Carbon Fund Fact Sheet – Quarter ending 30 June 2019

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	$1.5 million
Inception Date	8 November 2019
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 30 June 2019

Application	0.9424

CO2 price on NZX Main Board at 30 June 2019

NZX Close	0.92

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 2019

Carbon credits	93.07%
Cash	6.93%

Fund Performance to 30 June 2019

Period	Fund Return
1 month	-3.70%
3 months	-6.61%
6 months	-5.43%
Since inception p.a.	-8.05%

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

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CarbonFund

Factsheet June 2019

Quarterly Fund Commentary

Dear Fellow Investor,

The June quarter saw the price of carbon (NZUs) traded on the New Zealand Emissions Trading Scheme (NZ ETS), pull back after its strong run during the March quarter. Having started the quarter at $25.75, NZU's retreated as the "hot money" that had been speculating on the New Zealand Government removing (or at least lifting) the fixed price option (FPO), sold out. The NZU's closed at what looks like an attractive $22.90 on the 30th June. The movement in the underlying assets (currently NZUs and cash) saw the net tangible assets (NTA) of the Carbon Fund slip from $1.0125 to $0.9424 during the June Quarter.

Most commentators viewed the lack of action on the fixed price option as disappointing. The price of carbon on the NZ ETS remains the most direct influence on emitters' behaviour. If corporates in New Zealand are budgeting for and forecasting a carbon price of $40 and above, a lower, slower price path will see any capital expenditure that was planned to avoid the cost impost from a $40 carbon price delayed.

The latest update from the international independent Climate Action Tracker group[1] praised the New Zealand government for its initial efforts but highlighted concerns around the separate targets for agriculture. *"While the introduction of the Bill is a significant step forward, excluding such a substantial share of emissions from the net zero goal lowers its ambition."*

The report went on to point out that *"The Bill does not introduce any policies to actually cut emissions: New Zealand has very few policies to implement this bill."*

As a result New Zealand's efforts on climate change are still rated "insufficient" and tagged with **"***Commitments with this rating are in the least stringent part of their share range and not consistent with holding warming below 20C and up to 30C let alone with the Paris Agreement's stronger 1.50C limit. If all government targets were in this range, warming would reach over 20C and up to 30C."*

On 16th May the New Zealand Government announced changes to the Zero Carbon Bill before Parliament.[2] The amendment will set a new greenhouse gas emissions reduction target to reduce all greenhouse gases (except biogenic methane) to net zero by 2050 and reduce emissions of biogenic methane within the range of 24–47 per cent below 2017 levels by 2050 including to 10 per cent below 2017 levels by 2030. It will also establish a new, independent Climate Change Commission to provide expert advice and monitoring to help keep successive governments on track to meeting long-term goals.

Proposed changes to Emissions Trading Scheme (ETS)

Together the tranche one and tranche two decisions will result in a single bill amending the Climate Change Response Act 2002 (CCRA).

The tranche two decisions are designed to improve rates of compliance within the NZ ETS and make the scheme more transparent to participants and the public by transitioning from the fixed price option to the cost containment reserve and establishing a separate market governance work programme.

The Government has agreed to establish a separate work programme to advise on options for market governance. Previous decisions to prohibit insider trading and market manipulation and to find an appropriate market regulator will be deferred and included in this work programme. This approach ensures that proposals are fully developed and consulted on and that expected impacts on market participants are well understood.

What does all this mean for the next quarter for NZUs

Many commentators had felt the government would remove the FPO of $25 to allow the price to reflect the market. With the delay to the removal to late 2020 or beyond has seen the price drop away. This period is traditionally a quiet period for emitters. That aside the Paris Accord formally starts next year. For New Zealand to meet its Paris Accord obligations, commentators believe that the price of NZUs will need to rise.

[1] www.climateactiontracker.org/countries/new-zealand/

[2] www.mfe.govt.nz/climate-change/zero-carbon-amendment-bill