MUNRO

Quarterly report

Munro Climate Change Leaders Fund

MCCL.ASX

June 2022

Munro Climate Change Leaders Fund & MCCL.ASX
June 2022 – Quarterly report

MCCLF Fund quarter return
-11.8%

MSCI quarter return
-7.9%

MCCL.ASX Fund quarter return
-11.8%

MSCI quarter return
-7.9%

QUARTERLY HIGHLIGHTS

- The Munro Climate Change Leaders Fund and MCCL.ASX returned -11.8% over the June quarter.
- The second quarter of 2022 remained difficult for global financial markets. High inflation numbers were the key catalyst for the decline in markets, leading to the US Federal Reserve raising rates by 0.50% in their May meeting and a further 0.75% in June, higher than consensus expectations.
- As communicated in our last quarterly report, we have been positioning the Fund more defensively since entering 2022, to lower that beta to closer to 1 and reduce the cyclicality level.
- From a stock attribution perspective, the largest detractors for the quarter were precision farming companies Nutrien and Deere, as well as Tesla. Better performing stocks for the quarter included Waste Management (see stock story) as well as some of the clean energy companies including NextEra Energy (see stock story)

MUNRO MEDIA

Munro Partners Youtube, 11 July 2022
Area of Interest: Food Revolution

Invest in the Journey Podcast, 4 July 2022
Team Canada Journey to Melbourne

Munro Partners Youtube, 1 June 2022
Climate General Q&A

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QUARTERLY COMMENTARY

Fund commentary

The first half of 2022 has been the toughest start to any year since 1962 and the second quarter of 2022 remained difficult for global financial markets. High inflation numbers were the key catalyst for the decline in markets, leading to the US Federal Reserve raising rates by 0.50% in their May meeting and a further 0.75% in June, higher than consensus expectations.

The quarter marked the official beginning of a bear market for many indices around the world. The MSCI All Country World Index drawdown was more than 20% during the quarter before a late quarter-end rally. The NASDAQ drawdown was more than 30% at its troughs, while the S&P 500 also fell more than 20% from its peak during the quarter.

With such a difficult market backdrop, Climate stocks were not immune to the drawdowns. Given our focus on investing in the "enablers of decarbonisation", we generally expect this fund to invest more capital into the industrials, utilities, and materials sectors, as these are the companies that "make and build things" across the clean energy, building efficiency, transportation, and circular economy value chains. The result is a higher expected skew to more cyclical sectors within the Fund relative to the broader market. Accordingly, we expect this Fund to have higher cyclicality than other Munro funds and the market (expected beta of around 1.2x over the market cycle).

As communicated in our last quarterly report, we have been positioning the Fund more defensively since entering 2022, to lower that beta to closer to 1 and reduce the cyclicality level. This has broadly assisted relative to other climate funds, but the past six months have still been difficult. We continue to manage the portfolio toward Clean Energy (investing more in utilities) and Circular Economy (investing more in waste, recycling, and water management) positions of the Climate universe. These companies tend to hold up better in a slowdown as, in many cases, their earnings streams are regulated or the demand for their services is resilient in a recession.

Energy Efficiency and Clean Transport companies are more cyclical as they tend to be more leveraged to the building/construction and electric vehicles sectors respectively. While we continue to see strong structural growth for these areas longer term, we have decreased exposure short term, based on our view that there may be some shorter-term softness in demand.

From a stock attribution perspective, the largest detractors for the quarter were precision farming companies Nutrien and Deere, as well as Tesla. Better performing stocks for the quarter included Waste Management (see stock story) as well as some of the clean energy companies including NextEra Energy (see stock story).

We remain excited about the medium- and longer-term outlook for Climate companies. While the environment is tough short term, within the sector some excellent, resilient businesses are well placed to benefit from the transition to decarbonisation. So, any short-term pullbacks in share prices because of current macro weakness does present interesting opportunities.

Recent portfolio changes

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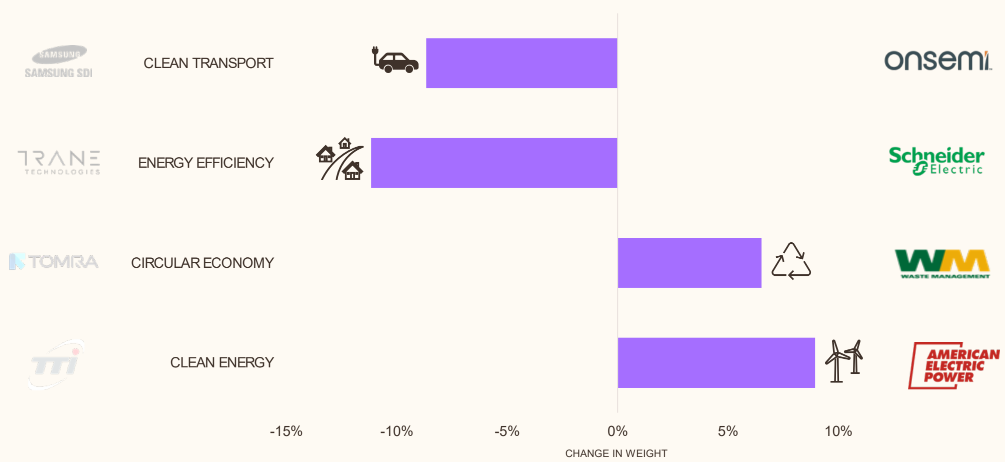
MUNRO CLIMATE CHANGE LEADERS BY SUB AREA OF INTEREST – NOV 2021 VS JUNE 2022



Source: Munro Partners 30 June 2022.

QUARTERLY COMMENTARY

Market Outlook

Global equity markets entered a bear market during the June quarter of 2022, the third bear market we have seen in the six years we have been managing money at Munro and the fifth bear market in our collective experience as investment managers. To remind readers, a bear market is classified as a 20% fall from peak in equity indices (e.g. S&P500).

Having experienced bear markets, it is a time when discipline needs to outweigh conviction. This is what our risk management and stop loss processes were created for, and we have relied on them heavily through this period. Having suffered a significant drawdown in January, the Fund moved quickly on multiple stock triggers to move to high-grading the portfolio to the largest capitalisation stocks with fortress balance sheets. Long term, we remain confident that these companies can grow through the current uncertainties, and we know that ultimately the share prices will follow that earnings growth.

However, it remains a difficult environment. We are often asked what are the signposts to signal the end of this current bear market.

- Stabilisation of long-term bond yields
- Attractive valuation multiples
- Earnings expectations to reset lower
- Time

Stabilisation of long-term bond yields

In our view, bond yields can only go up so much as there is simply too much debt in the world for long-term interest rates to get much higher than 3%. We suspect that long term interest rates are in the process of peaking. With higher expectations of how many rate hikes the US Federal Reserve will put through, the 2x10 year interest rate curve went negative at the beginning of the quarter. With growth expectations now rolling over, long term rates have probably peaked regardless of how many interest rate hikes the Fed needs to do to combat inflation.

Valuation multiples

Valuation multiples have de-rated significantly since the start of the year. At some point, the market multiple will price in an expectation of cuts to earnings. Towards the end of the quarter, the S&P 500 P/E multiple fell to 15.3x forward earnings, the trough multiple in 2015 and 2016 when bond yields were much higher. We believe we are close to the bottom of the de-rating process provided long term interest rates discussed above have peaked.

Earnings expectations to reset lower

As shown in the charts “are we there yet?”, there have been limited downward earnings revisions to date, despite the headwinds from supply chains to input cost pressures. We believe earnings for the market as a whole need to be revised downwards significantly as economic growth slows. We expect to see the start of this during the upcoming quarterly earnings season and this is the main reason we remain under exposed to equity markets at this point.

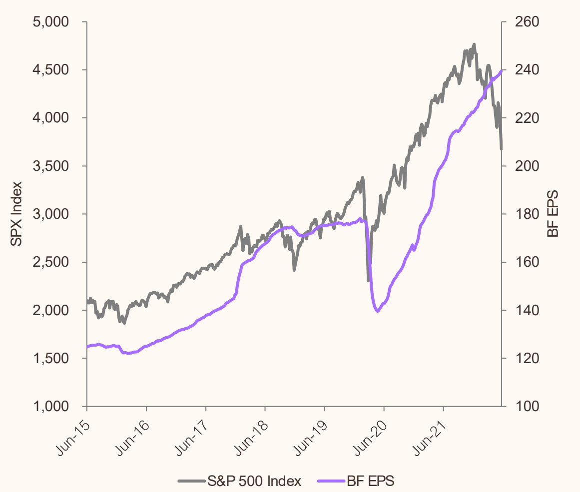
Time

The last factor we are waiting for is a simple one: time. The average bear market lasts just under 300 days and falls 37% and if history is any guide, this one may only be halfway done. Experience tells us to be patient in this environment and respect the history of previous down cycles.

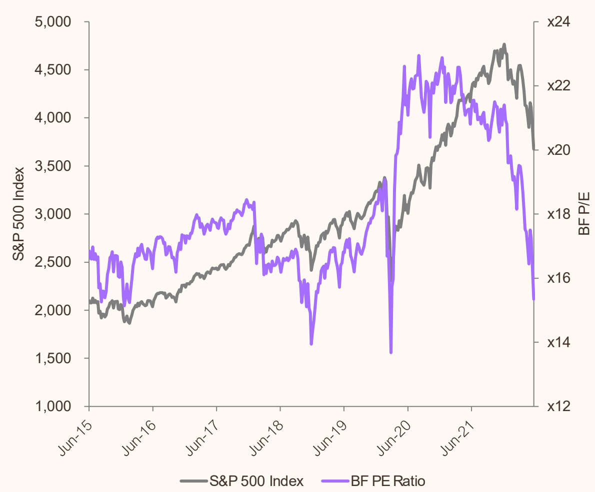
QUARTERLY COMMENTARY

Are we there yet?

S&P 500 & BLENDED FORWARD EARNINGS



S&P 500 & BLENDED FORWARD P/E RATIO



Source: Bloomberg Finance L.P 30 June 2022

Longer term the sun will shine again, it always does. As time passes, the market will eventually start looking over the valley of uncertainty and toward what normalised earnings look like for stocks and note that on a medium to long-term time horizon, stocks are looking attractive. The average bull market lasts 64 month and you do not need to pick the bottom to still enjoy the good times when they return. We remain excited about the opportunities presenting themselves out of this current bear market and are simply attempting to remain, prudent, disciplined and patient in what is a difficult time for markets.

STOCK STORY: WASTE MANAGEMENT

WASTE MANAGEMENT

AREA OF INTEREST: **Circular Economy**
MARKET CAP: **$63.5B USD**

Waste Management detracted 9 bps of performance for the Fund during the quarter.

Waste Management is the largest environmental services company in North America with an over 30% share of the US landfill market by volume. Collection is also a key component of the operation with Waste Management operating a fleet of 17,000+ routed trucks. The landfill and collection infrastructure is a significant strategic asset and a key point of differentiation for the company.

There is also considerable value in the company's network of recycling assets (named Material Recovery Facilities), where recycled commodities are recovered for resale or other uses. The company derives its revenue either by providing these services on a fee-for-service model or benefit from selling those recycled commodities in the market.

Waste Management also captures landfill gas at nearly 150 sites in the US and converts it into usable energy, helping avoid over three times their operational emissions. From engagement with the company, we have learned that their renewable natural gas projects represent around a 40% rate of return. And with more projects coming over the next 5 years it's a compelling win-win for investors and the environment.

From a stock perspective, we continue to like Waste Management, given the structural growth opportunities associated with waste and the circular economy. We expect the company's sales growth to prove to be resilient in a downturn with waste volumes generally quite durable and with an improved focus on recycling and renewable energy.

The company is part of an oligopoly with the three largest players representing 50% of trash volumes and it has a strong profitability profile with high 20%s EBITDA margins. The company has a strong focus on returning capital to shareholders via buybacks and dividends and has in recent years improved its ESG disclosures to ourselves and the market.

The circular economy: Untapped recycling potential

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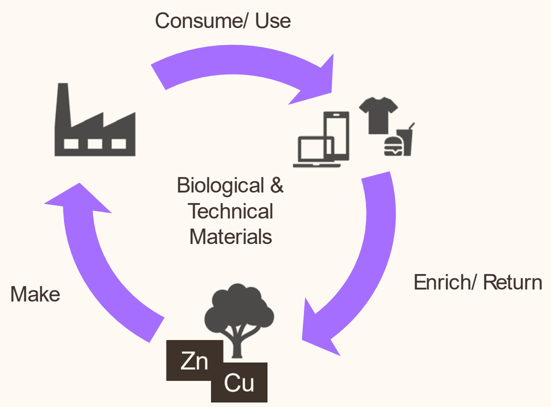
TRASH TO TREASURE

Sub-area of Interest

Circular Economy

PACKAGING, WASTE & WATER



STOCK STORY: NEXTERA ENERGY

NEXTera ENERGY

AREA OF INTEREST: **Clean Energy**
MARKET CAP: **$152.2B USD**

NextEra Energy (NEE) detracted 39 bps of performance for the Fund during the quarter.

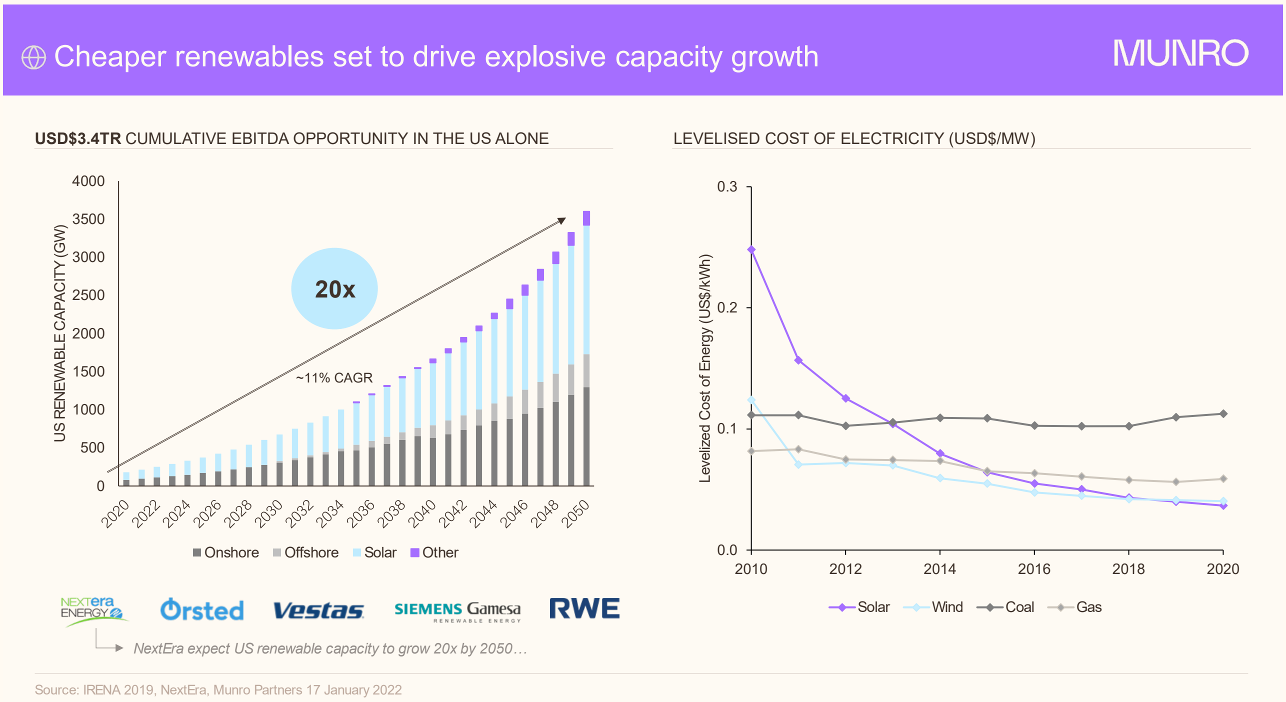
NEE operates two primary businesses in electricity generation in the US. Firstly, Florida Power and Light (FPL), which as the name suggests, is a Florida utility, and secondly, Nextera Energy Resources (NEER) which is the largest renewables and storage developer in the US.

FPL's investment plan is forecast to result in a high single-digit earnings growth rate over the longer term, driven by its programs to decarbonise Florida's power mix (replace coal and natural gas plants with cheaper renewable alternatives and battery storage). FPL also has considerable storm hardening investment programs, required to protect the state's electricity grid against increasingly adverse weather events.

NEER is the leading renewables and storage developer in the US with very attractive returns and will capitalise on the explosive growth ahead in renewables and storage. The company estimates that the US renewables market will grow at an 11% CAGR to 2050 (see graph below) and as the industry leader, we consider it to be in the box seat to capture its fair share of the clean energy transition. We expect NEER to generate more than 10%p.a. earnings per share growth for many years into the future.

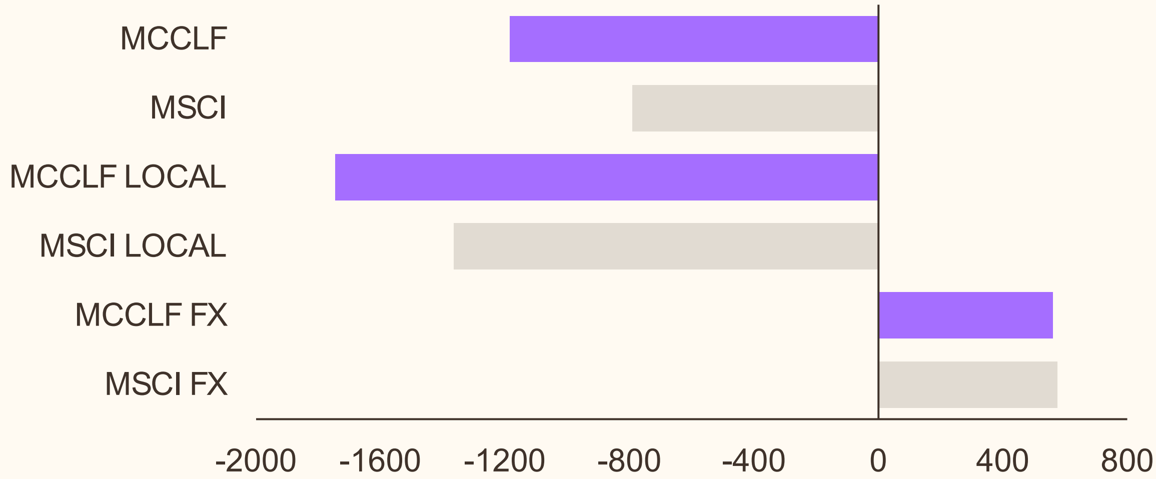
Aside from the pure financials, NEE, at its recent capital markets day, launched an ambitious plan to reach zero operational emissions by 2045 without reliance on carbon offsets, with an 82% reduction due by 2030, despite already generating energy at half the US average emissions. Although NEE is already well known as a leading renewables player, we believe this announcement further enhances its ESG profile with investors and hence should support or even enhance the valuation rating that the market assigns the stock.

From an earnings perspective, with long-term earnings per share and dividend per share growth profile of around 10%p.a. we consider NEE to be an attractive long-term portfolio holding.

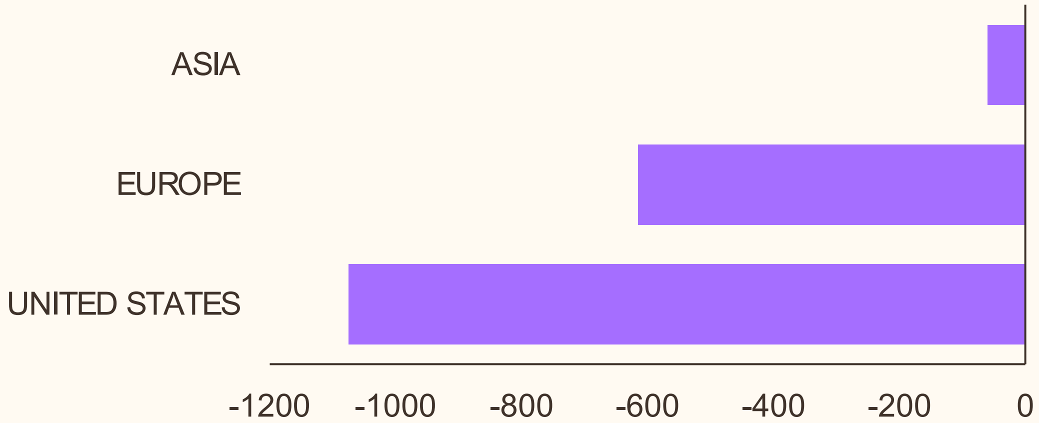


QUARTERLY FUND ATTRIBUTION (BASIS POINTS)

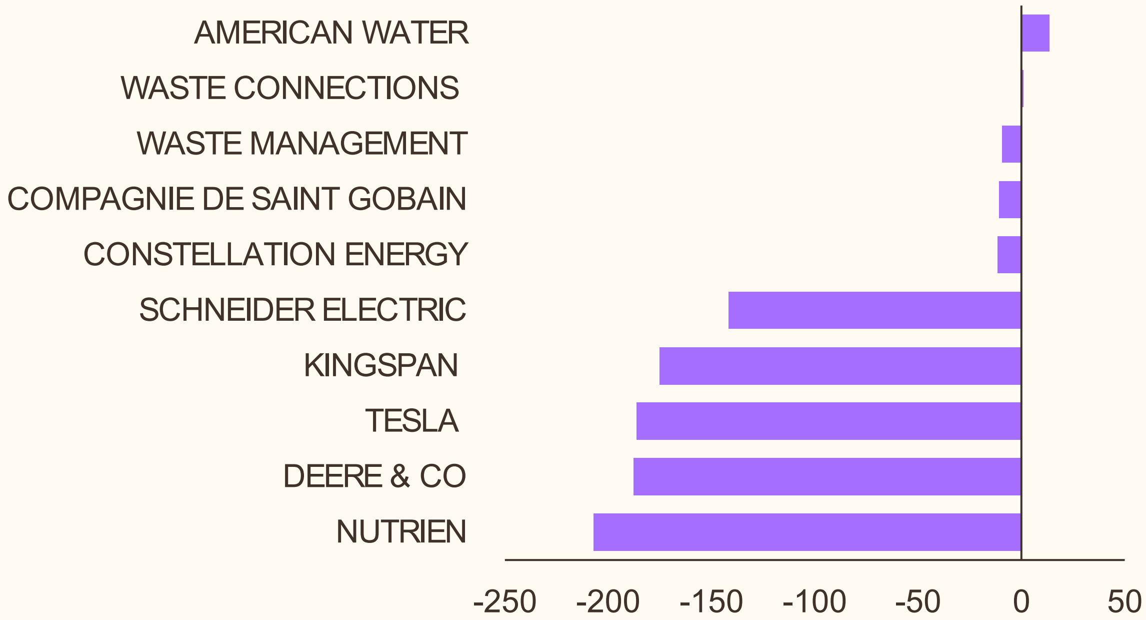
Category



Region (equities only)



Top & bottom contributors (equities only)



QUARTER END EXPOSURE

Category

LONG	93.0%
CASH	7.0%
NO. OF LONG POSITIONS	18

Sector

UTILITIES	39.8%
INDUSTRIALS	28.9%
MATERIALS	17.3%
INFORMATION TECHNOLOGY	3.5%
CONSUMER DISCRETIONARY	3.5%

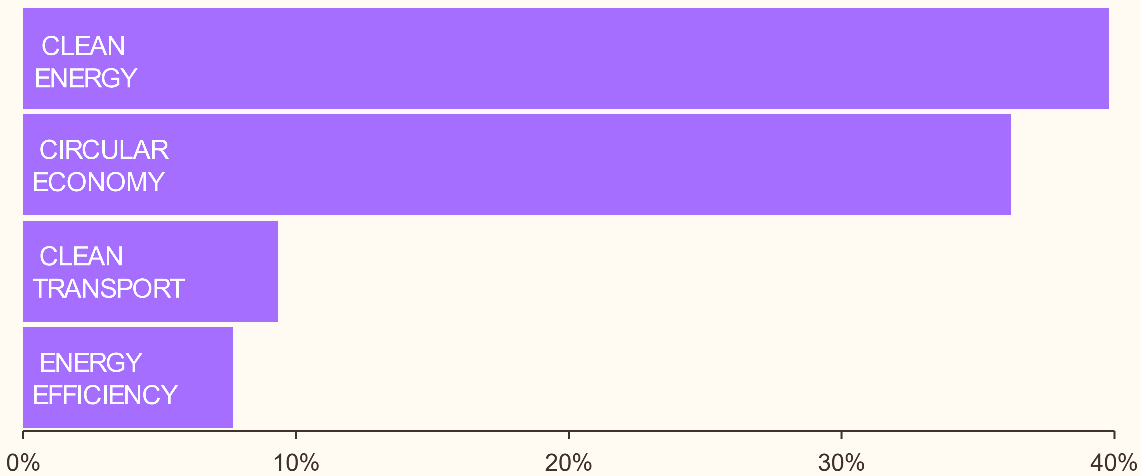
Region

	LONG
UNITED STATES	65.8%
EURO AREA	27.1%
DENMARK	2.1%
FRANCE	3.0%
GERMANY	8.6%
IRELAND	4.7%
NETHERLANDS	2.4%
SWITZERLAND	6.4%
CASH	7.0%

Holdings

TOP 5 HOLDINGS	
NEXTERA	9.6%
AEP	9.1%
RWE	8.6%
NUTRIEN	8.1%
WASTE MANAGEMENT	8.0%

Sub-areas of interest



Performance - MCCL

	3MTHS	6MTHS	INCEPT CUM.
MUNRO CLIMATE CHANGE LEADERS FUND (AUD)	-11.8%	-24.0%	-20.7%
MSCI ACWI TR INDEX (AUD)	-7.9%	-15.6%	-11.5%
EXCESS RETURN	-3.9%	-8.4%	-9.2%

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	TOTAL
2022FY					3.5%	0.8%	-10.5%	-3.9%	0.2%	-4.5%	-1.1%	-6.6%	-20.7%

Performance - MCCL.ASX

	3MTHS	INCEPT CUM.
MCCL.ASX (AUD)	-11.8%	-16.1%
MSCI ACWI TR INDEX (AUD)	-7.9%	-12.2%
EXCESS RETURN	-3.9%	-3.9%

	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	TOTAL
2022FY							-1.1%	-3.9%	0.2%	-4.5%	-1.1%	-6.6%	-16.1%

IMPORTANT INFORMATION Past performance is provided for illustrative purposes only and is not a guide to future performance. Differences in performance between the Munro Climate Change Leaders Fund (unlisted fund) and MCCL (ASX quoted fund) relate to their respective inception dates, the buy/sell spread around the iNAV for MCCL, and the timing difference between the issuing of units during the day on the ASX for MCCL. This may result in reporting small differences in performance.