



Aurora Liquidity Fund

QUARTERLY UPDATE DECEMBER 2023

Climate and environment developments

THE BEGINNING OF THE END FOR FOSSIL FUELS?

Enter the sweet smell of climate change optimism. Then subtract the urgency.

The latest United Nations Climate Change Conference (COP28) ended in Dubai with an agreement by almost every country in the world to, "transition away from fossil fuels." Given that fossil fuel emissions are the main driver of climate change, this was a milestone moment in the history of climate change negotiations.

Central to the COP28 discussions was the "global stocktake," which was a review of how far the world has come in addressing climate change and how far it has to go. The stocktake revealed that global greenhouse gas emissions need to be slashed by 43% by 2030, compared to 2019 levels, in order to limit global warming to 1.5°C. It admitted most countries were way behind on their emission reduction promises and called for a tripling of renewable energy capacity and the doubling of energy efficiency by 2030. It also called for efforts to phase down unabated coal power and cut fossil fuel subsidies.

All of that sounds pretty good. Until you dig deeper. There was no clear call for fossil fuels to be phased out in this decade. Many countries complained that many loopholes in the wording could enable continued production and consumption of coal, oil and gas. The final agreement had another big miss. Many developing countries insisted that the rich polluting countries should transition away from fossil fuels first, in recognition that the developed countries got wealthy while burning fossil fuels and are mostly responsible for the climate crisis. This was missing, leading many to believe that there was a lack of equity (or fairness) in the final agreement.

In his closing speech, the UN Climate Change Executive Secretary, Simon Stiell said, "Whilst we didn't turn the page on the fossil fuel era in Dubai, this outcome is the beginning of the end."

What comes next?

Countries are being urged to step up with ambitious plans to cut greenhouse gas emissions by 2025. These plans need to be aligned with the 1.5°C temperature limit.

While there is reason for optimism, it remains to be seen whether companies and countries can convert their pledges into real, actual emission cuts. Key to this will be whether governments put in place enforceable climate policies. The next few years will be critical.

How is New Zealand tracking on climate action?

NZ's climate pledge is to reduce emissions by 50% below gross 2005 levels by 2030, and to net zero by 2050. How are we tracking? According to analysis by Climate Action Tracker, New Zealand needs to set a 2030 target of a reduction in gross emissions of at least 44%, to keep the global warming temperature increase limited to 1.5°. There have been widespread criticisms of NZ using a 'gross' accounting system that has been regarded as misleading in how it calculates emissions, and in the short term, it appears that NZ is aiming to achieve its 2030 target through buying international offsets rather than reducing emissions from high emitting sectors. Overall, the Climate Action Tracker rates New Zealand's current climate targets, policies and finance as "Highly insufficient." You can read more about Climate Action Tracker's analysis of New Zealand's climate action at <https://climateactiontracker.org/countries/new-zealand/>.

New Zealand is no Robinson Crusoe, as most countries are well behind on delivering the change that's needed to limit global warming.

At Aurora Capital, we exclude investments in companies that are the worst fossil fuel polluters around the world. However, exclusions alone can't create the change that's needed to reduce carbon emissions, which is central to improving the climate crisis. We need to do more than simply exclude high carbon emitting companies; we also need to fund innovations that are needed to replace legacy carbon emitting processes. That's why we invest in companies that are transitioning to a lower carbon world. We note that the Aurora Liquidity Fund doesn't have exposure to equities. We included this information in your Quarterly Update as all of the other Aurora Capital portfolios invest across multiple asset classes and have exposure to companies that are in the process of transitioning.

INVESTING IN ENERGY EFFICIENCY AND RENEWABLE ENERGY

One of the fund managers we've selected to actively manage Global Equities is Stewart Investors. Stewart Investors believe that sustainable development is a key driver of long-term investment performance. Companies that are contributing to climate solutions feature prominently in the Stewart Investors portfolio. Our aim is to share information about some of the amazing companies we are invested in through this portfolio. A great example is WEG, which is providing fantastic energy efficiency and renewable energy solutions. We note that the Aurora Liquidity Fund doesn't have exposure to equities or to WEG, which is discussed below. We have included this information in your Quarterly Update as we believe that these types of investments are important in improving the health of the planet. We also hope you may be interested to learn about investments in other portfolios that we manage at Aurora Capital.

Case study – WEG

WEG is a Brazilian company that manufactures and sells energy-efficient electric motor and transformers that are used in solar and wind power generation, hydroelectric power plants and electric vehicles. WEG's products help society to shift away from fossil fuel energy production and reduce greenhouse gas emissions. They are well-placed to benefit from major trends in energy efficiency and renewable energy.

We note that WEG's production processes are currently emitting greenhouse gases. However, WEG is a great example of a company that is working to reduce its operational emissions while contributing across the renewable energy value chain by supplying products that support a lower carbon world.


In summary, the products made by WEG help to reduce greenhouse gas emissions. Here's a snapshot of a few:

- In 2022, WEG provided 6,300 MWA in renewable energy solutions.
- In 2013, WEG supplied its first wind turbines.



Image: Small Hydroelectric Power Plant Salto Goés, located in Tangara, Santa Catarina, Brazil.
<https://www.weg.net/institutional/US/en/solutions/energy>

- By 2019, WEG had become one of the largest suppliers of products for solar power plants in Brazil.
- Around 80% of the equipment they supply in Brazil is for renewable energies.



Carbon neutral program goals:

- 52% reduction in operational emissions by 2030.
- 100% net zero operational emissions in 2050. (Scope 1 and 2, using 2021 as the base year.)

By providing capital to companies like WEG, Aurora Capital is supporting investment in products and innovations that can reduce greenhouse gases, support renewable energy production and capacity, and improve the environment. We note that the Aurora Liquidity Fund doesn't have an exposure to Veolia.

When we run the Sustainable Platform analytics on WEG, we can see that 79.5% of the company's sales are contributing to the United Nations Sustainable Development Goals (SDGs). Of the 4 focus SDGs that we prioritise, 59% of WEG's sales are contributing to those goals, with the greatest contribution coming from WEG's contribution to Affordable and Clean energy. We are pleased to note that WEG outperforms the global equity index across all 4 focus SDGs.

Investment markets

WHAT HAS DRIVEN INVESTMENT MARKETS?

It wasn't so long ago, at the start of 2023, that the main concerns in investment markets were about stubborn inflation and rising interest rates that had the potential to trigger a recession in the world's largest economy, the United States (U.S). This led to forecasts that equity markets would deliver lukewarm or weak returns for the year.

Fast forward to the end of 2023 and the picture had changed. Inflation had started to ease in the U.S, and helped by strong employment, it appeared the economy could dodge a recession altogether. The slowing inflation resulted in a change in stance for the US Federal Reserve, who at the final policy meeting for the year signalled that rate cuts were expected in 2024, with more to follow in 2025.

The changing geopolitical landscape added uncertainty during the quarter, with conflicts erupting in the Middle East and the war in Ukraine pushing on, but this was overshadowed by the shift in the interest rate outlook. As a result, key global investment markets strengthened in the December quarter and recorded positive gains for the year. Despite the ups and downs of market movements throughout the year, both equities and bonds ended 2023 with positive returns. Most notably, global equities recorded a massive annual return of 21%.

New Zealand's economy faced a challenging quarter, with GDP data released during the period showing a contraction of the economy in the third quarter. This decline in GDP came despite rising immigration levels to NZ, suggesting that underlying economic activity has been quite weak. Inflation also continued to ease in NZ, but less so than other developed markets. With inflation still well above target, the Reserve Bank of New Zealand continued to suggest that rates would be held higher for longer. With rate cuts not on the cards in the near term, in addition to weak economic data, the NZ equity market lagged global equities.

Financial performance returns

AURORA LIQUIDITY FUND AS AT 31 DECEMBER 2023

RETURNS				
	3 month %	6 month %	1 year %	3 year %
Fund (after fees, before taxes)	1.45	2.76	5.21	-
Benchmark*	1.43	2.88	5.45	-

* Benchmark is the Bloomberg NZ Bond Bank Bill Index
As at 31 December 2023

Positive returns for cash continued through the fourth quarter for the portfolio, driven by strong cash yields, as the official cash rate (OCR) in New Zealand was held constant at 5.5%. Over the 1-year period, cash provided solid returns with low risk for investors.

While other central banks have started to signal rate cuts on the horizon, the Reserve Bank of New Zealand (RBNZ) maintained a view that rates would need to stay higher for longer. This decision reflects the central bank's focus on controlling inflation, which, despite a downward trend from its peak last year, remains above the target range of 1-3%. The RBNZ expressed concerns about ongoing excess demand and inflationary pressures, particularly in light of increasing migration which is stoking demand in the economy. The RBNZ indicated that there is a possibility of a further rate increase if inflationary pressures prove stronger than anticipated.

Where to from here? Our view is that further rates hikes are unlikely, but the question remains, where will inflation go this year. If inflation falls into the target range, we expect to see rate cuts. However, the ongoing Middle East conflict has the potential to have flow over effects on inflation, which could delay cuts to interest rates. Despite the caution about rate cuts from RBNZ, the NZ interest rate market is already pricing in a rate cut in the first half of the year, and several cuts by year end. We think this is probably too optimistic, although it's possible if inflation falls below 3%.

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.

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