Aurora Capital

Aurora RetirementPlus Strategy

Ages 0–50

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 Caruso, 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.

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.

Case study – WEG

WEG is a Brazilian company that manufactures and sells energy-efficient electric motor and transformers that are used in 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.
- 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.

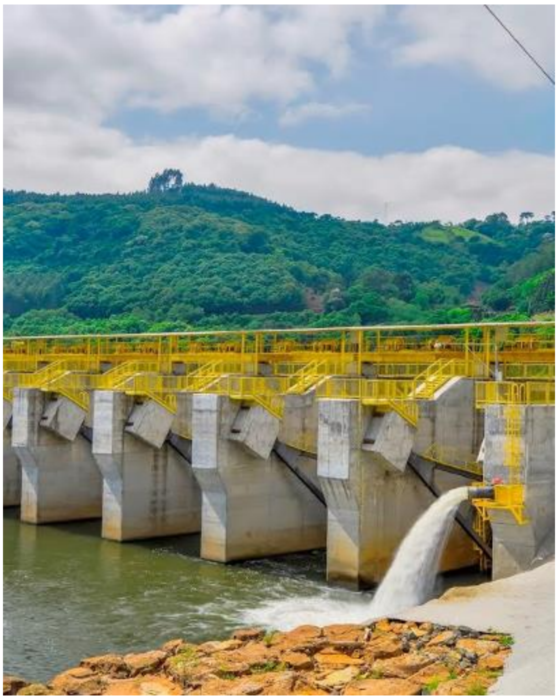

Image: Small Hydroelectric Power Plant Salto Goés, located in Tangara, Santa Catarina, Brazil.
https://www.weg.net/institutional/US/en/solutions/energy

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, your KiwiSaver investment with Aurora Capital is supporting investment in products and innovations that can reduce greenhouse gases, support renewable energy production and capacity, and improve the environment.

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.

Sustainability: We're biased to investing in companies and securities that are contributing to a more sustainable future. We support the United Nations (UN) Sustainable Development Goals (SDGs), and we specifically focus on the 4 SDG's that can positively influence the climate and environment.

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.

How your money is helping the planet

Financial performance returns

AURORA RETIREMENTPLUS AGES 0-50, AS AT 31 DECEMBER 2023

	RETURNS			
	3 month %	6 month %	1 year %	3 year %
Strategy Return*	6.54	3.14	11.01	-

*Strategy returns are after fees, before taxes and are derived from the returns of the funds into which the strategy invests. Strategy returns are calculated based on the target allocation to underlying funds.

It was a strong quarter for the portfolio, as all the main asset classes finished higher. The change in the US interest rate outlook, with interest rate cuts now expected in 2024, was key in driving positive returns for all main asset classes. This was especially true for the interest rate sensitive asset classes, namely bonds and infrastructure.

Bond markets roared higher, by pricing in expected cuts to official interest rates before any actual rate cuts have taken place. This is the forward-looking nature of markets. In our view, there's a risk that bond markets have priced in too many rate cuts, leaving bond markets vulnerable to disappointment.

Infrastructure also had a stellar quarter, posting a quarterly gain of 10%, which was a significant rebound after several months of poor returns, although not quite enough to finish in the green over the 12-month period. Apart from infrastructure, all the other main asset classes recorded positive gains for the year, which was positive for portfolio returns.

It was almost the opposite story of what took place in the third quarter of 2023, where both equities and bonds declined, due to expectations that interest rates would stay higher for longer. This goes to show that's it's incredibly difficult, almost impossible, to predict and time when markets turn up or turn down. When market sentiment turns, the price movement is usually rapid, so staying invested in a well-diversified portfolio is almost always going to be better than trying your luck with guessing short-term market movements.

2023 was a volatile year. As we step into 2024, the global financial landscape remains complicated. While lower interest rates likely will be positive for investment returns, there are still many risks at play. The lead-up to the U.S Presidential election will dominate news flow and add an element of policy uncertainty, especially on climate policy and foreign policy, if the current government is voted out. The ongoing Middle East conflict has the potential to have flow over effects on inflation, which could delay cuts to interest rates. Uncertainty and market volatility are normal features of the investment landscape. However, we and the manager's we've appointed are experts at finding investment opportunities and adding value throughout the market cycle.

Climate and sustainability measures of performance

We monitor the climate and environment impact of the investments in the portfolio through relevant metrics, using independent third-party sources. The metrics are currently provided for the equity (including listed infrastructure) component of the portfolio. We focus on measuring the carbon emissions of the portfolio, which can then be compared against the relevant equity index or 'benchmark.' We also look at how much the portfolio is aligned with the UN's Sustainable Development Goals (SDGs) and how this compares with the relevant global equity index. You can read more about the SDGs and why we look at each portfolio's contribution to SDGs here.

AURORA RETIREMENTPLUS AGES 0-50, AS AT 31 DECEMBER 2023

CARBON IN THE PORTFOLIO

	Portfolio Temperature Alignment (Based on portfolio carbon footprint)	Portfolio Carbon Intensity (Tonnes per $1m of portfolio value)
Portfolio	3.1 °C	427
Market Index*	3.6 °C	590

*MSCI All Country World Index (ACWI) is used.

SOURCE

EMMI

CONTRIBUTION TO THE UNITED NATIONS SDGs

Contribution to Sales (%)	SDG 7 Affordable & clean energy	SDG 9 Industry, innovation, & infrastructure	SDG 11 Sustainable cities & communities	SDG 13 Climate action	ALL Sustainable development goals
Portfolio	5.6%	5.3%	15.0%	3.8%	67.5%
Market Index*	2.9%	4.7%	10.8%	2.5%	57.2%

SOURCE

SUSTAINABLE PLATFORM

WHAT THIS MEANS FOR YOU?

The Temperature Alignment is 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 (including listed infrastructure) 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 adopted by international climate science bodies. For more information click here.

In order for the planet to avoid a catastrophic climate crisis, global warming needs to be limited to between 1.5°C and 2°C. The current temperature alignment of the portfolio is relatively higher, at 3.1°C, however this reflects the portfolio's exposure to companies that are in the process of transitioning to a low carbon world. Also of note, the portfolio's current temperature alignment is much lower than the Market Index, the MSCI ACWI.

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 (including listed infrastructure) 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 ACWI*, which is a global equity index. For more information click here.

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

The contribution to the UN Sustainable Development Goals (SDGs) looks at how much of the portfolio is aligned with the UN's Sustainable Development Goals (SDGs), based on annual sales of the underlying companies. It's currently applied only on the equity component (including listed infrastructure) of the portfolio.

The SDGs are a set of 17 goals established by the United Nations in 2015 as part of the 2030 Agenda for Sustainable Development We believe that all SDG's are important for a better and sustainable future, so we look at the portfolio's contribution to all 17 SDGs (see final column of the table above). However, we are most interested in how well the portfolio is aligned to the 4 SDGs that can positively impact the climate and environment. In our view, these are SDG 7,9, 11, and 13, and represent our focus SDGs. For more information click here.

Currently, 67.5% of the portfolio's sales are contributing to sustainability goals, which is on par with the MSCI World*, a global equity index. The portfolio is also making a positive contribution to the 4 focus SDGs.

* MSCI All Country World Index (ACWI) ETF

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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