



# CarbonFund

## Carbon Fund Fact Sheet – Quarter ending 30 June 2024

### 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	\$75 million
Inception Date	8 November 2018
Portfolio Manager	Paul Harrison
Total Fund Charges (p.a.)	0.96%
NZX Code	CO2

### Who is involved?

Supervisor	The New Zealand Guardian Trust Company Limited
Administration Manager & Custodian	Apex Administration (NZ) Limited
Unit registrar	Link Market Services Limited
Investment Manager	Salt Funds Management Limited

### Net Tangible Assets (NTA) Value on 30 June 2024

Application	1.5974
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### CO2 price on NZX Main Board on 30 June 2024

NZX Close	1.36
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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 30 June 2024

NZ carbon credits	94.77%
Aus carbon credits	4.56%
Cash	0.66%

### Fund Performance to 30 June 2024

Period	Fund Return
3 months	-10.57%
1 year	9.92%
2 years (p.a.)	-14.84%
3 years (p.a.)	2.95%
5 years (p.a.)	11.14%
Since inception (p.a.)	8.66%

Performance is based on NTA movement and is after all fees and 28% tax. Past performance is not a good indicator of future performance.

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## Quarterly Fund Commentary

Dear Fellow Investor,

Following the partial clearance of the NZ Unit (NZU) auction in March, the NZU price weakened over the June quarter. With NZUs trading well below the auction floor price, the secondary market provided a source of cheaper NZUs for any ETS-registered emitters caught short going into the May surrender deadline. The market's confidence was tested by a number of government announcements during the quarter. The Ministry for the Environment published a consultation document in May which surprisingly included a potential option to lower the auction price floor from the \$64.00 it had been set at for 2024. This document combined with Treasury's Budget Economic and Fiscal Update 2024 (also released in May) which used \$58.35 as its assumed NZU auction price, gave fuel to this speculation and dramatically impacted market confidence in the pricing of NZUs.

Given this uncertainty, it was no surprise that there were no bids for the circa 4.076m NZUs on offer in the June auction. This auction failed and the unsold units are now being carried over to the September auction. On auction day, the NZU price in the secondary market (NZ\$49.00) was trading well below the auction floor price of NZ\$64.00, with little to no reaction to the zero increase in NZUs from the auction, reflecting continued subdued demand. The June result marks the fifth failed auction since March 2023 and further reduces the likelihood of the Government collecting any further revenue from NZU auctions in 2024.

The nervousness around the government's commitment to the ETS only increased when during an Environment Select Committee meeting in June, Act's Climate Change spokesperson, Simon Court pressed Climate Change Minister, Simon Watt to confirm that the government did not have to accept the Climate Change Commission advice on ETS settings.

On a positive note, the secondary market is working to clear the overhang of NZUs on issue. The number of privately held NZUs fell 24.5m over the June quarter following the May 2024 surrender deadline for emitters to meet their prior 2023 obligations. This net reduction was far above the 9.5m NZU reduction in the previous year despite a very wet 2023 year when hydro generation dominated the electricity supply reducing the need for NZU surrenders.

As things currently stand, it is unlikely that any of the 7.6m NZUs to be offered in the September auction will be sold. The price in the secondary market will need to increase significantly to reach the \$64 auction floor price. With only the December auction remaining after that, the circa 11m NZUs still available in the 2024 auctions will likely not be sold and will be removed from supply and tighten the market up.

The latest Climate Change Commission recommendations on ETS settings call for a significant reduction in the planned volumes of NZUs available at auction from 2025-2029, to reduce the "surplus" of issued NZUs to zero by 2030. The Government has yet to accept these settings. The reduced auction volumes, combined with the likelihood of no more NZUs being sold at auction in 2024 and a significantly higher thermal electricity generation-driven demand for NZUs in 2024 creates the potential for a much tighter NZU market in 2025. The market is now eagerly awaiting the Government's decision re the Climate Change Commission recommendations.

Separately, the Ministry for the Environment released its draft proposals for NZ's second emissions reduction plan for 2026-2030. The plan details policies and actions aimed at reducing net carbon emissions at the least possible cost. It uses the ETS as the primary tool, with most net emissions reductions in the second emissions budget forecast to come from the forestry and agriculture sectors. The Government's forecasts assume a substantial contribution of NZUs from forestry into the 2030s based on the forecast of circa 30,000 ha/year of new plantings. This assumption contrasts with the 2023 MPI Survey of afforestation and deforestation intentions in New Zealand that suggested intended planting of less than 20,000 ha for 2025, falling further to circa 8,000 ha by 2030. Notably, the NZU price at the time of this survey was 40% higher than where it is now, suggesting the 30,000/ha projection is likely to be missed. Further, the Government is looking to restrict whole-farm conversions to exotic forests, seeking to preserve the amount of productive farmland in NZ. Hopes and expectations for significant afforestation appear highly unlikely under current settings.

The Fund continues to take advantage of the arbitrage opportunity created by the CO2 units trading on the NZX at below its NTA value and has continued to sell NZUs in order to buy back CO2 units at a level implying a much cheaper NZU price.

The NTA value of the Fund finished the quarter at \$1.60 (from \$1.79), moving 10.6% lower. This outperformed the 13.5% decline in the NZU price from \$58.35 to \$50.50. The Fund's small holding of Australian Units (ACCUs) rose slightly from \$33.37 to \$34.25.



Paul Harrison, BCA, MBA, CA