CarbonFund

Carbon Fund Fact Sheet – Quarter ending 31 December 2018

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	$1.4 million
Inception Date	8 November 2018
Portfolio Manager	Paul Harrison
Total Fund Charges (p.a.)	0.95%
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 at 31 December 2018

Application	0.9991

CO2 price on NZX Main Board at 31 December 2018

NZX Close	1.05

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 2018

Carbon credits	92.92%
Cash	7.08%

Fund Performance to 31 December 2018*

Period	
2 months	5.0%

Performance is after all fees and 28% PIE tax.

*Performance is based on NZX market close price and is for the period 8th November to 31st December 2018.

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Factsheet December 2018

Quarterly Fund Commentary

Summary

- NZUs traded in a tight range between $24.80 and $25.25 during the quarter.
- On the 12th of December the NZ government released details of the first tranche of planned changes to be made to the NZ ETS, including capping emissions and introducing an auction-based mechanism.

Dear Fellow Investor,

Welcome to the first quarterly Carbon Fund update.

For much of the December quarter the price of carbon in New Zealand, as reflected by NZUs, traded in a tight range between $24.80 and $25.25 on the back of little news flow, and closed out the year at $25. NZUs reached an all-time high of $25.85 on the 12th of December ahead of an announcement to be made by the Ministry for the Environment, which we discuss in a little more detail below.

Throughout 2018, the Labour-led coalition Government of New Zealand had been considering policy amendments to the Climate Change Response Act, working on the introduction of the Zero Carbon Act, and consulting on making progressive changes to the New Zealand Emission Trading Scheme (ETS). Alongside this, the Interim Climate Change Commission (ICCC) has been investigating priority areas of concern the Government has as New Zealand moves towards a low emissions economy. Principally, this has involved an assessment on the impact of including agricultural methane into the ETS and analysing the requirements to transition the electricity sector to be 100% renewable by 2035 (“in a normal hydrology year”). We expect to hear back from the ICCC early in 2019 as it delivers its final report to the Minister for Climate Change, James Shaw.

On the 12th of December acting Climate Change Minister Julie Anne Genter released to the market the first tranche of planned changes to be made to the ETS via the Climate Change Response Act. The proposed changes are intended to have the effect of strengthening the mechanisms that underpin the ETS. Two key proposals are worth a mention. Firstly, Minister Genter proposed introducing an emissions cap. This would have the effect of restricting the number of NZUs supplied into the scheme, increasing the incentives to reduce emissions rather than just offset them. The second key announcement was that an auction-based mechanism will be introduced, and replace the standing fixed-price option, currently set at $25/NZU. Throughout 2019 the details around how a new auction-based allocation mechanism are expected to be worked into policy. This is an important piece of legislation that needs to be well understood by market participants to understand the future supply and demand dynamics of NZUs.

A second tranche of planned improvements to the design of the ETS is expected to be announced in the first quarter of 2019. Meanwhile, the current timetable for introducing the Climate Change Act Amendment Bill sits at around Q2 2019. Overall, we welcome the steps taken by the Government to continue to strengthen ETS, preparing it to play a larger role as New Zealand actively sets about reducing emissions in line with its Paris Agreement commitments of 2015.

In the European ETS, traded volumes increased by 45% in a year where the price climbed more than 200% to €24.73 (NZ$42) at year end. As the European Union’s effort to reduce emissions increases throughout 2019, it is possible that reduced government emissions allocations, and incremental policy changes may again support the price of EUAs throughout the year.

Over 2019 we will be following developments in the progress of the launch of the China ETS, and political developments in Australia. China has reiterated a commitment to its Paris Agreement emissions reduction targets, with their ETS to initially include the tremendously large power sector. Meanwhile, Australia will have a general election this year where it is looking possible that a Labour-led government may be elected. The Australian Labour Party (ALP) has a strong renewables energy policy that includes a 45% reduction in emissions from 2005 levels, underpinned by a 50% renewable energy target. The ALP has long toyed with the introduction of market-based carbon pricing mechanisms, which we will be looking forward to any announcement on.

During December in Katowice, Poland, the United Nation’s “COP 24” climate change conference took place. Among the agenda was the herculean task of finalising the “rulebook” of the Paris Agreement as signed by nations, including New Zealand, in 2015. The operating manual for the Agreement beginning in 2020 was signed at the “11th hour” in which a single set of rules for all countries was outlined with respect to the measurement and reporting of emissions reductions. COP 25, to be held late in 2019 in Chile will focus on a common set of rules to be applied to Emission Trading Schemes.

We look forward to keeping you up to date throughout 2019 on developments in domestic and international carbon markets.