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.'

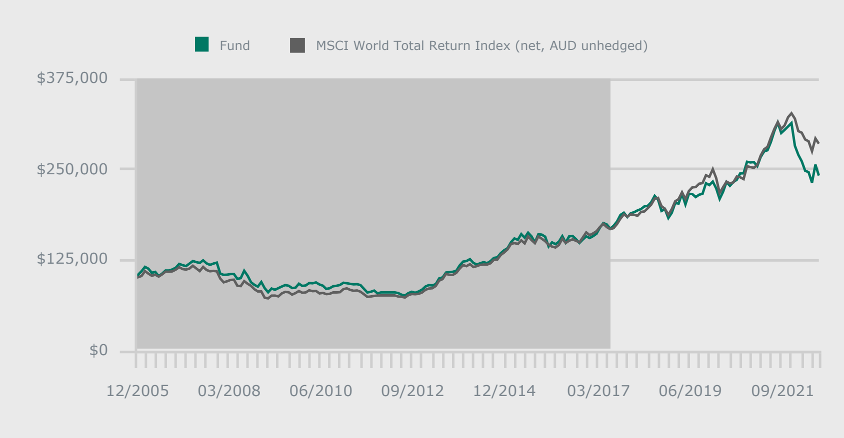
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 Aug 2022[1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	SINCE INCEPTION P.A.
WHEB Sustainable Impact Fund	-5.9%	-23.2%	4.5%	7.0%	
Strategy (partial simulation – see below)					5.4%
MSCI World Total Return Index (net, AUD unhedged)	-2.5%	-9.5%	8.1%	11.0%	6.5%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Advanced Drainage Systems Inc	Industrials
Ansys	Information Technology
Autodesk Inc	Information Technology
CSL	Health Care
Danaher	Health Care
Icon	Health Care
Infineon Technologies AG	Information Technology
Steris	Health Care
TE Connectivity	Information Technology
Thermo Fisher Scientific	Health Care

SECTOR BREAKDOWN

Consumer Discretionary	3.3%
Consumer Staples	2%
Health Care	30%
Industrials	24.1%
Information Technology	27.6%
Materials	12.2%
Cash	0.9%

CAPITALISATION BREAKDOWN

2-10bn	28.2%
10-20bn	22.3%
>20bn	48.6%
Cash	0.9%

CUSTOM SECTOR BREAKDOWN

Health	27.1%
Resource Efficiency	28.3%
Sustainable Transport	10.2%
Environmental Services	11.4%
Water Management	7%
Safety	2.2%
Cleaner Energy	5.4%
Wellbeing	6.1%
Education	1.4%
Cash	0.9%

REGION BREAKDOWN

North America	55.8%
Europe ex-UK	21.9%
Japan	9.2%
UK	7.1%
Asia Pacific	5.1%
Cash	0.9%

THE US INFLATION REDUCTION ACT – HOW SIGNIFICANT IS IT?

COMMENTARY

August was a month of two halves for Global Equity markets. At the beginning of the month, investors were upbeat following a better-than-expected earnings season. This soon gave way to broader macro concerns, with equity markets selling off sharply in the latter stages of the month.

Since Richard Nixon led the world by signing the US' Clean Air Act at the end of 1970 with bipartisan support, there have been many false dawns in the delivery of meaningful Federal policy on climate change. The consequence has been that the United States earned a reputation as a climate laggard. In this month's commentary, Seb Beloe discusses the significance of the US' recently passed Inflation Reduction Act with both spending provisions and tax breaks and aimed at lowering greenhouse gas (GHG) emissions and health care costs.

We are pleased to announce that Pengana has been named a Responsible Investment Leader by the Responsible Investment Association Australasia in its landmark annual Responsible Investment Benchmark Report launched this month. This recognises our commitment to responsible investing and attributes as an investment manager.

August was a month of two halves for Global Equity markets. At the beginning of the month, investors were upbeat following a better-than-expected earnings season. This soon gave way to broader macro concerns, however. The turn in sentiment followed comments from the US Federal Reserve. The Fed stated they would "use our tools forcefully" and inflict "some pain". As the month finished, the MSCI World had declined -2.5%.

The Fund underperformed the index returning -5.9% reversing a large portion of July's outperformance. Strength in Water Management was offset by Resource Efficiency, Environmental Services, and Well-being.

August saw strong performance from **Advanced Drainage Systems**, in our Water Management theme. ADS continues to demonstrate exceptionally strong pricing power in a difficult environment. The company also benefits from structural demand for its products, which are more environmentally friendly than most alternatives. These factors enabled ADS to raise their guidance for this financial year.

Semiconductor companies **Silicon Labs** and **Power Integrations** contributed to the underperformance in the Resource Efficiency theme. The overall semiconductor sector was weak in August due to investor fears that we may be entering an economic downturn. We take a longer-term perspective to investing. Especially in an environment of elevated energy costs, we continue to believe that structural demand for semiconductors that enable energy efficiency and connectivity will drive long-term growth for these companies.

DSM was the weakest performer in the Environmental Services theme. The company's results showed strong pricing power in this inflationary environment. However, volume growth slowed, and cash flow was weaker than expected. Despite these headwinds, the company kept full-year guidance intact. We are encouraged by DSM's ability to drive strong pricing, as this evidences the company's high quality and strong competitive position.

Looking forward, we expect heightened uncertainty through the rest of this year. We are particularly concerned about a worsening energy crisis, following news that Russia will cut off gas to Germany indefinitely. As we head towards the colder months, we expect the cost of living crisis to get tougher. We are already seeing production cuts in the European auto sector, partly as a result of high energy costs. Meanwhile, Covid continues to rear its head, and interest rate expectations will continue to fluctuate.

In this context, we expect markets to remain highly volatile during the coming months. Nonetheless, we believe the outlook for sustainability is stronger than ever. Cleaner Energy has never been more crucial, and we are hopeful that recent policy developments will bear fruit. We will continue to be led by the long-term opportunities for positive sustainable impact to guide us through these near-term uncertainties.

The US Inflation Reduction Act – how significant is it?

The BBC's trilogy 'Big Oil vs The World' is a depressing playlist of missed opportunities for climate action since the 1970s. Its episodes entitled 'Denial', 'Doubt' and 'Delay' describes the tactics used by the fossil fuel industry to prevent meaningful climate action over half a century.

Perhaps surprisingly, it was a Republican President (Richard Nixon) who signed the US's Clean Air Act at the end of 1970. The Act had bipartisan support and led the world. Since then, however, there have been many false dawns in the delivery of meaningful Federal policy on climate change. The consequence has been that the country has rightfully earned a reputation as a climate laggard.

But after many decades, this may now be changing. In the Spring, a comprehensive plan involving both spending provisions and tax breaks and aimed at lowering greenhouse gas (GHG) emissions and health care costs was put before Congress. After months of wrangling, a package was finally backed by the Democratic Senator from West Virginia Joe Manchin, allowing it to pass in the Senate by 51 votes to 50 – with Vice President Kamala Harris casting the decisive 51st vote. On 16 August, the final step was completed with President Biden signing the 'Inflation Reduction Act' (IRA) into law.

Broad-based action on climate change

Although the words 'climate change' do not appear in the title, a substantial proportion of the 730 page document is devoted to the issue, and with total spending amounting to US$385bn it is the biggest area of investment under the Act. The various provisions tackling GHG emissions are too numerous to cover here, but together they provide substantial support that will dramatically increase the deployment of renewable power, accelerate the take-up of electric vehicles as well as support efforts to decarbonise other forms of transport, and boost energy efficiency and renewable power in buildings.

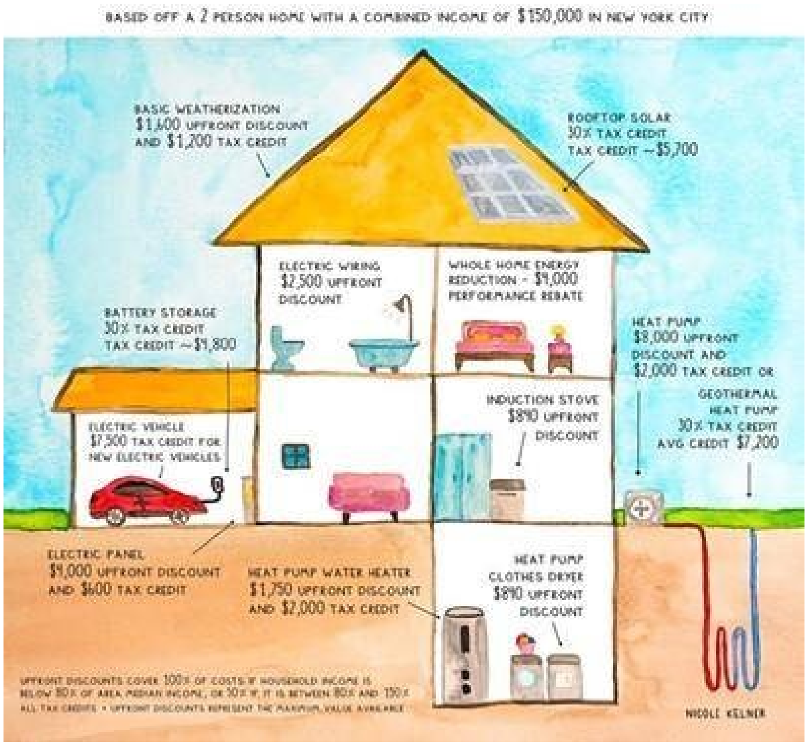


Figure 1: Potential savings from the Inflation Reduction Act

One example that illustrates the remarkable scale of ambition is the provisions supporting the development of community-owned solar power projects. These aim to reduce the cost of connecting solar systems to the electricity grid and provide specific support to low income households who want to use community solar to reduce their electricity bills. Together these measures are intended to [boost the deployment of community solar by 700% over the next four years].

US emissions of greenhouse gases peaked in 2007 and have fallen 12% since then. This downward trend would have continued over the next ten years with emissions expected to have been 24-35% lower in 2030 compared to 2005. The [provisions of the IRA] are expected to accelerate this trend putting the US on track to reduce emissions by 31-45% over the same timeframe. This is insufficient to get the US to achieve their own ambition to reduce emissions by 50% by 2030 and to have net zero emissions by 2050. It is nonetheless an important step in the right direction and directly benefits many WHEB portfolio companies in all five of the environmental themes and representing nearly one third of the total portfolio.

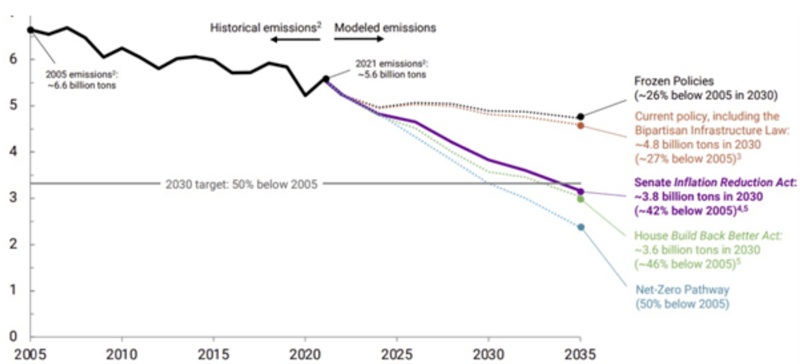


Figure 2: Historical and modeled net US greenhouse gas emissions

Poor and vulnerable communities

Alongside tackling climate change, another major objective of the IRA is to support poor and vulnerable communities in the US. This ambition is integrated into many of the provisions addressing climate change, such as on community solar, but is also evident in the approach to healthcare reform. These focus mainly on extending subsidies to consumers who have taken out health insurance through the Affordable Care Act (ACA) and in lowering prescription drug prices and out-of-pocket costs for Medicare beneficiaries.

Both these reforms target vulnerable groups. The ACA primarily serves middle and low income households who cannot afford commercial health insurance but who are also not covered by Medicaid. The new legislation provides support for these groups ensuring that they can continue to access healthcare insurance through the ACA markets.

Medicare patients will also directly benefit from action to tackle prescription drug costs. For example, the Federal government will be allowed to negotiate drug prices with pharmaceutical companies, something that – incredibly – has heretofore been illegal. Inflation caps will also be enacted to stop pharmaceutical companies from increasing drug prices at more than the rate of inflation and there will also be caps on individuals' out-of-pocket expenses with extra costs being met through Government programmes.

These provisions are also clearly a net positive for our strategy – though with a few more puts and takes than in the climate change provisions. Companies such as Centene that provide health coverage through the ACA marketplaces will likely benefit as will several of our other investments in our Health and Well-being themes. We estimate that these provisions will positively impact upon approximately 20% of the portfolio.

And inflation reduction?

The title of the Act isn't a complete misnomer. The biggest impact on inflation is expected to come from the reductions in prescription drug prices. Support for renewables and for EVs are also likely to reduce household energy and transportation costs.

From a budgetary point of view, the net result of the Act will be to spend US$455bn over the next ten years and collect US$720bn over the same time period. This increased collection comes from some of the healthcare reforms described above, but also from other parts of the Act that raise new corporate taxes, and improve collections of existing and historic taxes. The US$264bn left over will go towards lowering the fiscal deficit.

A laggard no more?

The Act is not perfect and much more work still needs to be done. For example, the domestic manufacturing requirements mean that many major electric vehicle manufacturers will become increasingly shut out from the US market. The current slow pace of renewable energy deployment owes as much to slow permitting processes as it does to elapsing tax credits. Both issues have the potential to limit the positive impacts of the IRA.

Nonetheless, it is a remarkable piece of legislation that will accelerate GHG emission reductions in the US and give new energy to international negotiations taking place in Egypt in the Autumn. So yes, we think we can say that the US is no longer a laggard, but much more will still be required – including more bipartisan support – before we can confidently call the US a leader on climate action.

FEATURES

APIR CODE	HHA0007AU
REDEMPTION PRICE	A$ 1.3251
FEES *	Management Fee: 1.35%
MINIMUM INITIAL INVESTMENT	$10,000
FUM AT MONTH END	A$ 265.45m
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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PENGANA CAPITAL LIMITED

ABN 30 103 800 568

AFSL 226566

CLIENT SERVICE

T: +61 2 8524 9900

F: +61 2 8524 9901

E: clientservice@pengana.com

PENGANA CAPITAL GROUP

PENGANA.COM