Aurora RetirementPlus Strategy

- at age 55, 65, 75

MONTHLY UPDATE **JUNE 2022**

Climate and Environmental, Social, Governance developments

The great leap to electric transport is underway and here to stay

We were excited to read in a recent report[1] that the sale of combustion vehicles around the world peaked in 2017. Combustion vehicle sales are now falling, while electric vehicle sales are on the rise and growing fast. It seems that the electrical vehicle revolution is well and truly underway.

This is great news. We all know that combustion engines are fossil fuel guzzlers, consuming gasoline and diesel for fuel. The rise in electric transport is reducing oil demand by 1.5 million barrels per day, which is equivalent to approximately 3% of total road fuel demand. By 2025, the report estimates that sales of internal combustion passenger vehicles will be 19% below their 2017 peak. The biggest take-up of electric transport is happening with two and three wheelers, which account for nearly 70% of electric transport. In Asia alone, there are almost 300 million electric two and three wheelers: bikes, scooters, trikes and tuk-tuks.

The demand for electric transport is expected to shoot higher in coming years. Over time, this should help to shrink the amount of oil we consume globally. And the less we rely on fossil fuels for energy, the better off our climate will be, giving future generations a better chance to enjoy the planet we all love.

That said, some serious planning is needed. The shift to electric transport will have a massive impact on how much electricity is needed. The report estimates that EV's could account for 15% - 21% of global electricity demand in 2050. There is also a huge need for investment in charging stations and chargers, which will have knock-on effects for how countries build these at street level and into their grids. If the world is serious about getting to net-zero emissions by 2050, we will likely see incredible innovation and investment to create this much needed change.

[1] BloombergNEF, Annual Electric Vehicle Outlook, 2022

Investment markets

The battle of inflation... and rising interest rates

It's a first for some. Surging inflation and rapid increases in interest rates, that is. The developed world, including the U.S, U.K and NZ, is now rising at a pace last seen three or four decades ago, with no signs of slowing down.

For a generation that has only known U.S interest rates fairly close to zero, it may be hard to believe that the official interest rate in the U.S was a whopping 20% back in 1980. This is the highest interest rate the U.S has ever seen. Why was it so high back then? Inflation was a massive headache for policy makers, running away at over 14%! This period of hyper-inflation and high interest rates didn't end so well. It ended with an economic recession.

History tells us that it is very hard to tame the inflation beast once it becomes entrenched in expectations and decision-making by households, workers, companies, and governments.

Official interest rates have not been 'normal' in a long time

In the U.S, U.K and most of Europe, official interest rates have generally been falling or kept fairly close to zero for the past 15 or so years. This has stemmed from two major crises. The first was the Global Financial Crisis, which reared its ugly head in 2007. The second was the global pandemic, which emerged as a serious problem by March 2020.

Throughout 2022, we have seen many central banks around the world start to increase their official interest rates from ultra-low levels. NZ began this process in late 2021. The U.S started to raise official interest rates in March 2022, from near-zero levels.

Overall, you could say that interest rates in the U.S, have been ultra-low for a long time. Raising interest rates to more 'normal' levels would take rates to at least 2-3%, from the current 1.5%, but given how much inflation has already overshot the Fed's target (which is 2-3%), the official cash rate could end up higher. In NZ, ultra-low interest rates have been in place only recently, in response to the COVID-19 pandemic.

Given how quickly inflation is rising, it is completely appropriate that rates are raised in economies such the U.S, U.K, and NZ.

What has driven investment markets?

Investment markets generally had a terrible time throughout the June quarter. Key equity, bond and listed property markets ended with large declines for the quarter, 6-month and 1-year period. In the U.S, most of the supercharged gains in equity markets over 2021 have now been erased. In bond markets, yields have skyrocketed higher throughout 2022, causing bond markets to fall.

The main driver of these dramatic market movements has been the sharp rise in global interest rates, as central banks around the world have responded to surging inflation by raising official interest rates. However, the speed and size of interest rate hikes in the U.S have taken markets by surprise. In mid-June, the US Fed raised rates by 0.75%, which was the largest single increase in U.S interest rates since 1994. This followed a large 0.5% increase in the previous month. Usually, interest rates are moved in smaller, gradual increments. The message is clear: the U.S Fed is absolutely serious about breaking the back of inflation.

The U.S rate hike cycle is turning out to be more aggressive than what bond markets and equity markets were pricing in, just a few months ago. The risk is that higher interest rates in the U.S and other economies could eventually lead to a recession. That said, we support the aggressive action taken by central banks because the danger is that inflation becomes imbedded in consumer expectations. This often manifests in expectations for large wage increases, which can then produce a damaging spiral of rising wages and prices.

Markets are forward-looking, which means that they attempt to anticipate future changes in inflation and interest rates before they actually happen. There is a lot of uncertainty about how far inflation and interest rates will rise, and while this uncertainty continues, markets are likely to stay jittery.

How the portfolio has performed

FINANCIAL PERFORMANCE RETURNS

AURORA RETIREMENTPLUS AS AT 30 JUNE 2022

	RETURNS		
	3 months %	6 months %	1 year %
Strategy at age 55*	-9.49	-16.38	n/a
Strategy at age 65*	-7.51	-13.50	n/a
Strategy at age 75*	-5.59	-10.71	n/a

* Strategy returns are after fees, before taxes.

We are focused on achieving long term financial returns that can help you meet your financial goals and will generally provide commentary on returns over timeframes that are meaningful for a long-term investor. Short term performance returns (daily, monthly, quarterly, and even 1 year time periods) can be volatile and reflect noise that is unrelated to the long-term value of your investments, so focusing on these shorter timeframes is rarely helpful to KiwiSaver investors, in our view.

With that in mind, we note that the negative returns recorded by the portfolio over 3 months and 6 months were driven by broad market declines in bonds, listed property and equities. While negative portfolio returns are disappointing, we note that for the bond portion of the portfolios, investors who stay invested will receive the return of their money when each bond matures. However, for those who sell before maturity, the fall in bond prices will translate to losses. The allocation to bonds rises every year for member's aged 51 and above.

ESG & SUSTAINABILITY MEASURES OF PERFORMANCE

We measure the sustainability and ESG performance of the portfolios through several lens, with each providing a slightly different focus or perspective. Ultimately, these help us to identify which assets in the portfolio are doing well or are lagging on ESG and sustainability factors. We use independent third-party sources to analyse the portfolios sustainability characteristics.

If you are invested in the Aurora RetirementPlus Strategy, your exposure to each of the underlying Funds will be determined by your age, and this can be viewed by logging in to the Client Portal. The underlying Fund exposure for ages 55, 65, and 75 is as follows:

At age 55: Aurora Growth Fund 42.5%, Aurora Conservative Fund 15%, Aurora Future Focused Fund 42.5%
At age 65: Aurora Growth Fund 25%, Aurora Conservative Fund 50%, Aurora Future Focused Fund 25%
At age 75: Aurora Growth Fund 7.5%, Aurora Conservative Fund 85%, Aurora Future Focused Fund 7.5%

EMMI Carbon Intensity Temperature Alignment as at 30 June 2022		
Aurora Conservative	**Aurora Growth**	**Aurora Future Focused**
1.5 degrees Celsius	**1.5** degrees Celsius	**3.9** degrees Celsius

How to read this:

The EMMI Carbon Intensity Temperature Alignment is the portfolio's implied warming impact in the future.

There are 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.

The Growth Fund and Conservative Fund both have a temperature alignment of 1.5°C, which is the best of the climate scenarios. The Future Focused Fund has a much higher temperature alignment of 3.9°C, owing to its investments in companies and industries that are leading the transition away from fossil fuels to renewables.

Source: EMMI.

EMMI Global Carbon Efficiency Rating (GCER) as at 30 June 2022		
Aurora Conservative	**Aurora Growth**	**Aurora Future Focused**
89/100	**93**/100	**85**/100

How to read this:

The higher the GCER Rating, the lower the carbon exposure of a company/portfolio, and the lower the financial risk of transitioning to a future net zero emissions world. The GCER Rating is a measure of a company's financial exposure to carbon and whether that company is aligned with a future economy where carbon emissions are low.

We look at carbon risk because the majority of climate risk is carbon risk.

The current Growth and Conservative GCER Rating Score of 89/100 and 93/100, respectively, suggests a very low carbon exposure. The Future Focused Fund has a lower GCER Rating than the Growth and Conservative Fund, because of its investment in companies transitioning to a low carbon world, mainly within the Clean Energy ETF.

Source: EMMI

MSCI Weighted Average Carbon Intensity Score as at 30 June 2022	
Aurora Future Focused	**How to read this:**
Fund: **191** Benchmark: 161	The MSCI Weighted Average Carbon Intensity Score describes the carbon output per $million of revenue, for each company. The lower the score, the lower the Fund's exposure to carbon. The Fund is showing higher than average carbon intensity compared with a traditional market exposure, which we are referring to as the 'benchmark.' This is mainly due to the Fund's US Green Bond exposure, where there has been an increased investment in US power companies transitioning to renewables. Source: MSCI

Questions?

If you have questions about this report, we encourage you to contact your adviser who can discuss this with you.

We welcome all feedback and would like to hear from you should 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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