Nanuk New World Fund

Monthly Report – February 2017

The Nanuk New World Fund is a long only equity fund generating its returns from investments in a universe of listed equities exposed to the broad theme of environmental sustainability. The Fund invests globally in companies involved in clean energy, energy efficiency, agriculture, water, waste management, recycling, pollution control and advanced manufacturing and materials. All of these industries are undergoing significant changes as the world tries to reconcile economic growth with longer term sustainability and are a potentially rich and ongoing source of investment returns.

The Fund seeks to hold a globally diversified, yet relatively concentrated, portfolio of positions that align with Nanuk's views on security valuation and the evolving trends within these industries. The Fund aims to achieve long term capital appreciation and outperformance of traditional global equity indices while reducing volatility of returns and risk of capital loss through appropriate diversification and risk management strategies.

Performance Summary[1] (AUD)

	1 Month	3 Months	6 Months	1 Year	Since Inception[1]
Fund Return (%)	**0.5**	**2.2**	**5.4**	**16.9**	**7.9**
Benchmark Return[2] (%)	1.1	4.3	4.7	16.9	6.3
Value Added (%)	(0.6)	(2.1)	0.7	0.0	1.5
MSCI ACWI Return[3] (%)	1.5	3.7	5.1	13.4	1.9
Value Added (%)	(1.0)	(1.5)	0.3	3.5	5.9

Macro and industry commentary

The digestion of changes in the United States' environmental policy following Donald Trump's election continued, although despite President Trump's strong posturing during his election campaign and the appointment of controversial nominees in key roles, it remains unclear whether his administration will be able to bring effect to his promises to unwind key policies. Even if he is successful in this, uncertainty regarding the impact of such changes remains unclear both in the US and beyond. February saw Scott Pruitt sworn in as head of the US Environmental Protection Agency (EPA), despite the attempts of Democratic senators to delay the confirmation. Mr Pruitt has strong links to the oil and gas industries, and since his appointment he has stated - in conflict with the views of the organisation he now runs- that he does not believe carbon dioxide is a primary contributor to global warming. Mr Pruitt is charged with dismantling President Obama's Clean Power Plan, which aimed to reduce carbon dioxide emissions from power plants. Doing so is likely to prove a lengthy and complicated task requiring the development of new regulations, a process likely to take years. Even if he is successful, the declining competitiveness of coal fired generation (against the falling costs of cleaner alternatives), the risks of subsequent reversals of policy, State-based support of renewables and separate State legislation and regulations will limit the impact from any changes to the federal policy.

Notes (1) Inception date 2 November 2015 (2) Benchmark return is the FTSE Environmental Opportunities All Share Total Return Index in Australian dollars (3) MSCI ACWI return is the MSCI All Countries World Index Total Return Net Index in Australian dollars

Also in the cross hairs of the new EPA head are the ambitious federal automotive fuel efficiency standards that were significantly tightened by the Obama administration. These standards require automakers to achieve large improvements in average fuel efficiency by 2025 - from around 32 miles per gallon in 2016 to 54 miles per gallon in 2025. Achieving these standards has become more challenging as the price of gasoline has fallen and consumer demand for larger vehicles has increased. Although a change to the standards is possible, it is unlikely to significantly interrupt the longer term technology roadmaps and investment plans of global auto manufacturers who are facing similar standards around the world or the US States who will likely retain their far more ambitious State based regulations and standards. The future for the US's renewable fuels standard (RFS), which mandates the blending of renewable biofuels in gasoline, is also uncertain. Whilst it seems that President Trump remains supportive of the policy - which is important to agriculture in the US - a shift in the blending obligation from refiners to blenders is on the table.

Significant change is also on the agenda at the Department of Energy, now headed by Rick Perry, a former Texas governor with strong ties to the oil and gas industry. The White House has indicated that significant cuts to divisions (such as the Office of Energy Efficiency and Renewable Energy) are likely to be announced as part of the administrations 'budget blue-print' in mid-March. Interestingly however, a recent survey has shown that (even) Republican voters want to see more emphasis on clean and renewable energy. (https://www.greentechmedia.com/articles/read/new-survey-shows-renewable-energy-polls-ridiculously-well-among-trump-voter). Once again this underscores a growing sense that the impact of changes made at the US Federal level may be considerably less than touted. The significant deployment of utility scale solar energy in the US, for example, has largely been driven by state based renewables targets and dramatic improvements in cost associated with a 25 times expansion in global production over the last 10 years. The federal tax based incentives for solar, wind and other clean technologies are already scheduled to scale down in coming years as falling prices negate the necessity for the subsidy, and don't appear to be targeted for immediate elimination. Indeed, as President Trump seeks to step backwards, we see others taking more steps forward. Notably, California's Senate Leader introduced a bill during February that would mandate utilities in its State to purchase 100% renewable energy by 2045 (and accelerating the current requirement of 50% from 2030 to 2025), in line with Hawaii's existing mandate.

Outside of the US, the European Commission (EC) announced in two separate releases that most member states were ahead of a 2020 target of generating 20% of energy from renewable sources. Further, the EC stated that it was ready to "assume global leadership" in case of a retreat by the US, including efforts to improve its collaboration with China.

The economic arguments for the transition of energy supply to renewable sources continues to strengthen: 2016 marked a milestone in the EU, where wind-energy-generating capacity now exceeds that of coal generation and is second only to gas. In the UK, wind generation exceeded coal generation over the full year. As the cost of new generation from solar and wind falls below conventional alternatives, the expensive fixed subsidy regimes that initiated these changes are now giving way to far more efficient market-driven processes. In Germany, wind and solar will compete in 'open technology' auctions next year for new capacity, an approach that has led to very competitive tendering in other parts of the world. In India for example, a 1GW wind energy auction achieved pricing of 5.2c/kWh this month, following record low prices in the similar solar auction held last month. Interestingly we also saw the announcement of an unsubsidised, 'merchant' solar project in Portugal. The 220MW project, due for completion in 2018, has received financing without subsidies or a power purchase agreement, based on competitive economics selling into the electricity market. Whilst the long term success of such a project is not assured and will depend on market prices, it is indicative of what will happen as the cost of solar power falls below the cost of conventional power generation.

Another 'milestone' in renewable energy worth noting this month was the completion by SolarCity (now part of Tesla) of a solar project in Hawaii incorporating battery storage. The 'Kapaia' project includes a 13 megawatt solar system and a 52 megawatt-hour battery storage system, sufficient to store the majority of the project's daily generation for dispatch during night time. The project supplies electricity to the local utility at 13.9c/KWh, notably lower than the cost of diesel generation, and significantly less than consumer prices. This price, for a relatively small scale project, was achieved with the benefit of a 30% investment tax credit, but with both solar module and battery prices falling at more than 20% per annum the potential for solar and storage to provide round the clock 'baseload' generation at competitive pricing in the next few years is very clear.

It is worth noting that the cost being achieved in Hawaii is already comparable to the optimistic estimates for carbon capture and storage (CCS) technology. Given the challenges and limitations to implementing CCS and the continued falls in solar and storage costs, it appears the longer term solution to clean baseload power is likely to be with renewable technologies. While CCS may have a role to play in minimising emissions from conventional generation, it is unlikely to be the fulcrum of a modern energy system – a position more than likely reserved for energy storage, not carbon storage.

As the US looks to relax regulation, its policy direction is increasingly at odds with China which continues to ramp up efforts in its 'war on pollution'. The Chinese government recently announced a halt to development of new coal fired generation and is looking at increasing administrative oversight of local and regional governments in order to better manage its pollution issues. An indicator of the urgency of the environmental challenge in China is summed up in plans for Beijing to create an "environmental police" force (initially) numbering 50 officers; in February, smog forced the city (once again) to warn children and the elderly not to go outside.

February also saw an interesting development in fuel-cell electric vehicles (FCEVs), a technology that has so far failed to live up to the high hopes for its adoption in automotive, home and industrial applications. Recently, fuel cell technology has been very much in the shadow of battery electric vehicles (BEVs), but Royal Dutch Shell, the oil supermajor, announced it will build seven hydrogen fuel stations in California as part of a partnership with Toyota Motor. The announcement itself is relatively minor. However, Toyota's ongoing commitment to its fuel cell vision is instructive – Toyota is preparing for a scenario in which "no more combustion of fuel is allowed". Fuel cell EVs face both higher production costs and infrastructure requirements to battery EVs today, and this is reflected in lower adoption. However, FCEV's offer driving ranges (and refuelling times) comparable to internal combustion engines – Toyota's first FCEV, the recently released Mirai, has a range of approximately 500km. If fuel cells can achieve economies of scale and further cost reductions they remain a potentially competitive solution for vehicles that drive long distances or have large payloads, segments that today's battery EVs are largely avoiding. Fuel cell technology also has significant potential in applications in large scale energy storage, where excess electricity can be used to generate hydrogen which can be 'stored' within existing natural gas infrastructure.

Market commentary

Global equity markets continued their strong start to 2017, with the MSCI All Country World Total Return Index up a further 2.8% and all key regional indices rising. The US' S&P 500 index led the way, rising 3.7%. Europe's Stoxx 50 was up 2.8%, Japan's Nikkei 225 0.4%, and Hong Kong's Hang Seng Index 1.6%. Environmental equities under-performed slightly, with the Fund's benchmark index , the FTSE Environmental Opportunities Total Return Index, up 2.4% in USD terms. The Australian dollar strengthened slightly against the US dollar during the month, reducing performance measured in Australian dollar terms.

Fund commentary

The New World Fund returned 0.5% during the month but underperformed its benchmark index by 0.6%.

The top company contributor to returns was First Solar. As mentioned in our November letter, its share price has been arguably trading at a discount to the value of its cash and utility scale solar projects (and ascribing no value to its world leading solar PV technology and manufacturing business). The stock performed strongly during February amid a general relief rally in the solar sector, in which several other companies had also seen their valuations compress significantly. The Fund's smaller position in module manufacturer Canadian Solar, which similarly had traded at less than the value of its solar projects, was up 24% during the month. However, annual reporting in the solar sector has painted a rather mixed outlook for companies in the industry. First Solar confirmed its ambitious cost improvement program. However, Jinko Solar, the latest Chinese manufacturer to claim the mantle of the world's largest module producer by volume, announced plans to increase its output by as much as 40% in 2017, indicating the margin pressure the industry is currently suffering is not yet sufficient to induce more capacity discipline among the Chinese manufacturers. We expect this lack of discipline will exacerbate weak solar module pricing in the near term and thus reduced our position in First Solar and exited from our position in Canadian Solar.

Other notable contributors to monthly performance were Japanese company Kyukoto - which manufactures a range of environmental equipment and systems, and specialty vehicles for waste management - and ON Semiconductor, a US company producing energy efficient semiconductor solutions for a wide range of consumer and industrial applications.

The largest detractor from monthly performance came from exposure to salmon farming. The salmon price edged downwards, retreating from record levels reached earlier in the year although it remains at historically high levels. Several producers also revealed that production conditions remain extremely challenging, with both volumes and costs not meeting targets. The Fund's exposure to operational risk is reduced somewhat by holding several companies, and to the extent that industry production is curtailed pricing is likely to rise.

At the end of February 2017 the Fund's major sector exposures include advanced and sustainable materials (eg composite materials like carbon fibre as well as sustainable materials like biochemical and bioplastics), waste management, building energy efficiency, high speed rail and aquaculture.

The Fund's underperformance year to date is in part a result of relatively defensively positioning during a period of strong market returns. The Fund is holding a meaningful proportion of what we consider to be lower risk positions in more defensive sectors like rail, waste management and transmission utilities. We continue to seek out good businesses that are likely to benefit from longer term growth trends in the sectors on which we focus, but we are finding it increasingly difficult to identify these opportunities at prices that make sense to us. The Fund has an expected beta of less than one against its benchmark index and a lower expected volatility. This is a result of the Fund's valuation-driven approach to stock selection but it also reflects our top-down view that equities markets, particularly in the US, are expensive at a time when equity market volatility is at historically low levels and is at risk of rising significantly.

Historic Returns[2] (AUD)

%	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2015	-	-	-	-	-	-	-	-	-	-	(0.7)	(0.3)	(1.0)
2016	(4.5)	(0.0)	2.0	2.5	7.2	(5.2)	3.6	0.9	0.0	(1.3)	4.5	4.8	14.5
2017	(2.9)	0.5	-	-	-	-	-	-	-	-	-	-	(2.5)

Fund Details

Fund Name	Nanuk New World Fund	Currency	AUD
Type	Global Equity	Subscriptions	Monthly
Domicile	Australia	Minimum Subscription	AUD 500,000
Investment Manager & Trustee	Nanuk Asset Management Pty Ltd	Redemptions	Monthly
Administrator & Custodian	RBC Investor Services Trust	Notice period	One week
Inception	2 November 2015	Buy-Sell spread	0.25%
Management Fee	0.8%	Total management costs	1.2%

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[2]Returns are calculated net of all fees and expenses and on the basis of a shareholding since inception (2 November 2015).

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