MONTHLY REPORT
AUGUST 2024

PENGANA WHEB SUSTAINABLE IMPACT FUND

DESCRIPTION

The Pengana WHEB Sustainable Impact Fund invests in companies with activities providing solutions to sustainability challenges. WHEB have identified critical environmental and social challenges facing the global population over coming decades including a growing and ageing population, increasing resource scarcity, urbanisation and globalisation. The Fund invests in companies providing solutions to these sustainability challenges via nine sustainable investment themes – five of these are environmental (cleaner energy, environmental services, resource efficiency, sustainable transport and water management) and four are social (education, health, safety and well-being). WHEB's mission is 'to advance sustainability and create prosperity through positive impact investments.'

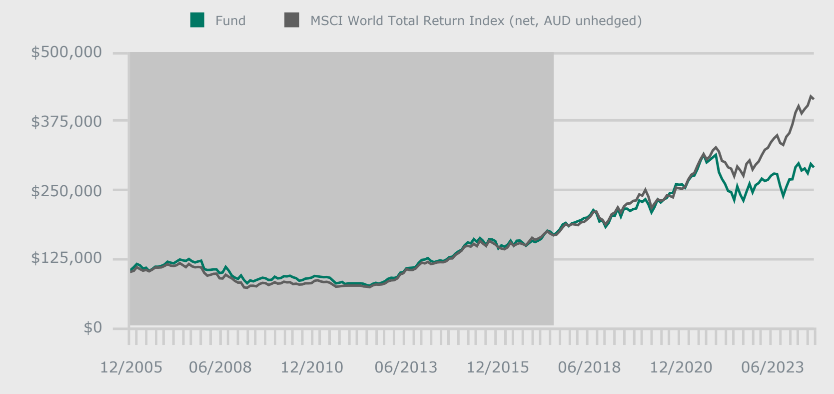
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 Aug 2024 [1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	SINCE INCEPTION P.A.
WHEB Sustainable Impact Fund	-2.1%	4.4%	-2.6%	6.6%	
Strategy (partial simulation – see below)					5.9%
MSCI World Total Return Index (net, AUD unhedged)	-1.2%	18.8%	9.6%	13.0%	7.9%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Agilent Technologies Inc	Health Care
Autodesk Inc	Information Technology
Bureau Veritas SA	Industrials
Ecolab Inc	Materials
ICON PLC	Health Care
Keyence Corp	Information Technology
Schneider Electric SE	Industrials
STERIS PLC	Health Care
Thermo Fisher Scientific Inc	Health Care
Xylem Inc/NY	Industrials

SECTOR BREAKDOWN

Consumer Discretionary	3.1%
Health Care	31.4%
Industrials	30.6%
Information Technology	22.5%
Materials	10.4%
Utilities	1.6%
Cash	0.4%

CAPITALISATION BREAKDOWN

2-10bn	19.2%
10-20bn	9.3%
>20bn	71.1%
Cash	0.4%

CUSTOM SECTOR BREAKDOWN

Health	27.2%
Resource Efficiency	25.3%
Sustainable Transport	7.5%
Environmental Services	8%
Water Management	14.9%
Safety	10.6%
Cleaner Energy	4.1%
Education	1.9%
Cash	0.4%

REGION BREAKDOWN

North America	43%
Europe ex-UK	38.8%
Japan	6.1%
UK	10.5%
Asia Pacific	1.1%
Cash	0.4%

ELECTRICITY VS GAS - THE DEVIL IS IN THE DETAILS

COMMENTARY

In this month's commentary Ted Franks considers the complex and controversial relationship between gas and electricity pricing. He reflects on green energy taxes in the UK and how they are affecting decarbonisation targets and potentially slowing adoption of lower carbon solutions.

We are thrilled to announce that WHEB's UK Fund will be adopting the 'Sustainability Impact' label on the 20 September 2024 under the UK Financial Conduct Authority's (FCA) Sustainability Disclosure Requirements (SDR) regime. We are very pleased that WHEB is among the first fund managers to be able to do so, and it is a real testament to the authenticity of their investment approach. WHEB have welcomed and support the SDR's introduction in order to tackle widespread greenwashing, and encourage the level of impact reporting they have championed for over a decade.

WHEB were recently announced as award finalists for:

- 'Impact Manager of the Year' award at the LGC Investment Awards 2024
- 'Responsible Investor of the Year' award at Reuters Events Sustainability Awards 2024
- 'Best Impact Report' category in the Pensions for Purpose Content Awards 2024

Join Associate Fund Manager Claire Jervis for a webinar update, where she will discuss the Fund's current portfolio holdings, the factors influencing recent performance, and some of the market variables the investment team is considering moving forward. Register here.

Market Review

Markets witnessed significant volatility during August, largely driven by global economic concerns.

The month began with a sharp sell-off driven by growth fears following weakness in employment and manufacturing reports in the US. This raised fears that the risk of a recession in the US, which is currently the healthiest of the major global economies. However, this fear was short-lived, as subsequent economic data soothed nerves, and the prospect of US rate cuts restored some market enthusiasm. The strategy's benchmark MSCI World Index was down -1.2% in the month.

Real Estate was the strongest sector in the Global market, followed by Healthcare and Consumer Staples, while Energy and Consumer Discretionary were the weakest.

Fund Review

The fund delivered a negative return during the period.

Spirax, the British industrial engineering business, was the largest detractor. The company reported results which were impacted by the weak macro environment, and a downgrade to full year guidance disappointed the market. Spirax addresses the growing need for more efficient and lower carbon industrial processes, and its portfolio of Steam and Electric Thermal Solutions is industry-leading. With the increase in the pace of electrification and decarbonisation globally it is in a very strong position going forward.

Advanced Drainage Systems was another negative contributor. The company is a leading provider of stormwater management systems in the US. It reported quarterly results in August with growth in all business segments except for its smaller Agriculture segment. It has guided for positive but somewhat muted growth for the coming year, but the longer-term demand for its flexible and easily-installed solutions is underpinned by the rapidly changing climate.

On the other side of the ledger, Ecolab was the best performer. The company sells cleaning products and services and has a particular focus on energy and water efficiency. The shares continued to perform ahead of end-market demand and guidance was upgraded during the period. Ecolab is on a path of margin expansion which is winning market approval.

Another significant positive contributor was Keyence, in the Resource Efficiency theme. After a covid peak, demand for Keyence's market-leading automation solutions fell for two years. That cycle turned earlier this year and Keyence reported healthy numbers at the end of July, boosting the stock.

From a thematic perspective, Water Management was the largest positive contributor, while Cleaner Energy was the main laggard.

Electricity vs gas – The devil is in the details

By Ted Franks

There is always a lot of noise around clean energy policies. Today's politics is all slogans and soundbites, and clean energy is a frontline issue in the West's culture wars. We see this reflected in the share prices of the many of the companies in our environmental themes, which sometimes seem to act as barometers of pure sentiment, with little regard for underlying fundamentals.

But underneath the noise and headlines, the transition to a low carbon economy is in many ways a dry, technical and detailed affair. Companies generally use technical specifications to reduce their carbon footprint. Gains in efficiency and yield are generally measured in tiny increments. And the details of how those noisy headline policies are actually implemented, can have profound implications.

A great example of this is in the current fight to electrify heat. At the moment, space heating is still dominated by fossil fuels. Systems for using coal and natural gas have been embedded for hundreds of years. They have the advantages of incumbency, including perfected supply lines, and network effects.

But, the scientists on the electric heat side are catching up. Heat pump technology, where heat is effectively conjured out of thin air, has moved on leaps and bounds in recent years. We are big fans, with investee company Trane Technologies making the pumps themselves, and other holdings such as Infineon deeper into the value chain.

Outside residential heating, things are moving on too. The Electric Thermal Solutions division of portfolio company Spirax delivers ever-higher temperature, more consistent and more flexible electric heat, for all kinds of industrial uses. So the range of applications where fossil fuels beat electricity for heat is shrinking fast.

There is, of course, another big advantage for electricity, in that its price will only fall in the long term. In the last decade, the cost of solar power has fallen by around 80%, and onshore wind, 40%. And this cost curve is still a long way from completion.

So why isn't electric heat being adopted more quickly? Well, one reason is that the playing field isn't always level.

And this is a great example of a small detail that could really help to speed things up.

The key metric to understand this is the electricity-to-gas price ratio. This is how much a unit of electric energy costs, relative to the same unit of energy provided by natural gas. In most of Europe at least, natural gas is the leading fossil fuel source of energy, as coal has largely been phased out.

If the electricity-to-gas ratio is high, then the cost of switching to electric heat from natural gas will be high. Too high, for example, to encourage consumers to make that switch to a heat pump.

But what determines what this ratio is? Well, obviously there are some “natural” market features which determine the relative prices of the two sources. Having abundant natural gas, or a very developed gas grid network, will make gas relatively cheaper. This works the other way too, of course. This is why WHEB is investing in companies that help build more green electricity, and a bigger and better grid, through holdings such as FirstSolar, Schneider Electric and TE Connectivity.

Crucially, there are market distortions which can also tip the scales one way or another. In many countries with above-average electricity-to-gas ratios, such as Belgium, Germany and the UK, government policies, and taxes, can be the sand in the gears.

Many readers will be familiar with the concept of fossil fuel subsidies, which remain remarkably widespread even in rich countries. These can be buried in the supply chain and in tax codes, or more visible in adjusting the price of fossil fuels.

Ironically, even some levies designed to boost low carbon alternatives can be part of the problem. Here in the UK, for example, electricity generation is subject to carbon pricing, but no carbon taxes are applied to gas or oil for residential use. And what’s worse, there are surcharges such as the Electricity Generator Levy and Feed-in Tariff charges, which are currently only applied to electricity bills.

With electric heat adoption trailing way behind decarbonisation targets, these anomalies haven’t gone unnoticed. The power industry globally is pushing for a fairer share of the burden to fall on heat-generating fossil fuels.

Where these anomalies arise, most governments will want to straighten them out. But, staying with the example of the UK, the noise now dominating the debate on heating is around the Winter Fuel Payment… and whatever attention the price ratio had, has been lost. Of course, the Winter Fuel Payment is a very worthy subsidy for the elderly to stay warm in winter… but it does unfortunately also benefit the entrenched dominant heat provider, fossil fuels.

It also makes the decision to rebalance between electricity and gas that much more controversial. But this remains another detail that will need to be fixed on the road to a low-carbon future.

FEATURES

APIR CODE	HHA0007AU
REDEMPTION PRICE	A$ 1.5976
FEES *	Management Fee: 1.35%
MINIMUM INITIAL INVESTMENT	$10,000
FUM AT MONTH END	A$ 261.3m
FUND INCEPTION DATE	31 October 2007

FUND MANAGERS

Ted Franks
Partner, Head of Investment

Seb Beloe
Partner, Head of Research

1. From August 2017, performance figures are those of the Pengana WHEB Sustainable Impact Fund's class A units (net of fees and including reinvestment of distributions). The strategy's AUD performance between January 2006 and July 2017 has been simulated by Pengana from the monthly net GBP returns of the Henderson Industries of the Future Fund (from 1 January 2006 to 31 December 2011) and the FP WHEB Sustainability Fund (from 30 April 2012 to 31 July 2017). This was done by: 1) converting the GBP denominated net returns to AUD using FactSet's month-end FX rates (London 4PM); 2) adding back the relevant fund's monthly ongoing charge figure; then 3) deducting the Pengana WHEB Sustainable Impact Fund's management fee of 1.35% p.a. The WHEB Listed Equity strategy did not operate between 1 January 2012 and 29 April 2012 – during this period returns are zeroed. The Henderson Industries of the Future Fund's and the FP WHEB Sustainability Fund's GBP net track record data is historical. No allowance has been made for buy/sell spreads. Please refer to the PDS for information regarding risks. Past performance is not a reliable indicator of future performance. The value of the investment can go up or down.
2. The Fund incepted on 31 October 2007 as the Hunter Hall Global Deep Green Trust. The Fund was relaunched on 1 August 2017 as the Pengana WHEB Sustainable Impact Fund employing the WHEB Listed Equity strategy. This strategy was first employed on 1 January 2006 by the Henderson Industries of the Future Fund and currently by the FP WHEB Sustainability Fund.
3. Annualised standard deviation since inception.
4. Relative to MSCI World Total Return Index (net, AUD unhedged)

* For further information regarding fees please see the PDS available on our website.

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