MONTHLY REPORT
MARCH 2022

PENGANA CAPITAL

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.'

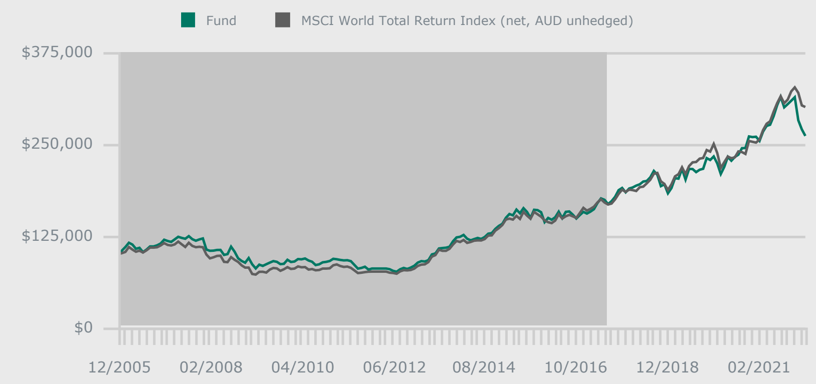
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 Mar 2022[1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	SINCE INCEPTION P.A.
WHEB Sustainable Impact Fund	-3.3%	-2.2%	8.8%		
Strategy (partial simulation – see below)				10.1%	6.1%
MSCI World Total Return Index (net, AUD unhedged)	-0.7%	11.7%	12.9%	12.8%	7.0%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Advanced Drainage Systems Inc	Industrials
Ansys	Information Technology
CSL	Health Care
Danaher	Health Care
Ecolab	Materials
HelloFresh SE	Consumer Staples
Infineon Technologies AG	Information Technology
Koninklijke DSM	Materials
TE Connectivity	Information Technology
Thermo Fisher Scientific	Health Care

SECTOR BREAKDOWN

Consumer Discretionary	3.7%
Consumer Staples	3%
Health Care	30%
Industrials	25.7%
Information Technology	26%
Materials	10.9%
Cash	0.7%

CAPITALISATION BREAKDOWN

2-10bn	30.2%
10-20bn	15.7%
>20bn	53.4%
Cash	0.7%

CUSTOM SECTOR BREAKDOWN

Health	24.9%
Resource Efficiency	26.4%
Sustainable Transport	10.4%
Environmental Services	9.5%
Water Management	7.1%
Safety	4.8%
Cleaner Energy	5.2%
Wellbeing	9.5%
Education	1.5%
Cash	0.7%

REGION BREAKDOWN

North America	55%
Europe ex-UK	23%
Japan	9.2%
UK	7.1%
Asia Pacific	5%
Cash	0.7%

ESG RATINGS - A QUICK FIX OR A BOTCHED JOB

COMMENTARY

Global equity markets bounced back in March, despite the continued war in Ukraine and the significant disruption to global supply chains. Many regard the bounce as a bear-market rally, as the macro backdrop remains gloomy with waning fiscal stimuli and increasing stagflation risks. The Fund underperformed the benchmark MSCI World Index in March with supply chains being further disrupted by the war in Ukraine which weighed on the performance of the Sustainable Transport and Resource Efficiency themes.

In this month's commentary, WHEB discuss the drivers of dramatic growth in ESG and sustainable investing over the past few years, and how the rapid adoption of standardised ESG ratings is likely to be an impediment to the holistic understanding of sustainability issues going forward.

Global equity markets bounced back in March, despite the continued war in Ukraine and the significant disruption to global supply chains. Many regard the bounce as a bear-market rally, as the macro backdrop remains gloomy with waning fiscal stimuli and increasing stagflation risks.

The Fund underperformed the benchmark MSCI World Index in March, returning -3.3% versus -0.7%. Supply chains were further disrupted by the war in Ukraine which weighed on the performance of the Sustainable Transport and Resource Efficiency themes in particular. The underperformance was partially offset by the relatively strong performance in the Education and Cleaner energy themes.

Sustainable Transport was the most significant detractor, largely driven by our two automotive OEM suppliers TE Connectivity and Aptiv. The war in Ukraine raised concerns over the supply of wire harnesses for automotive manufacturers, with concerns that this might disrupt auto production. Ukraine also accounts for the majority of the world's neon gas supply which is used to manufacture microchips. Many industries that rely on microchips have been hampered by shortages for some time and this issue will add further shortages, this is likely to have a ripple effect across multiple sectors, including the automotive sector. Due to these supply chain disruptions, the sentiment around the automotive sector was extremely weak. However, we remain confident in the long-term outlook for our automotive OEM suppliers, as they are well positioned to benefit from the fast-growing battery electric vehicle market.

For similar reasons, our Resource Efficiency theme also performed poorly in March. The major detractor in the theme was Kion, which is a leading German manufacturer of materials handling equipment such as warehouse automation equipment and industrial trucks. Its latest results were with a mix of very strong sales growth offsetting weak margins due to the supply chain disruption and higher input costs. After the results announcement, its CEO warned that the supply chain could continue to deteriorate. . One of Kion's peers also issued a major profit warning, which led to a negative outlook for the whole sector. Kion has performed strongly through the pandemic, so we believe it has the ability navigate through these short-term challenges.

The Education theme was the best contributor in March due to the strong performance from our only holding in the theme, **Grand Canyon Education**. It provides a variety of education services including enrolment, academic counselling, learning management system support, curriculum development and faculty recruitment and training. The education sector is largely shielded from recent macro challenges, so the stock benefitted from the market rotation towards less cyclical sectors.

The Cleaner Energy theme also contributed positively this month. Both of our solar energy companies **First Solar** and **SolarEdge Technologies** performed well. High oil prices typically stoke increasing interest in renewable investments. Policy statements aimed at accelerating renewable power deployment, as a strategy to wean Europe off Russian fossil fuels, also supported companies in the theme. SolarEdge recently had an analyst day, highlighting its growth opportunities in the commercial sectors as it saw growing demand from business clients driven by corporate sustainability goals and the higher electricity prices.

While the surge in oil and energy prices led to short term pain for a lot of sectors and companies, we believe it bodes well for our strategy over the long term. Many of our holdings provide cleaner energy and energy efficient technologies, which stand to benefit as countries and companies come to realise the massive urgency to accelerate the clean energy transition in order to reduce their reliance on fossil fuels.

ESG ratings – a quick fix or a botched job

The dramatic growth in ESG and sustainable investing over the past few years is now well documented. What was once a sleepy backwater of the financial industry is now very much in the limelight.

Why this has changed so dramatically is not entirely clear. From our perspective as a dedicated sustainability-focused investment boutique, we think the primary driver has been the end client. Just as consumers switched to fairly-traded chocolate and free-range eggs in the 1990s and 2000s, so investors now demand portfolios that help drive positive change in the world around them, or at the very least avoid making things worse.

According to the 2Degrees Investing Initiative, 46% of retail investors who are interested in investing sustainably do so because they want to have a positive impact on the world. A further 19% want to avoid negative impacts with the remainder investing this way because they think it will enhance their returns

Asset managers – not backward in coming forward

Asset managers have been quick to respond to this shift in demand. According to Morgan Stanley, since the first quarter of 2021, Morningstar has added 3,450 sustainability funds to its database. Net inflows into ESG funds have been running at an annualized rate of c.24% over the past three years. This compares with just over 5% for the broader market. Our own asset growth at WHEB has also been remarkable. The strategy had around A$800m invested in it in mid-March 2020. Just two years later it has over three times this amount at A$2.4bn. Over the same period, the amount invested in the Pengana WHEB Sustainable Impact Fund has grown over five-fold from A$49m to A$$269m.

It is perhaps inevitable that this spectacular market growth will stimulate product development that includes funds that only consider sustainability issues in a perfunctory way. ESG ratings, often generated through algorithms or grounded on overly simplistic assumptions, have flooded the market, and provide a cheap and quick way to add 'ESG' to a fund label.

Flawed and unquestioning use of ESG ratings

That these ratings are often deeply flawed is now widely acknowledged. Our own experience bears this out as well. In recent months one rating agency estimated that 0% of the revenues of one of our portfolio companies would be considered eligible for the EU Taxonomy. This is because the company sits in a 'power supply and electronics' sub-sector. The company though is called SolarEdge for a reason; it gets effectively 100% of its revenues selling electronic components that make solar modules more efficient.

We also had to respond recently to a client who had been alerted by an ESG data provider to a major reputational risk facing another company that we own in the strategy. The company was reported to have had a spill of hydraulic fluid from a truck at a construction site in Connecticut. While the spill was of course wholly regrettable, it was small, caused no damage to the environment and had no ill-effects or even presented any risk to workers. The company employs 28,000 people in 350 offices across 40 countries and generated nearly €4bn in revenues last year. It is absurd that this issue was flagged as a potential reputational issue for the company.

Fund managers have also been publicly harangued for unthinkingly adopting voting positions set out by their proxy agencies. In a recent opinion piece in the Financial Times, Michael Moritz, a partner at Sequoia Capital, labelled investors that fail to question proxy agency guidance as 'lazy'. 'It's just easier to outsource these decisions to a third party', he said.

Caveat emptor

We have a lot of sympathy with this perspective, not just when it comes to corporate governance, but on ratings that address the full spectrum of sustainability issues. The agenda is too complex and nuanced to be captured by a simplistic rating. It requires experience alongside deep research and scrutiny. The problem is this takes time and is expensive.

Asset managers that view sustainability merely as a marketing exercise want a quick and cheap solution to 'tick the ESG box'. But not all asset managers see sustainability this way. For us, sustainability is about creating deep structural changes in the global economy that are already driving asset prices. Understanding these changes and factoring them into our assessment process is at the core of what we do. ESG ratings and the investment strategies that rely on them may turn out to be less of a quick fix, and more a botched job.

FEATURES

APIR CODE	HHA0007AU
REDEMPTION PRICE	A$ 1.4356
FEES *	Management Fee: 1.35%
MINIMUM INITIAL INVESTMENT	$10,000
FUM AT MONTH END	A$ 269.32m
FUND INCEPTION DATE	31 October 2007

FUND MANAGERS

Ted Franks
Partner, Fund Manager

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. 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.

PENGANA WHEB SUSTAINABLE IMPACT FUND

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