



CarbonFund

Carbon Fund Fact Sheet – Quarter ending 31 December 2020

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees. We are active managers. Our shared investment philosophy is centred on the belief that market inefficiencies exist that can be exploited over time to deliver superior risk-adjusted returns.

Further, the consideration of environmental, social and governance (ESG) factors is integral to the research we carry out. Salt analysts consider the potential for ESG factors to influence long term returns on invested capital (positively and negatively).

Investment Strategy

The Fund's aim is to provide investors with a total return exposure to the price of carbon credits. The Fund has the ability to buy carbon credits in emissions trading schemes in New Zealand and offshore.

The Fund gains its exposure to the price of carbon credits in the NZ ETS through purchasing and holding carbon credits on the NZ ETS. We may also use swaps or other derivatives to gain exposure to the NZ ETS.

The Fund will also have the ability to buy carbon credits in international emission trading schemes, as well as futures, swaps or other derivatives that provide exposure to international schemes. As a result, the Fund may also provide exposure to the price of carbon offshore.

The Fund is actively managed by us. This means we buy and sell carbon credits on emission trading schemes, or hold cash based on our own analysis and assessment of the market. This includes our assessment of the price of carbon credits relative to the demand and supply of carbon credits and other factors including technological advancements, politics, regulation, fuel prices and even global weather and climate change.

Fund Details

Fund Assets	\$9.1 million
Inception Date	8 November 2018
Portfolio Manager	Paul Harrison
Total Fund Charges (p.a.)	0.97%
NZX Code	CO2

Who is involved?

Supervisor	The New Zealand Guardian Trust Company Limited
Custodian	The New Zealand Guardian Trust Company Limited
Administration Manager	MMC Limited
Unit registrar	Link Market Services Limited
Investment Manager	Salt Funds Management Limited

Net Tangible Assets (NTA) Value on 31 December 2020

Application	1.3175
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CO2 price on NZX Main Board on 31 December 2020

NZX Close	1.35
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Investment Guidelines

The guidelines for the Carbon Fund are shown below:

Carbon credits	0% – 100%
Cash	0% – 100%

Target investment Mix

The target investment mix for the Carbon Fund is:

Carbon credits	98.00%
Cash	2.00%

Fund Allocation at 31 December 2020

Carbon credits	91.96%
Cash	8.04%

Fund Performance to 31 December 2020

Period	Fund Return
1 month	3.78%
3 months	5.54%
1 year	22.98%
2 years	15.54%
Since inception p.a.	14.26%

Performance is based on NTA movement and is after all fees and 28% tax.

SALT INVESTMENT FUNDS LIMITED

Level 3, The Imperial Buildings, 44 Queen Street | PO Box 106-587, Auckland 1143

P: +64 9 967 7276 | E: info@carbonfund.co.nz | www.carbonfund.co.nz

Quarterly Fund Commentary

Dear Fellow Investor,

The last quarter of 2020 was an eventful one for investors. Globally we saw the election of Joe Biden as US President, the end of the Kyoto Protocol, the agreement of the Brexit deal between the UK and the EU, and a slight change in stance on climate change and emissions reduction by Australia. Locally, it was just as eventful with the Labour's re-election, declaration of a national Climate Emergency by the NZ Government, and conclusion of the last emissions year with the old ETS (and its Fixed Price Offer for emitters). All of which impacted New Zealand's carbon market and contributed to the price of NZU's consistently trading above the FPO since 20 October 2020.

In the December quarter, the NZU price increased 7% from \$34.95 to \$37.55. In the 12 months ending 31 December 2020, the NZU price increased 32% (\$9.05). The NZU price peaked in the first half of December as demand continued, supply tightened, and the NZ Government declared a national Climate Emergency. The quarter's peak was \$3 above the FPO, demonstrating the FPO and NZU prices disconnect. Limited supply, the old ETS ending, buoyant global log prices, and continued demand caused upward pressure on the NZU price, supported by buyers with a long-term view and purchasing 'at market', irrespective of the \$35 FPO.

The European carbon market (EUA) continued to move around during December as it was pushed and pulled by Covid-19 lockdowns and upgraded outlooks for economic growth. The EUA price increased 21% from €26.48 (NZ\$45.12) at the start of the quarter to €32.75 (NZ\$54.60) by the end of December. This rise understates the volatility during the quarter, with the price dropping to €23.03 (NZ\$39.25) during October and peaking at €33.28 (NZ\$56.71) on 28 December 2020.

The movement in the underlying assets (currently NZUs and cash) saw the net tangible assets (NTA) of the Carbon Fund increase from \$1.2506 to \$1.3175 (+5.3%) during the December quarter. The traded price of the Carbon Fund on the NZX went from \$1.24 to \$1.35. For the 12 months ending 31 December 2020, the Carbon Fund's traded price went from \$1.08 to \$1.35.

The Carbon Fund was an active buyer of NZUs during the quarter, purchasing 14,500 tonnes of NZUs at an average price of \$37.00.

Looking ahead

With NZ's new Cap and Trade Scheme underway, the first auction will occur on 17 March 2021, followed by three others throughout the year. There will be 4.75 million units available at each auction as well as a Cost Containment Reserve (CCR) of 7 million units that the government can access if the auction

unit price hits \$50. Unsold units will roll over to the next auction, until the fourth auction, where unsold units will be cancelled, along with any units remaining in the Cost Containment Reserve (CCR).

In December, we observed commentary that the government has reversed its decision to omit a technical reserve price (TRP), yet we have not seen any official communication to date. A TRP would provide more certainty going into the first auction as it stops the sale of NZUs during the auction from materially undermining the secondary market price. For the TRP to be applied at the first auction, an amendment bill will need to be passed by parliament.

The last day of 2020 marked the end of the Kyoto Protocol, with the Paris Agreement kicking in on 1 January 2021. New Zealand ratified the Paris Agreement in 2016 and communicated its first nationally determined contribution.

In 2019 the New Zealand Government established an independent Climate Change Commission to provide expert advice on New Zealand's climate change settings. The Climate Change Commission was tasked with providing advice and recommendations to the government on whether the NDC should change to make it consistent with the global 1.5°C temperature goal and, if so, how. Draft advice is expected at the start of February 2021, followed by a six-week consultation. Theoretically, if emission budgets are reduced for greenhouse gases and biogenic methane, so will the number of available NZU's.

Offshore, we will gain more certainty of the speed at which President-Elect Joe Biden will implement his campaign policies. The Democrat's will control the White House, House of representatives and, very narrowly, hold the balance of power in the Senate. This will give Biden the opportunity to back up his climate commitments with domestic climate change action via legislation in Congress.

We can expect the USA to re-join the Paris Agreement and commit to net-zero carbon emissions by 2050 at the earliest opportunity. We also expect Biden to focus on trade policy, most likely imposing carbon adjustment fees or quotas on carbon intensive goods from countries failing to meet their climate and environmental obligations.

Thank you for your interest in the Carbon Fund. We look forward to bringing you more developments in the New Zealand and International carbon markets in the future.



Paul Harrison, BCA, MBA, CA