



Aurora Liquidity Fund

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 issues¹.

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.

We note that the Aurora Liquidity Fund doesn't have exposure to equities or specifically invest in assets that are transitioning to clean energy. We included this information in your Quarterly Update as most of the Aurora Capital portfolios do have exposure to 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.

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

Investment markets

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 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.

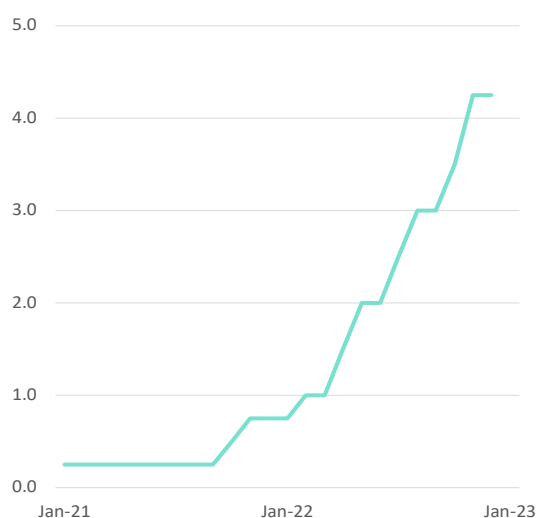
NZ RECESSION - A DONE DEAL?

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.

A rapid rise in the New Zealand Overnight Cash Rate (%)



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.

Financial performance returns

AURORA LIQUIDITY FUND AS AT 31 DECEMBER 2022

	RETURNS		
	3 month %	6 month %	1 year %
Strategy (after fees, before taxes)	0.88	1.53	-
Benchmark**	0.97	1.68	2.33

** Benchmark is the Bloomberg NZ Bond Bank Bill Index
As at 31 December 2022

Positive returns for the quarter were driven by rising cash yields. The official cash rate was raised twice in the December quarter by the N.Z central bank, to its highest level since January 2009. Yields have risen significantly since the cash rate hiking cycle began in October 2021. Further increases to the N.Z cash rate from the current 4.25% are widely expected, which should continue to be positive for yields.

We provided incorrect returns for this strategy in the September Quarter report. We sincerely apologise for this error. For the period ended 30 September, the 3 month return was reported as 0.71%. The correct return is 0.64%.

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

Sean Henaghan



Aurora Capital

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

This Publication is provided by Aurora Capital Limited (Aurora) in good faith and is designed as a summary to accompany the Product Disclosure Statement (PDS) for the Aurora KiwiSaver Scheme (Scheme), and the Aurora Conservative Fund, Aurora Future Focused Fund and Aurora Growth Fund (Funds). The PDS is available from Aurora at <https://www.aurora.co.nz/>, or the issuer Implemented Investment Solutions Limited (IIS), and on <https://disclose-register.companiesoffice.govt.nz/>. The information contained in this Publication is not an offer of units in the Funds or a proposal or an invitation to make an offer to sell, or a recommendation to subscribe for or purchase, any units in the Funds. Any person wishing to apply for units in the Funds must complete the application form which is available from Aurora or IIS. The information and any opinions in this Publication are based on sources that Aurora believes are reliable and accurate. Aurora, its directors, officers and employees make no representations or warranties of any kind as to the accuracy or completeness of the information contained in this Publication and disclaim liability for any loss, damage, cost or expense that may arise from any reliance on the information or any opinions, conclusions or recommendations contained in it, whether that loss or damage is caused by any fault or negligence on the part of Aurora, or otherwise, except for any statutory liability which cannot be excluded. All opinions reflect Aurora's judgment on the date of this Publication and are subject to change without notice. This disclaimer extends to IIS, and any entity that may distribute this Publication. The information in this Publication is not intended to be financial advice for the purposes of the Financial Markets Conduct Act 2013 (FMC Act), as amended by the Financial Services Legislation Amendment Act 2019 (FSLAA). In particular, in preparing this document, Aurora did not take into account the investment objectives, financial situation and particular needs of any particular person. Professional investment advice from an appropriately qualified adviser should be taken before making any investment. Past performance is not necessarily indicative of future performance, unit prices may go down as well as up and an investor in the Funds may not recover the full amount of the capital that they invest. No part of this document may be reproduced without the permission of Aurora or IIS. IIS is the issuer and manager of the Scheme. Aurora is the investment manager of the Scheme.