, it gives us the best chance of maintaining our outperformance over the decades ahead. This is especially true as more overseas companies devour our local heroes and the US remains the world's leading source of innovation and investment opportunities.

Many investors worry about the currency impacts of investing abroad. The truth is much of the revenue from the Fund's holdings is already generated overseas, with the healthcare companies and **Auckland Airport** leading examples.

Being able to select a small number of ethical international stocks from our *Select Value Share Fund* increases the opportunity pool and allows these investments to compound at high rates in a tax friendly environment.

Our *Ethical Share Fund* will remain a collection of Australia's best businesses that pass our ethical screen, plus a handful of the world's best opportunities that also pass our ethical filter. We think this approach makes sense and hope you do, too.

Being able to continue to perform at a high level is our primary consideration and this change, we believe, offers us the best chance of doing so.

Should you have any further questions, please contact our investor services team at invest@intelligentinvestor.com.au or 1300 880 160.

Yours faithfully

Nathan Bell
Head of Research and Portfolio Management