PENGANA
CAPITAL GROUP

MONTHLY REPORT
MAY 2022

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.'

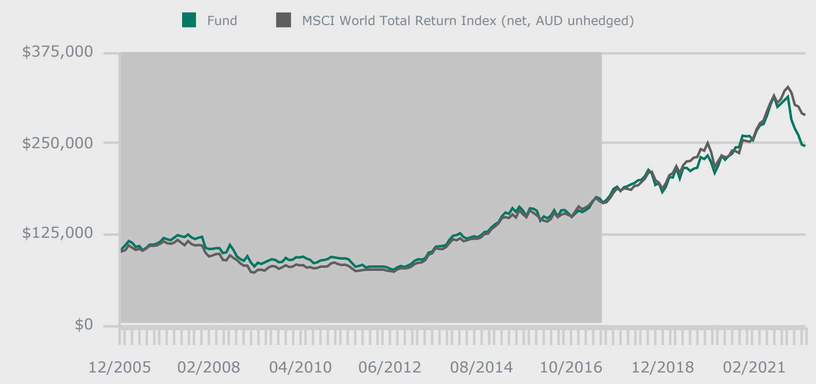
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 May 2022[1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	SINCE INCEPTION P.A.
WHEB Sustainable Impact Fund	-0.8%	-10.9%	6.9%		
Strategy (partial simulation – see below)				6.9%	5.6%
MSCI World Total Return Index (net, AUD unhedged)	-0.9%	2.7%	11.3%	10.5%	6.7%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Ansys	Information Technology
Autodesk Inc	Information Technology
CSL	Health Care
Danaher	Health Care
Infineon Technologies AG	Information Technology
Keyence	Information Technology
Koninklijke DSM	Materials
Linde	Materials
TE Connectivity	Information Technology
Thermo Fisher Scientific	Health Care

SECTOR BREAKDOWN

Consumer Discretionary	3.6%
Consumer Staples	2.6%
Health Care	28.4%
Industrials	26%
Information Technology	26.8%
Materials	11.1%
Cash	1.7%

CAPITALISATION BREAKDOWN

2-10bn	33.4%
10-20bn	14.4%
>20bn	50.5%
Cash	1.7%

CUSTOM SECTOR BREAKDOWN

Health	25.6%
Resource Efficiency	27.4%
Sustainable Transport	10.4%
Environmental Services	9.6%
Water Management	7.2%
Safety	4.9%
Cleaner Energy	5.2%
Wellbeing	6.8%
Education	1.4%
Cash	1.7%

REGION BREAKDOWN

North America	54.8%
Europe ex-UK	22%
Japan	9.3%
UK	7.2%
Asia Pacific	5.1%
Cash	1.7%

INDECISIVE DAVE AND THE BACKLASH AGAINST ESG

COMMENTARY

Global equity markets, represented by our benchmark the MSCI World Index of stocks, finished May little changed from where they started but volatility remained high. While there was a lot of talk about peak inflation this month, the data showed little hard evidence to support that. Ongoing monetary policy tightening and China's COVID lockdown remained the major concerns for the market.

Our strategy performed slightly better than the benchmark MSCI World Index in May. We saw strong performance from the Sustainable Transport and Health themes. This was partially offset by the weaker performance in the Wellbeing and Education themes.

Sustainable Transport was the best performing theme in May. Infineon was the largest positive contributor in the theme. Infineon is a global market leader in power semiconductors. Its electronic components enable a range of technologies including electric vehicles, active safety, renewable energy, and the Internet of Things. The company announced solid quarterly results in the month driven by improving global car production volumes and continuous strong demand for power infrastructure and renewable energy.

The Health theme also contributed positively this month. There were strong contributions from the life sciences tools companies, including Agilent, Danaher and Thermo Fisher. Their shares were weak in April due to the concerns over the roll-off of COVID related businesses but the underlying demand for the full range of their products remains strong. Agilent posted a solid set of results and raised its full-year guidance driven by continuous strong demand for their equipment in the pharmaceutical and biotech markets. Thermo Fisher also presented an upbeat long-term growth outlook in its Analyst Day, guiding 7-9% long-term organic growth. This is driven, amongst other things, by the strong growth prospects in its bioproduction business.

The Wellbeing theme was the worst performer over the month. HelloFresh was the major detractor from relative performance. It is a leading supplier of fresh food meal kits to consumers. There has been continuous selling pressure in food delivery stocks in general this year, amidst concern over the demand for food delivery in a deteriorating economic environment. However, there was no sign of such a slowdown in HelloFresh's latest results. The company continues to be able to acquire new customers and improve average values per order.

Our Education theme also performed poorly in May. This was due to weak performance from Grand Canyon Education. It provides a variety of education services predominantly in the US, including enrolment, academic counselling, learning management system support, curriculum development and faculty recruitment and training. Before May, it was one of the best performing companies in the strategy so far this year, and we believe the share price weakness may be due to investors taking profits. We still see positive fundamental momentum as enrollment rates have just begun to improve following COVID-driven challenges.

Market volatility has clearly increased over the last few months. Short-term share price movements have been largely driven by investor sentiment and concerns over macro factors. This has been particularly evident in the last couple of months when most of our major positive and negative performance contributors have seen no major changes to their fundamentals. We believe this environment enables us, as long-term investors, to look through this short-term noise and identify attractive sustainability investment opportunities through our impact lens.

Indecisive Dave and the backlash against ESG

For readers who have yet to discover the great British comedy 'The Fast Show', you are in for a treat. I was reminded of one of the show's characters known as 'indecisive Dave' when reading about the latest intellectual gymnastics asset managers are getting into on the subject of ESG.[i]

We've all met indecisive Dave. He is the one who reverses his opinion to echo whichever of his mates spoke last. Dave's opinions are infinitely malleable, driven by his desire to avoid conflict and consequently he ends up offering no point of view at all.

Until recently, ESG advocates had enjoyed a wonderful couple of years. The past few months though have offered more of a test. Like indecisive Dave, asset managers that had previously proclaimed their commitment to ESG, are now wavering. BlackRock, HSBC and Vanguard have all seemed to row-back from previous climate change commitments for example. Should they now disavow their previous allegiance?

Certainly the critique of ESG seems to be coming from all angles. Stuart Kirk, Head of Responsible Investment at HSBC Asset Management has argued that climate change is not a risk that financiers need worry about. Elon Musk has called ESG a 'scam' after Tesla was ejected from S&P's ESG index. Leading Republicans in the US are also sticking the boot in. Former Presidential candidate Mitt Romney says that ESG is politicising S&P ratings. Former Vice President Mike Pence has attacked ESG principles as "pernicious".

Meanwhile, the performance of ESG strategies has also taken a turn for the worse. With inflation worries, interest rates on the up and a resurgent oil and gas sector, many ESG funds have underperformed. Fund flows have also reversed. According to Jefferies, European domiciled funds designated as Article 8 and 9 both saw outflows in March 2022 after many months of strong inflows.[ii]

Is the party over?

At WHEB we think that writing an obituary for ESG is premature. Clearly Mr Kirk along with Messrs. Romney and Pence think that any attention to ESG is too much attention. A second group, including many regulators and asset owners, think that asset managers are just greenwashing. For them, there is not enough ESG. And for a third group, the problem is the type of ESG. Mr. Musk, for example, thinks that S&P should focus on Tesla's product rather than on the company's labour relations.

Materiality matters

So where do we go from here? It is clearly no longer an esoteric view to consider material ESG issues as potentially significant risks to a company's commercial prospects. That these issues should be analysed and understood is now well recognised across mainstream investment analysis. Moreover, this approach is increasingly becoming institutionalized, not least through the work of the International Sustainability Standards Board.[iii] ESG of this sort, it seems, is here to stay.

But material for who?

Much more contentious though is whether analysts should also consider the risk that company activities represent to the world around us. As a Bloomberg article criticizing MSCI put it, '*MSCI… doesn't even try to measure the impact of a corporation on the world. It's all about whether the world might mess with the bottom line*'.[iv] Under the rubric of ESG, should investors be strong-arming companies into taking positions on wider social and environmental issues irrespective of whether they are material to the company's own operations? In many ways, this ship has already sailed.

Stakeholders – most importantly employees – are already putting pressure on companies to adopt clear positions on social issues. According to a report by the Public Affairs Council, 60% of companies were already feeling the heat in 2016. Last year nine out of ten companies reported that this was the case. A full 96% expect pressure to increase further in the next three years.[v]

What about impact?

The positive or negative impact of the products and services that a company sells, has not typically been covered by ESG analysis which focuses instead on a company's operational issues. For example, an oil and gas company with strong operational health and safety and environmental performance can still garner a high ESG rating, even though the product is cooking the planet. And equally a company making an electric car that refashions an entire industry can get a low ESG rating if its labour relations are poor. This doesn't mean ESG is a scam, but it does mean that it provides an incomplete picture.

What's next

The rapid rise to prominence of the ESG agenda was always going to generate a backlash. There is also still a lot of confusion about what 'ESG' is and is not. In this regard, the current criticism offers a useful test which should help validate the approaches that deliver real value to clients and sift out those that do not.

While everyone is applauding, it is easy for asset managers to tout their ESG credentials. But like indecisive Dave, if applause is the objective, they'll be quick to change their tune when harder questions are asked.

[i] https://www.youtube.com/watch?v=KRPcssq-7Us

[ii] ESG Strategy Equity level analysis of Art. 8 and 9 fund holdings, Jefferies, 17th May 2022

[iii] https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information.pdf

[iv] https://www.bloomberg.com/graphics/2021-what-is-esg-investing-msci-ratings-focus-on-corporate-bottom-line/?sref=YEfLHut7

[v] https://pac.org/wp-content/uploads/Taking-a-Stand.pdf

FEATURES

APIR CODE	HHA0007AU
REDEMPTION PRICE	A$ 1.3533
FEES *	Management Fee: 1.35%
MINIMUM INITIAL INVESTMENT	$10,000
FUM AT MONTH END	A$ 263.23m
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.

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