Aurora Capital

# Aurora Liquidity Fund

QUARTERLY UPDATE JUNE 2023

# Climate and Environmental, Social, Governance developments

## ELECTRIC VEHICLE SALES ARE MOVIN' ON UP

The electric vehicle (EV) market is booming. In 2022, sales of passenger EV's rose by more than 60%, globally. According to the latest annual Electrical Vehicle Outlook report from BloombergNEF, EV sales rose in every major market: by 100% in Japan, almost 100% in China, 90% in Australia, 50% in the US and 17% in Europe. China is the single largest market for EVs and is also a big exporter of EVs.

That said, passenger EV's still have a lot of catching up to do. Last year, EV's represented only 1.7% passenger vehicle kilometres driven. It's expected that by 2050, more than 75% of all driving will be in EV's. That's a trend we can support!

For those of us who are riddled with EV battery anxiety, take heart. There's been a massive increase in the supply of EVs that can travel at least 400 kilometres without needing a charge. Five years ago, there were only nine long-range EV options available, globally. Today, there are more than 200, and the majority of these come from China automakers.

Currently, long range EV's are more expensive to buy than combustion engine passenger cars, making EVs unattainable for a lot of people. Looking ahead, though, we can expect automakers to make a push into a lower-priced and lower-range EV market. That will be a great step forward in helping people to switch from traditional combustion vehicles to EVs.

EVs can help in the fight against climate change because they emit significantly lower amounts of greenhouse gases compared with traditional gas and diesel-powered combustion engine vehicles. On the road, pure EVs don't emit carbon, however, EV batteries need to be charged at some point and if some of the electricity grid is powered by fossil fuels, the process is emitting carbon. It's argued that smart charging – or charging during off-peak times when renewable energy is more likely to be the source of power - can alleviate some of the carbon impact. It's also known that the EV batteries are carbon intensive to produce. It's estimated that the lithium-ion batteries used to power EVs is the biggest source of embedded emissions for both electric cars and trucks, and account for approximately 40 to 60 percent of total production emissions*. Looking ahead, we are optimistic that carbon emissions from battery production will decline.

While carbon emissions are created in the production of EV batteries and to a much lesser extent, in charging the batteries, total EV emissions are still significantly lower than for combustion engine vehicles. We expect that a combination of tighter regulations, technological improvements and action across the entire battery supply chain can help to reduce the embedded emissions from EV battery production in coming years. At Aurora Capital, we recognise that change is a process. We believe that the increased use of EVs is a positive shift towards a lower carbon world.

*McKinseys & Company, 'The race to decarbonize electric-vehicle batteries,' 2023.

# Investment markets

## WHAT HAS DRIVEN INVESTMENT MARKETS?

As we always say, it's impossible to predict when markets will bounce, but when they do, the timing can sometimes be unexpected. It's a good reason to stay invested and stick to your strategy, especially when it feels uncomfortable to do so during those times when markets are volatile and falling.

Take last year. Back in September 2022, investment markets were in the doldrums and dealing with high levels of uncertainty about the economic backdrop: the risk of economic recession, rising inflation, and how much further interest rates would have to be raised. Reflecting this poor sentiment, 1-year returns for the key asset classes were negative (except for cash), with equities being the hardest hit. Fast forward to the end of the June quarter 2023 and 1-year returns for most of the key asset classes are back in the black, or close to it, with global equities leading the charge higher, lifted by double digit gains from the U.S equity market. Within U.S equities, the technology sector dominated, with staggering gains for the quarter and half year, fuelled by optimism about artificial intelligence and the outlook for chipmaking companies.

So, what exactly has changed? Well, we are nearing the end of the rate hike cycle, at least in the U.S. But that aside, it's fair to say that a whole lot of uncertainty remains about whether the U.S economy is headed for a mild or hard recession hit this year (as interest rates bite), and just how long rates will remain at these higher levels. Economic and consumer activity has been surprisingly resilient given the rapid increase in rates, in part due to employment staying strong. Company profitability, in general, has held up well, which has supported continued high levels of employment. However, it does take time for higher rates to hit spending and economic activity, and this long lag time most likely means that the negative impact is yet to come.

New Zealand's economy technically fell into recession in the quarter. Despite the slowdown in growth, NZ interest rates could stay higher for longer because employment is still strong and inflation remains high. That said, we are seeing encouraging signs of inflation starting to ease, which could see NZ bond markets price in the likelihood of rates being cut sooner rather than later. In other economies, we saw rate hikes in the UK, Europe and Australia over the quarter, with inflation still a key concern. Many central banks are signalling that rates could stay higher for longer, even if the absolute peak in rates is near.

# Financial performance returns

## AURORA LIQUIDITY FUND AS AT 30 JUNE 2023

| | RETURNS | | |
|---|---|---|---|
| | 3 month % | 6 month % | 1 year % |
| **Strategy** (after fees, before taxes) | 1.25 | 2.37 | 3.94 |
| **Benchmark**** | 1.33 | 2.49 | 4.22 |

** Benchmark is the Bloomberg NZ Bond Bank Bill Index
As at 30 June 2023

Positive returns for the quarter were driven by rising cash yields. The official (overnight) cash rate was raised twice in the June quarter by the N.Z central bank, by a combined 0.75% to 5.5%. Over the 1 year period, cash has provided both safety in volatile times as well as solid returns. Where to from here for the overnight cash rate?

Looking ahead, we expect continued market volatility as we approach the cycle turning point. All eyes are on signs of easing inflation, which would give the central bank in N.Z a reason to lower interest rates. We've seen that higher interest rates have led to slowing growth in the N.Z economy. In our view, this will eventually lead to reduced inflationary pressures. It’s a difficult balancing act: the longer interest rates remain at these high levels, the greater the risk that growth falls sharper than intended. It's likely that cash rates in N.Z have peaked or are very close to peaking.

# 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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