Aurora Capital

Aurora Climate Growth Strategy

QUARTERLY UPDATE DECEMBER 2022

Climate and Environmental, Social, Governance developments

UN CLIMATE SUMMIT FALLS FLAT ON REAL CLIMATE ACTION

The main United Nations (UN) climate change summit, known as COP, was held in November 2022. COP stands for Conference of the Parties to the UN Framework Convention on Climate Change, quite the mouthful, and is hosted in rotation by cities around the world. It brings together world leaders so that new global commitments to tackle climate change can be agreed and tracked. Well, that's the goal.

You could say the latest summit (COP27) fell short of meeting any really significant climate change ambitions. There was no agreement reached on the two major issues that can move the dial on improving climate pressures: bigger cuts to greenhouse gas emissions, and a roadmap for ending fossil fuel use. Disappointingly, the urgency in reducing emissions was pushed to the side, as a resolution calling for emissions to peak in 2025 was taken out of the agreement. The general view is that COP27 missed the mark, a view shared by New Zealand's minister for climate change, James Shaw, who noted that not enough progress was made on the most important climate change issues[1].

On the positive side, almost 200 countries agreed to set up a fund for "loss and damage" stemming from disastrous or irreversible climate impacts. Also positive, countries remained committed to the phasing down of coal.

Perhaps the UN Secretary-General said it best, in his concluding comments at the COP27 summit, "Our planet is still in the emergency room. We need to drastically reduce emissions now – and this is an issue this COP did not address."

The planet has already warmed by at least 1.1 degrees Celsius above pre-industrial levels. To limit global warming to 1.5 degrees Celsius, which is the level that Scientists have indicated that temperature increases need to be capped at to prevent a potent climate catastrophe, carbon dioxide emissions need to be urgently reduced in this decade.

At Aurora Capital, we invest in companies that have already transitioned or are in the process of transitioning to clean energy. In order to create positive change for the climate, we believe it's important to allocate capital to companies that are actively seeking to reduce their carbon emissions, rather than invest only in low carbon emitting companies.

Investment markets

2022 – THE YEAR INFLATION ROARED

The inflation beast roared across the world in 2022 after four decades of quietly dozing in its cage. This was the biggest market theme for the year, as it became apparent that inflation was no longer a temporary or 'transitory' problem, but rather, one that kept pushing higher. While the initial COVID related supply chain blockages

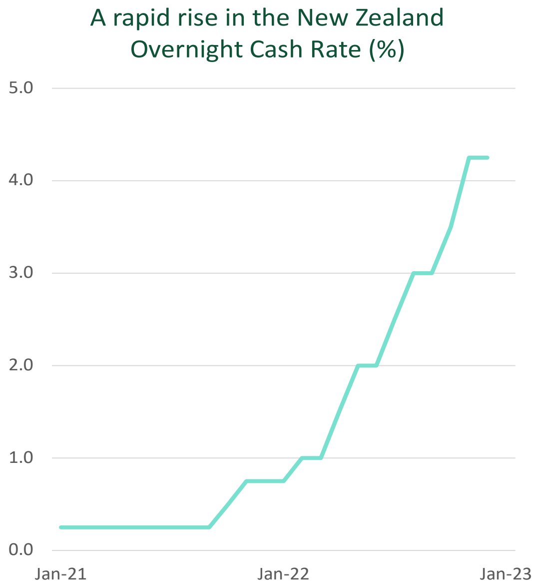
[1] https://www.beehive.govt.nz/release/global-climate-talks-underline-need-domestic-action

provided an early catalyst for the inflation beast to stir, the Russian invasion of Ukraine in early 2022 and the resulting spike in energy prices, together with China's "zero-COVID" policy, saw global inflation surge higher.

One of the problems created by rising inflation is that it can become entrenched in behaviour and expectations. When that happens, a virtual spiral of ever-rising inflation can kick in. For example, expectations of permanently high inflation can lead businesses to price their goods higher, or employees to demand higher wages, all of which ultimately feeds back into rising inflation. Of course, we can also feel inflation in our hip pocket, and this can cause a big strain on household budgets.

NZ RECESSION - A DONE DEAL?

The Reserve Bank of New Zealand (RBNZ) raised rates 9 times since October 2021, taking the Overnight Cash Rate (or cash rate) 4% higher to 4.25%. The cash rate is now at its highest level since January 2009 and the speed of these rate hikes has been breath-taking. So far, the NZ economy has proven to be fairly resilient to these rapid rate rises, with employment remaining strong and household spending intact. However, there's usually a lag between rising interest rates and higher mortgage payments, as borrowers who fixed mortgage rates below 3% in previous years will have to refinance at much higher rates in coming months, and this is expected to bite into household budgets.



Inflation in NZ still remains high at 7.2% (year on year), and wages are on the rise. As a result, we can expect more increases to the cash rate, with the RBNZ recently confirming that the cash rate will be raised to a likely peak of 5.5%. The central bank has also said that the NZ economy is expected to record negative growth in the June quarter of 2023 and will continue to shrink for approximately a year. In short, the NZ economy is headed for recession.

That said, investment markets are forward-looking and have already priced in a mild recession for 2023, which we believe is the most likely scenario. In our view, the recession is likely to be mild owing to ongoing labour shortages, which will make employers reluctant to lay-off scarce workers; and the absence of a massive rise in unemployment should support a mild recession. However, a strong labour market increases the risk that the RBNZ will need to raise rates more than is currently expected, which in turn could trigger a larger than expected increase in unemployment, that could lead to a deeper recession.

WHAT HAS DRIVEN INVESTMENT MARKETS?

Price gyrations were a defining feature of investment markets in 2022. For the first time in decades, markets had to grapple with surging global inflation. With this came a high level of uncertainty about the policy response. How fast and how high would interest rates need to rise to tame the inflation beast? Would this lead to a short or deep economic recession? For equity markets, would company earnings take a hit as economic conditions cooled? All over the world, central banks raised official interest rates, some with greater speed than others. This shift in the economic landscape saw investment markets across all major asset classes end the year lower than where they started.

While key equity markets around the world ended the December quarter higher, returns for the year remained negative. The US equity market fell by -18% (local currency), while NZ equities fared a bit better with returns of approximately -12%. Global bond markets also ended the quarter higher but this wasn't enough to offset earlier weakness, so bonds ended the year with negative returns.

How your money is changing the world

Financial performance returns

AURORA CLIMATE GROWTH STRATEGY AS AT 31 DECEMBER 2022

	RETURNS		
	3 month %	6 month %	1 year %
Strategy (after fees, before taxes)	1.38	1.10	-14.98
Objective: CPI + 4%*	n/a	n/a	11.18

CPI is the headline Consumer Price Index
* As at 31 December 2022

The small positive return recorded by the portfolio for the 3 month period was mainly underpinned by gains in equities and bonds. For the 1 year period, broad-based declines across most asset classes, including equities, bonds, and listed property dragged portfolio returns lower. Cash remained one of the few asset classes to deliver positive returns for the year, reflecting the rise in cash yields.

Throughout most of 2022, the US Dollar was a star currency performer and ended the year higher against a basket of currencies. But the final quarter of the year was an exception with the NZ Dollar one of the strongest performing currencies: against the United States Dollar, the NZ Dollar increased from under US$0.56 in October to nearly US$0.64 at the end of December. The impact of a stronger NZ Dollar on the portfolio was to dampen the returns from unhedged global equities.

2022 has been a challenging year for investment returns. Heightened levels of uncertainty about the outlook for economies and company earnings is likely to remain a feature of investment market performance in the near-term. On the positive side, the decline in investment markets over 2022 means that key asset classes are now more attractively priced today versus a year ago. The sharp rise in bond yields means that bonds are now able to offer some diversification to portfolios. There is still a risk that equities will weaken from here, as we don't think that corporate earnings downgrades have been fully factored into share prices. That said, given the stickiness of employment globally, there is a possibility that corporate earnings will be resilient in a mild recession.

As you are invested in the Aurora Climate Growth Strategy, we encourage you to remember that this strategy is intended for those with a long-term investment timeframe. Staying invested is key.

CLIMATE SUSTAINABILITY MEASURES OF PERFORMANCE

We focus on measures of carbon risk in the portfolio because the majority of climate risk is carbon risk. We use independent third-party sources to analyse the portfolio's carbon sustainability characteristics. A portion of the portfolio is exposed to sectors and companies that are transitioning away from carbon to renewable energy over the medium term. These investments can elevate the current carbon risk of the portfolio, but as long as companies stick to their decarbonisation plans, the carbon risk of these companies will reduce over time. Like we always say, change is a journey.

TEMPERATURE ALIGNMENT AS AT 31 DECEMBER 2022	GLOBAL CARBON EFFICIENCY RATING (GCER) AS AT 31 DECEMBER 2022	PORTFOLIO CARBON INTENSITY AS AT 31 DECEMBER 2022
BASED ON PORTFOLIO CARBON INTENSITY	A MEASURE OF CARBON RISK IN THE PORTFOLIO	PER TONNE, PER $1M OF PORTFOLIO VALUE
2.8 DEGREES CELSIUS	90 /100	PORTFOLIO 384 MSCI WORLD* 573

WHAT THIS MEANS FOR YOU?

The Temperature Alignment is based on the portfolio's carbon intensity. It captures the temperature scenario that the portfolio is currently in line with, based on its current carbon footprint. It's currently applied only on the equity component of the portfolio.

The temperature alignment is calculated from its carbon emissions and the current carbon budgets associated with three globally acknowledged climate scenarios: 1.5°C, 2.0°C, and 4.0°C. These scenarios have been

WHAT THIS MEANS FOR YOU

The higher the GCER, the lower the carbon exposure of a company or portfolio, and the lower the financial risk of transitioning to a future net zero emissions world.

The GCER Rating is a measure of a companies' carbon efficiency and alignment with the future transition to a carbon-constrained economy.

This metric enables us to quantify underlying carbon risk in our investments.

WHAT THIS MEANS FOR YOU

Portfolio Carbon Intensity is a measure of carbon dioxide equivalents emitted by a portfolio per $1 million of assets under management. It's currently applied only on the equity component of the portfolio.

The metric allows us to look directly at the carbon impact of the equity part of the portfolio and to compare that with market indexes, such as the MSCI World*, which is a global equity index.

The portfolio currently has a lower carbon intensity than the MSCI World*.

adopted by international climate science bodies.

The current temperature alignment of 2.8°C reflects the portfolio's exposure to companies in the process of transitioning to a low carbon world.

Source: EMMI

The current GCER Rating of 90/100 suggests a low carbon exposure.

Source: EMMI

* MSCI World ETF

Source: EMMI, BlackRock iShares

Questions?

If you have questions about this report, please contact your adviser who will be happy to help.

We welcome all feedback and would like to hear from you if you have any questions or concerns about your investment, as this can form the basis of future articles and reports that we write. We invite you to ask us questions through our website: www.aurora.co.nz, and through your adviser.

Sean Henaghan
Aurora Chief Investment Officer

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Aurora Capital

0800 242 023
hello@aurora.co.nz
www.aurora.co.nz