Aurora Capital

Aurora Liquidity Fund

QUARTERLY UPDATE MARCH 2023

Climate and Environmental, Social, Governance developments

CLIMATE CRISIS GOT YOU DOWN? HERE ARE 3 REASONS FOR HOPE.

You wouldn't be alone if you felt a bit down after reading any climate reports from the United Nations (UN), over the past few years. Getting into the weeds of climate data can be sobering.

Some of the most important reports on the science of climate change are from the UN Intergovernmental Panel on Climate Change (IPCC), representing the world's leading climate scientists. Their most recent update (the AR6 synthesis report) was released in March 2023. Straight up, this report highlighted some grim climate facts. For example, at the current level of CO2 emissions, the surface temperature of the planet is expected to rise above the targeted 1.5 degrees Celsius. That said, the report also gave us cause for optimism, provided that governments and policymakers move quickly on climate action. So, the case for hope stays alive, in our view.

Here are 3 reasons to be hopeful after reading the UN IPCC Report :

The cost of clean energy has fallen quickly over the past decade:

> solar power is -85%
> wind power is -55%
> batteries are -85%.

In some regions and sectors, moving to clean energy is cheaper than running fossil fuel energy.

We still have time to act:

Every degree of avoided warming can make a difference. We have a window of opportunity, but it's closing quickly. The choices we make in this decade will determine how much the planet warms in the future.

We need to move from fossil fuels to cleaner energy, urgently:

Limiting global warming to between 1.5°C and 2°C needs fast and large cuts to greenhouse gas emissions.

We're not sugar coating the scale of the climate challenge. Action needs to be taken in this decade to avoid the worst consequences of climate change. Policymakers are being urged to take action now to reduce emisisons. Amidst this urgency, there is hope.

At Aurora Capital, we're investing in companies that have already transitioned or are in the process of transitioning to lower carbon emissions. In order to create positive change for the climate, we believe it's important to allocate capital to companies that are actively seeking to reduce their carbon emissions, rather than invest only in low carbon emitting companies. We note that the Aurora Liquidity Fund doesn't have exposure to equities. We included this information in your Quarterly Update as most of the Aurora Capital portfolios do have exposure to companies that are in the process of transitioning

INVESTING IN BETTER WATER MANAGEMENT

Aurora Capital invests in the water sector because water is life, and good management of our precious water resource can help to protect it, improve how water is treated and accessed, and offset some of the effects on climate change.

We note that the Aurora Liquidity Fund doesn't have exposure to equities or investments in water, or to Veolia, 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 – Veolia

An example of a company doing good work in the water sector is Veolia, which is a French service and utility company, providing water management, waste management and energy services. Your KiwiSaver investment has an exposure to Veolia via the Global Water ETF. The water management sector is Veolia's largest business, providing treatment, distribution and the recycling of water across 4,000 treatment plants, globally. Veolia's water services provides clean water to over 100 million people.

The number of people who benefitted from access to water or sanitation, which Veolia provide, was up to 6.71 million in 2021. **This is up 17.5%** from the prior year, and a **25% increase** from 2 years ago.

The efficiency of their drinking water networks have **improved 72.5% to 75.6%** over the same period, meaning less water wasted.

Source: Veolia 2021 Integrated Report

Closer to home, Veolia works with Danone Nutricia NZ, where they recently developed a water recovery system for their milk drying plant in the South Island of New Zealand. The system is the first of its kind in the southern hemisphere, closing the loop on water resources at this plant, which minimises the use of fresh water.

Within the waste management and recycling industry Veolia provides services such as collection, sorting and treatment of waste, in addition to developing new solutions for recycling and waste reduction. And, in the energy sector Veolia work in the spaces of energy efficiency consulting, renewable energy production, and district heating and cooling, to give a few examples.

When we run the Sustainable Platform analytics on Veolia, we can see that 82% of the company's sales are contributing to the United Nations Sustainable Development Goals, mainly SDG 6: 'Clean Water and Sanitation'. This reinforces our view that an investment exposure to Veolia can help with creating better water outcomes.

By providing capital to companies like Veolia, Aurora Capital is supporting the accessibility and management of clean water to communities worldwide. We note that the Aurora Liquidity Fund doesn't have an exposure to Veolia.

Investment markets

WHAT HAS DRIVEN INVESTMENT MARKETS?

Investment markets started the year with a bounce, with all key asset classes ending the March quarter higher. This was helped by the re-opening of the Chinese economy, which is expected to power a one-off global growth spurt. Elsewhere, signs that economic growth in the U.S and Europe had not yet fallen into a ditch, also fed some optimism that perhaps a 'bad' recession could be avoided in coming months.

It's been quite some time since the we've seen positive quarterly returns from the key asset classes, but it wasn't all clear sailing. There were some notable bumps along the way, including the collapse of two U.S banks and Swiss banking giant, Credit Suisse, which sparked fears about the stability of the global banking system. In response, central banks moved quickly to provide support to the banking system and give assurances to depositors that they wouldn't lose their money. While there were specific factors behind each banks' demise, a common theme was that these banks had large holding of bonds, which lost value throughout 2022 as bond yields rose. These bank collapses highlight the risks from central banks increasing interest rates quickly.

The most influential central bank in the world, the U.S Federal Reserve (the Fed), continued to make it clear that bringing down high inflation is a priority. Helping the Fed to do some of the work in slowing down the U.S economy, was the tightening in bank lending standards which should result in less credit being available. In our view, it's going to be a tough balancing act for the Fed. Continued high inflation means that a couple more interest rate increases can't be ruled out. However, concerns about the stability of the banking system and the likelihood of a recession kicking in over the next 12 months means that the Fed will probably respond more cautiously. In short, it's widely believed that the U.S is now nearing the end of its rate hike cycle - this was also a reason why key investment markets rose over the quarter.

Financial performance returns

AURORA LIQUIDITY FUND AS AT 31 MARCH 2023

	RETURNS		
	3 month %	6 month %	1 year %
Strategy (after fees, before taxes)	1.11	2.01	2.99
Benchmark**	1.14	2.13	3.26

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

Positive returns for the quarter were driven by rising cash yields. The official cash rate was raised twice in the December quarter by the N.Z central bank, to its highest level since January 2009. Yields have risen significantly since the cash rate hiking cycle began in October 2021. Further increases to the N.Z cash rate from the current 4.25% are widely expected, which should continue to be positive for yields.

Since the end of 2021, we've seen a lot of volatility in investment markets, stemming from the rapid rise in inflation and central banks around the world playing catchup in hiking interest rates. It takes quite a long time for higher interest rates to slow down an economy, and it still remains unclear how much economic growth will decline as a result of interest rate hikes from central banks around the world. Based on U.S history , we know that when the Fed raises interest rates, it's often the case that the economy falls into a recession, although the length and severity varies in each episode. Historical lag times suggests the U.S could be in a recession within 12 months, although any downturn is widely expected to be mild at this point. In New Zealand, the central bank stunned markets in early April 2023, with a larger than expected increase in the overnight cash rate, to 5.25%, in an effort to bring down high inflation. It's possible that the New Zealand economy is already in a recession, given that GDP fell by 0.6% in the December quarter of 2022. The risk is that the NZ central bank doesn't get the shallow recession it's forecasting, but rather, something more severe. This scenario would likely result in the RBNZ lowering the overnight cash rate. As markets are forward-looking, they tend to price in future events before they happen, and at the time of writing, the NZ interest rate market started to price in the likelihood of lower rates at the start of 2024.

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.

Sean Henaghan
Aurora Chief Investment Officer

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Aurora Capital

0800 242 023
hello@aurora.co.nz
www.aurora.co.nz