Aurora Conservative Fund

QUARTERLY UPDATE **MARCH 2022**

Climate and Environmental, Social, Governance developments

How good would it be if companies had to report their emissions?

It can be frustrating when companies say all the right things about trying to reduce their emissions but get cagey about providing data about their emissions. We are inspired by recent efforts to change this, from the United States Securities and Exchange Commission (SEC), which is the top U.S watchdog protecting investors in markets and securities. The SEC put forward new rules in March 2022 that would make it compulsory for companies to report their greenhouse gas emissions. Even better, these records would need to be audited by an independent third party, much like financial records, to help make sure that the information is correct and can be trusted.

This is a great leap. It will standardise emissions reporting across all companies. Refreshingly, it will more easily allow investors such as Aurora to compare companies by their climate risks and their readiness to transition to a lower emission world, and also, whether they have met their stated goals for cutting down on emissions. Sounds simple enough, but this is quite a big deal. Up until now, getting your hands on emission information hasn't been easy, and the task of comparing and understanding the data is made even more difficult when companies provide the data in the format that suits them, without clearly explaining what is being measured and how. At Aurora, we use EMMI, an analytical system that does nifty modelling to describe a company's carbon risk, sometimes this is done without company-issued data using sophisticated data modelling tools. EMMI's job would be made a lot easier if companies had to provide audited emissions data.

That said, we are bracing for some hurdles before this rule kicks in. First of all, this is a draft rule. We now face a period for public comment. There is a good chance that fossil fuel dependent companies will protest about how expensive the cost of compliance will be. There are other question marks about how broad the emissions capture will be. We hope that the SEC rule will force companies to do more than talk the talk, by providing reliable and standardised emissions information. By casting a stronger light on emissions, and holding companies accountable to pledges they make, we can move closer to solving our climate change problems.

Investing in better health for the planet

At Aurora, we are all about improving the health of the planet and creating a better climate for the future, through the investments we make on your behalf. In our view, it isn't enough to just avoid investing in the 'problem' companies that are greenhouse gas polluters. We want to be investing in companies that are working on solutions and creating the change to a cleaner and healthier planet for us all.

As energy is the main source of global greenhouse gas emissions (73%[1]), it's also a key focus area for the Aurora portfolios. A good example of a company that is creating change in the energy sector is Orsted, a Danish power company that the Future Focused Fund has exposure to via the Clean Energy ETF.

Orsted was founded in 2006, from a merger combining six Danish energy companies. Incredibly, at that time, it was one of the most coal-intensive companies in Europe and was responsible for a third of Denmark's greenhouse gas emissions. Not long after the merger, in 2008, Orsted got focused on a green transformation. They set their sights on renewable energy generation and cut down their fossil fuel dependency. Fast-forward to today, Orsted is the largest offshore wind generation company on the planet and one of the largest renewable energy players globally. The carbon emission cuts they have achieved along the way is impressive: in 2020, their carbon emissions were a mammoth 86% lower than 2007 levels[2]. Expressed using metric tons of carbon dioxide equivalent (or MT CO_2e), emissions fell from 14 Mt CO_2e down to 2 Mt CO_2e[2]. In Denmark, this decline has accounted for over half of the country's total emission reductions since 2006[3].

Orsted has played a massive role in driving down the cost of offshore wind generation. Since 2012, the cost of offshore wind generation has been slashed by over 60%, making it one of the lowest-cost energy generation options available[2]. In providing capital to Orsted, your Aurora KiwiSaver Scheme is supporting their good work in developing renewable technology and generating capacity. We believe that through investment in companies like Orsted, we are helping to solve the energy and climate challenges the world is facing.

Investment markets

What has driven investment markets?

The start of 2022 was turbulent for investment markets and a number of negative factors weighed heavily on sentiment. This included Russia's horrific invasion of Ukraine, which sparked widespread condemnation around the world. It also led to a slew of economic and financial sanctions on Russia, with many countries banning Russian oil and petroleum exports. With Russia being a major oil producer, global oil prices spiked higher. Also adding to the general theme of rising global prices, was the removal of 40% of the global wheat supply by Ukraine. By quarter end, the alarm bells about rising global inflation were ringing even louder than at the start of the quarter.

In response to the growing inflation risks, central banks in the U.S and England decided to quicken the pace of their official interest rate rises. In New Zealand, the official cash rate was raised in February and again in April, to 1.5%, to be the fourth official interest rate hike since October 2021. More interest rate increases can be expected in New Zealand. It is hoped that by raising rates, the central bank will be able to stem the rise in inflation, which is now at its highest in decades, and stop inflation expectations from being entrenched.

Reflecting these influences, most of the main asset classes ended the March quarter with losses. This included global and NZ sharemarkets, global and New Zealand bond markets, and listed property. The asset classes that managed to record better returns for the quarter were those that tend to do well when inflation is rising, such as commodities and inflation-linked bonds. While global equities took a hit in the quarter, we note that returns over the 1-year and 3-year periods remain very strong, thanks to their previous breath-taking gains in 2019, 2020, and 2021.

How the portfolio has performed

FINANCIAL PERFORMANCE RETURNS

AURORA CONSERVATIVE FUND AS AT 31 MARCH 2022

	RETURNS		
	3 month %	6 month %	1 year %
Strategy (after fees, before taxes)	-5.04	-4.66	n/a
Objective: CPI + 2.50%*	n/a	n/a	9.40**

* CPI is the headline Consumer Price Index
** AS at 31 March 2022

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 will keep our comment on short term performance brief, by noting that the negative returns for the quarter were driven by overall market weakness in equities, bonds, and listed property. We will provide more detailed comments on longer term performance as the return history of the Scheme builds.

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.

EMMI Carbon Intensity Temperature Alignment* as at 31 March 2022

1.5

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 Conservative Fund currently has a temperature alignment of 1.5°C, which is the best of the climate scenarios.

Source: EMMI

EMMI Global Carbon Efficiency Rating (GCER) as at 31 March 2022

86

/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 Conservative GCER Rating of 86/100 suggests a low carbon exposure.

Additional analysis shows that 83% of the portfolio is equipped to transition to a world where the global warming temperature increase is limited to 2 degrees above pre-industrial levels.

Source: EMMI

1. "Sector by sector: where do global greenhouse gas emissions come from?", Our World in Data, Emissions data for 2016
2. "Our Green Business Transformation", Orsted, Version 1.0 April 2021
3. "Science-Based Targets Case Study: Orsted", Science Based Targets, June 2019

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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