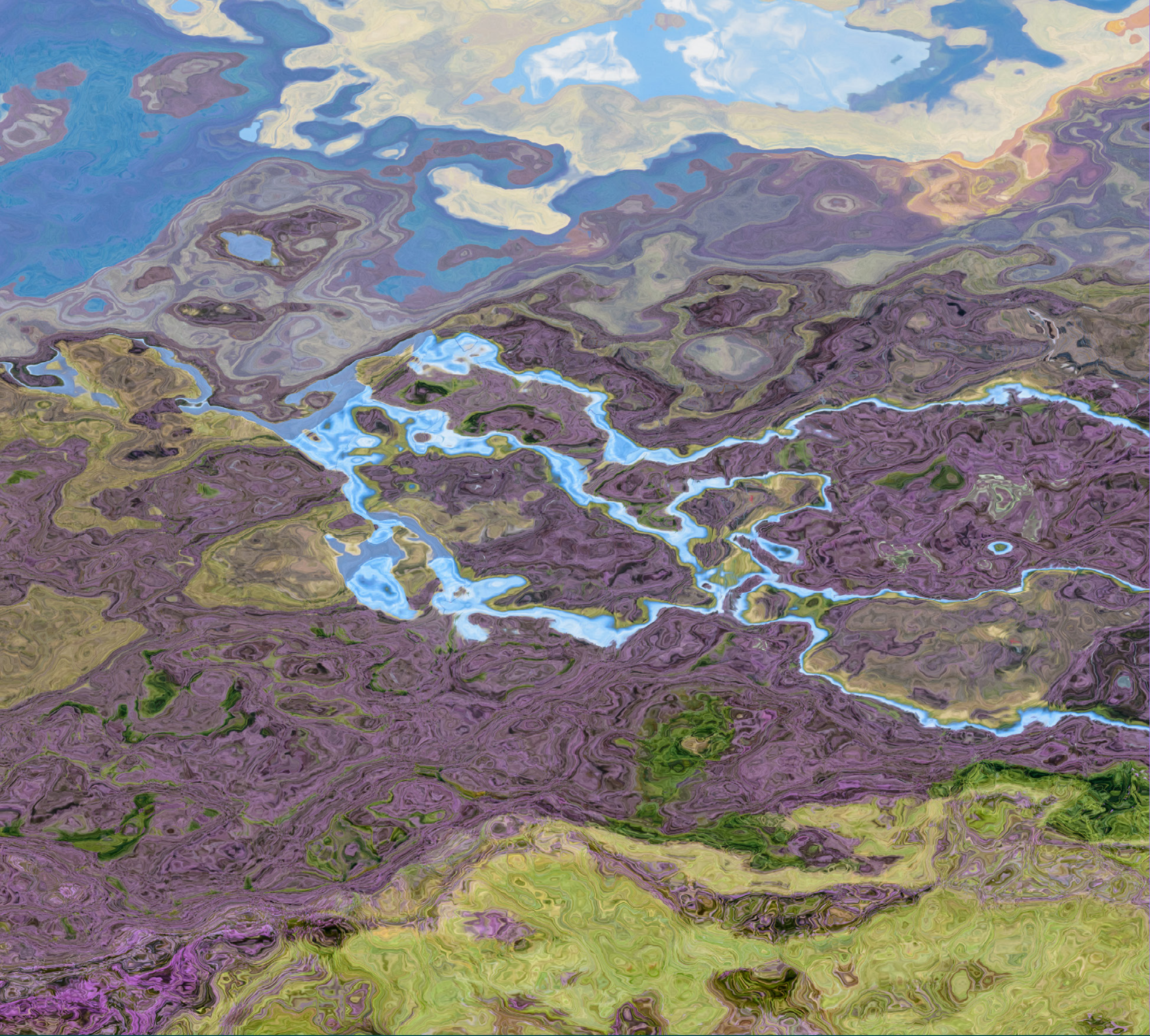


Quarterly report

Munro Climate Change Leaders Fund

MCCL.ASX

December 2022

Munro Climate Change Leaders Fund & MCCL.ASX

December 2022 – Quarterly report

MCCLF Fund quarter return
-1.4%

MSCI quarter return
4.1%

MCCL.ASX Fund quarter return
-1.4%

MSCI quarter return
4.1%

QUARTERLY HIGHLIGHTS

- The Munro Climate Change Leaders Fund and MCCL.ASX returned -1.4% in the December quarter.
- After a rise of almost 14% in the S&P 500 during October and November, equity markets reversed course in December as investors became increasingly concerned about the effects of continued hawkishness from the Federal Reserve impacting the underlying economy after a 50bps rate rise was delivered in mid-December.
- Climate as an Area of Interest is one of Munro's favoured parts of the market heading into 2023 as we expect growth to accelerate as countries, companies and investor groups continue to up their net zero commitments, and hence increase their orders and spending.
- From a quarterly stock attribution perspective, clean energy wind turbine manufacturer Vestas Wind Systems and semiconductor automaker manufacturer Infineon Technologies, were two key contributors, while Clean Transport EV maker, Tesla, was the key detractor.
- We are positive about the year ahead. While volatility may continue in the first quarter, we are getting closer to the overall market adequately pricing this COVID-induced macro adjustment.

MUNRO MEDIA

Forbes Australia, 21 December 2022
The Agricultural circular loop of decarbonisation

Invest in the Journey podcast, 22 December 2022
Nick Griffin & Ronnie Calvert look in the rear view mirror

Firstlinks, 4 January 2022
Compelling Investment opportunities in Healthcare

CONTENTS

QUARTERLY COMMENTARY

Fund commentary

The Munro Climate Change Leaders Fund and MCCL.ASX returned -1.4% (1.5% from equities and -2.9% from currency) while the MSCI ACWI in AUD returned 4.1% (7.6% from equities and -3.2% from currency) in the December quarter.

Equity markets started the quarter with a strong bounce after acknowledging that potential systemic credit issues emanating from the UK were resolved and US earnings proved to be more resilient for companies exposed to the broader macro environment. Light positioning in equity markets from institutional investors also contributed to a bounce in October and November.

During Q3 earnings, sentiment from corporates was broadly positive, particularly for companies in the industrials, materials and energy sectors who are yet to show significant headwinds from the US Federal Reserve raising interest rates by 325bps in the first nine months of the year. In the technology sector, earnings were mixed as large cap companies were not able to show the market continued progress on their ambitions to right-size their cost structures.

Positive equity market sentiment was encouraged by the US CPI coming in sequentially weaker in October and November. US inflation has now decelerated from a high of 9.1% in June 2022 to 7.1% in November. Market participants were encouraged by this fall and are now increasingly comfortable that inflation is now under control through Federal Reserve action and tougher comparisons moving forward. After a rise of almost 14% in the S&P 500 during October and November, equity markets reversed course in December. Investors became increasingly concerned about the effects of continued hawkishness from the Federal Reserve impacting the underlying economy after a 50bps rate rise was delivered in mid-December. With inflation now sequentially declining, the focus shifted towards the impact on the economy, corporate earnings, and the potential for a policy mistake in too many rate hikes.

From a stock attribution perspective over the December quarter, clean energy wind turbine manufacturer Vestas Wind Systems (page 7) and semiconductor automaker manufacturer Infineon Technologies (see page 8), were two key contributors, while Clean Transport EV maker, Tesla, was the key detractor.

In our market outlook, we review the key signposts we are looking for to become meaningfully more constructive on equity markets.

QUARTERLY COMMENTARY

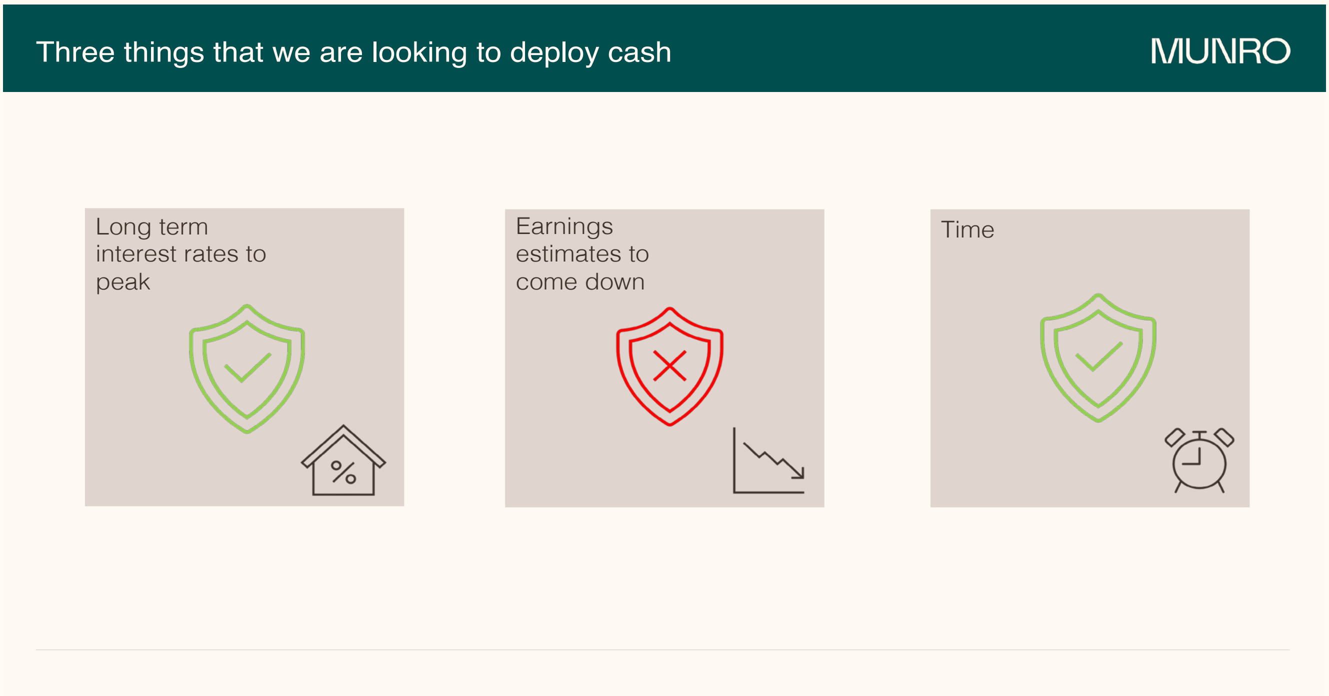
Market Outlook

Global equity markets and, particularly, growth equities had a tough year in 2022. The end of COVID lockdowns and the resulting inflation shock has seen a dramatic rise in global interest rates, which pressured all asset prices, but higher multiple growth stocks fared worse than most.

Having recognised the change of environment in early 2022, the Munro Climate Change Leaders Fund (and MCCL.ASX) have run most of the year with a more conservative tilt. Higher cash weightings and a focus on larger capitalisation growth companies with better valuation support to protect against the higher rate environment. We have noted three criteria since the first quarter of 2022 that need to play out before we can get more constructive on markets:

- Long-term interest rates to peak;
- Earnings estimates to come down; and
- Time

While two of these three factors have likely occurred, being interest rates have probably peaked and we are past the average duration of a bear market, the outlook for 2023 is more contingent on earnings estimates, which to date have remained stubbornly high. The Funds remains conservatively positioned as we enter 2023 with the expectation that earnings estimates need to be revised (now likely in the 1st half of 2023). Below we go into further detail as to why the earnings outlook still concerns us and where we want to invest for the year ahead.



Long-term interest rates have probably now peaked
The main driver of the rate rises throughout 2022 has been rising global inflation, which has led to central banks around the world increasing cash rates. Inflation looks to have peaked in June 2022, while recent inflation data points have been elevated, the comparative monthly numbers are increasing and so we expect inflation to continue to decelerate. The US 10-year bond yield has started to factor in growth slowing and rates peaking, with this key reference rate falling from 4.25% in October to 3.5% during December, which suggests the bulk of global rate rises required to contain inflation have now been done.

Central banks heavy lifting now looks done

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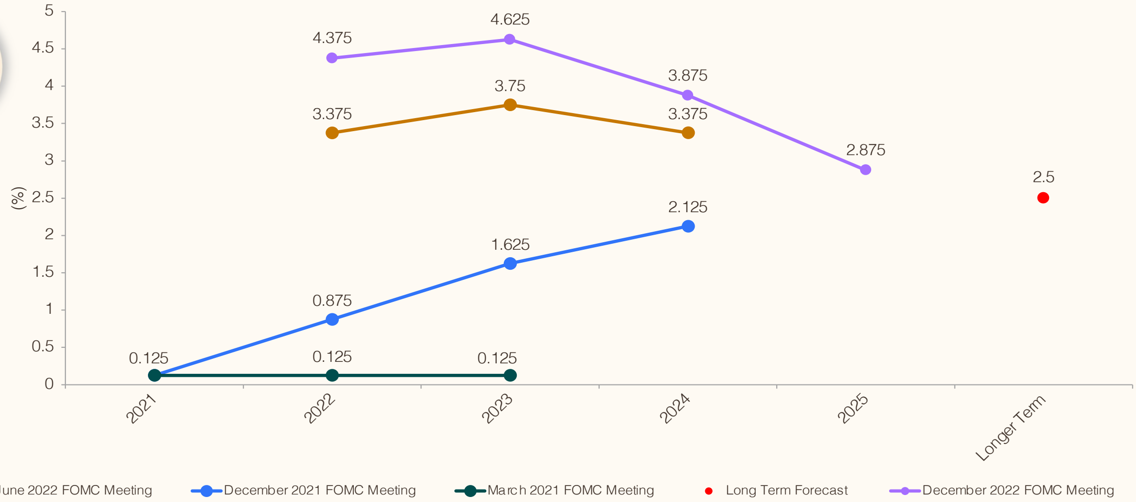
MEDIAN FOMC DOTS



Source: Bloomberg Finance L.P 6 December 2022

Time
Since 1928, the S&P 500 has experienced 21 bear markets (excluding the current bear market). The average length of a bear market, if you exclude the longest and shortest bear markets, is 330 days. The S&P 500 peaked on the 4th of January 2022, so on a purely statistical basis, we have now passed that mark. Macro forces can only dominate equity markets for so long before they are correctly priced. Having now passed the average bear market length, we should be cognisant that we are getting close to most of this bear market being priced in.

Earnings estimates to come down
Using the S&P 500 as a proxy for global markets, earnings estimates have come down from $241 in June to $227 in December, a fall of 6%. In some previous recessions and market drawdowns, earnings estimates have come down more than 20%. We do expect demand should soften as the impact of rate rises starts to bite and for margins to come under pressure as wage inflation likely remains elevated at least initially. For Munro, this is the last shoe to drop, we do expect the Q4 earnings season to lead to downward earnings revisions as companies are more likely to guide conservatively for 2023. Our biggest concern here is that the market level today does not price in any possibility of a hard landing for growth and appears to be fully priced under a mild slow-down scenario, hence we are still not comfortable with the risk-reward entering a period where companies need to set full-year guidance. Should earnings estimates begin to reset over the first quarter then we will be much closer to removing any further macro overhangs from our outlook and stocks can go back to what they do best, which is following their earnings growth.

S&P earnings estimates do not reflect a hard landing

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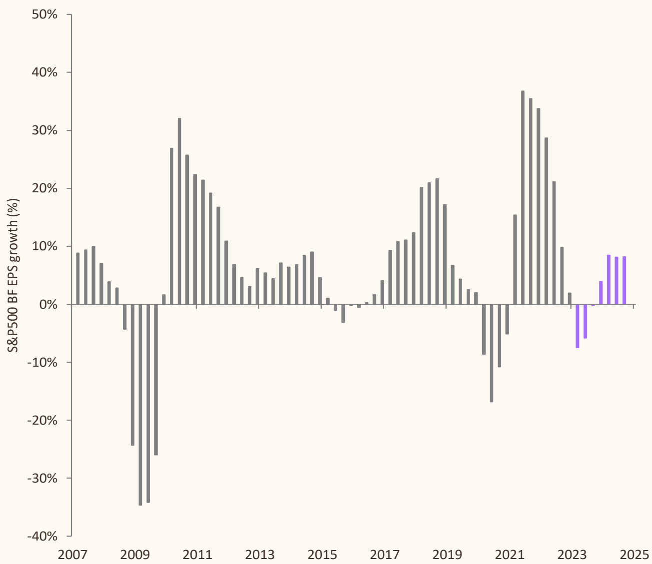
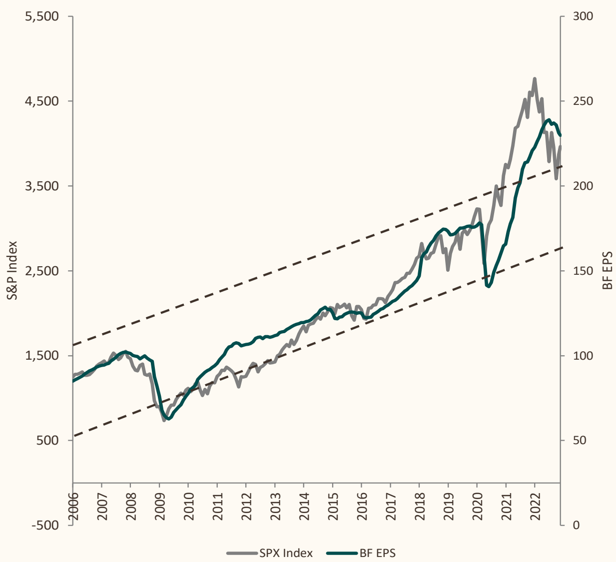
S&P 500 EARNINGS GROWTH YOY – REFLECTS A SOFT LANDING



S&P 500 EARNINGS VS S&P INDEX – STILL OVEREARNING?



Source: Bloomberg Finance L.P 12th December 2022

S&P price level does not reflect a hard landing either

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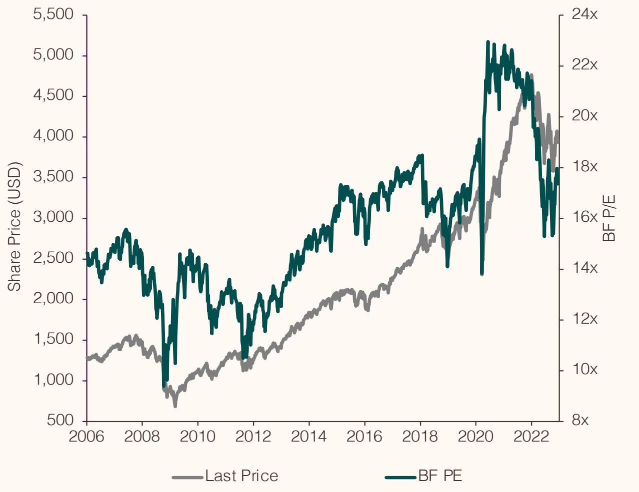
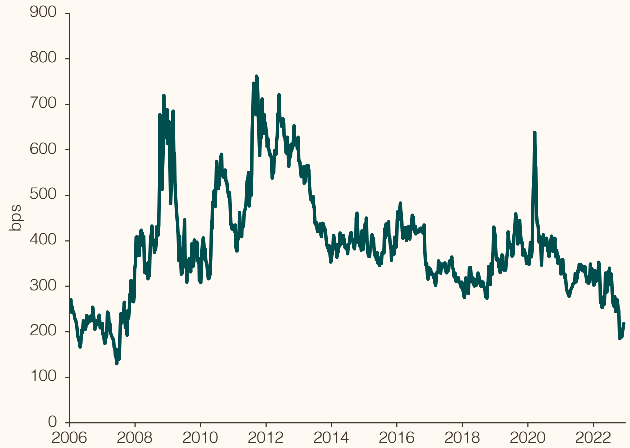
S&P 500 & BLENDED FORWARD P/E RATIO



EQUITY RISK PREMIUM



Source: Bloomberg Finance L.P 12th December 2022

Fund positioning

Climate as an Area of Interest is one of Munro's favoured parts of the market heading into 2023 as we expect growth to accelerate as countries, companies and investor groups continue to up their net zero commitments, and hence increase their orders and spending. This is at odds to much of the stock market, where we see earnings growth decelerating as the macro demand environment worsens.

The primary driver for this is the US Inflation Reduction Act. This Act is effectively a $386bn climate spending regime, which will support the US renewables industry and other decarbonisation enablers for over 10 years.

Countries have embraced net zero and are adopting national policies

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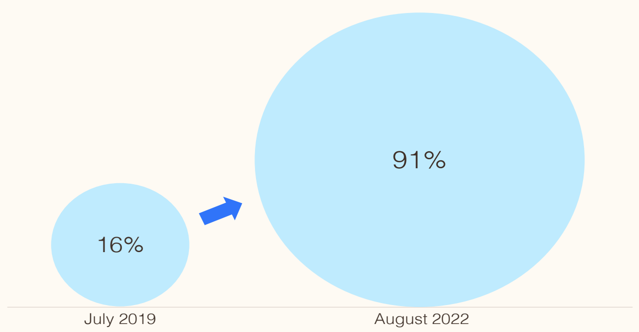
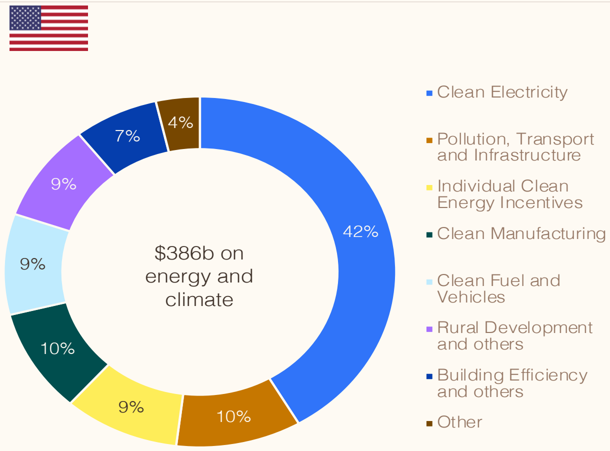
GLOBAL GDP COVERED BY NET ZERO COMMITMENTS



US INFLATION REDUCTION ACT PROVIDES 10+ YEARS OF POLICY SUPPORT



Source: Net Zero Tracker, Committee for a Responsible Federal Budget

Conclusion

In conclusion, we are positive about the year ahead. While volatility may continue in the first quarter, we are getting closer to the overall market adequately pricing this COVID-induced macro adjustment. With interest rates peaking at still historically low levels, and earnings estimates likely to be rebased, this will ultimately set markets up for their next bull run. With the down cycle played out, individual share prices will go back to following their earnings growth, which is what they have always done. Structural changes in how we decarbonise the planet, and drive AI will ultimately become the key drivers of earnings growth and that earnings growth will drive share prices. We remain excited about the opportunities presenting themselves out of this recent adjustment and are merely exercising (and asking our investors too) to remain patient as the final phase of this adjustment plays out.

STOCK STORY: THE WIND BENEATH THE CLIMATE WINGS

Vestas

SUB AREA OF INTEREST: **CLEAN ENERGY**
MARKET CAP: **$195.5B DKK**

Vestas contributed 155bps to Fund performance for the December quarter.

Vestas is the world leader in wind turbine manufacturing. The company has the best scale in the industry, which gives its strong locational advantages over its peers. It has proven wind turbine technology and has the strongest financial position of its cohort, which is critical for attracting new orders given the long-term nature of its customer service agreements.

While Vestas is a large beneficiary of energy transition globally, it is particularly supported by the US Inflation Reduction Act and the build-out of wind assets because the US is its largest market. Further, it will be a critical onshore and offshore wind turbine supplier to the renewables developers in Europe, who are under considerable pressure to diversify away from natural gas as an energy generation fuel post the Russian invasion of Ukraine.

The company has had a difficult 2021-22 period with unprecedented labour, shipping and commodities cost inflation crimping their margins. While some of these higher costs may remain sticky, we see deflation in much of their cost base coming through in 2023. Further, the company has been adjusting pricing higher to get it back on track to achieving its pre-covid profitability margins by the middle of the decade.

Below, we lay out the huge opportunity for the renewables developers and the Original Equipment Makers (OEMs). It is important to note that electricity will itself grow as it takes share of the power generation mix from oil and that within this growing pie, renewables will also gain share from fossil fuels. With the cost of rolling out new renewables now below the cost of new coal and gas, and the aforementioned energy security issues in the world, we continue to see energy transition occurring at pace.

Set to drive explosive capacity growth in renewables

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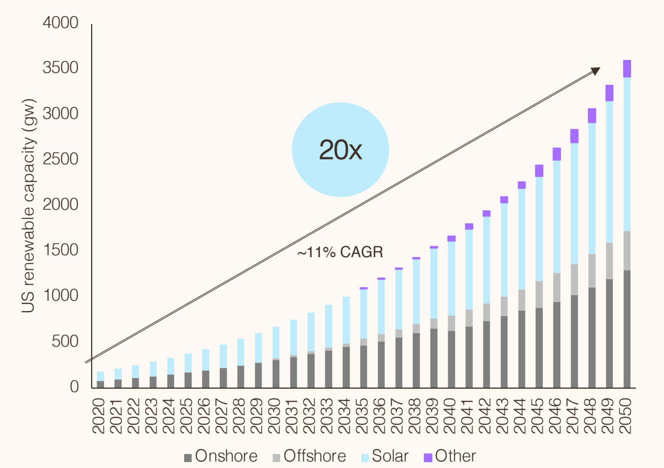
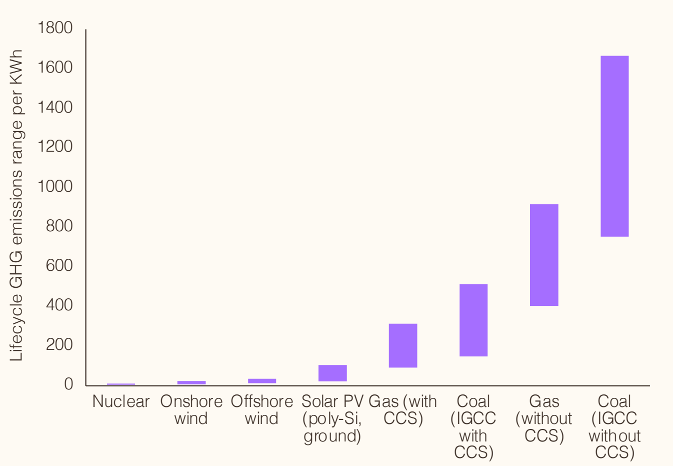
USD$3.4TR CUMULATIVE EBITDA OPPORTUNITY IN THE US ALONE



LIFECYCLE EMISSIONS OF ANY FUEL SOURCE



NextEra Energy · Ørsted · Vestas · Siemens Gamesa Renewable Energy · RWE

NextEra expect US renewable capacity to grow 20x by 2050…

Source: IRENA 2019, NextEra, Munro Partners 17 January 2022

STOCK STORY: (EM)POWERING THE SHIFT TO EVS

SUB AREA OF INTEREST: **CLEAN TRANSPORT**
MARKET CAP: **$38.7B EUR**

Infineon contributed 95 bps to Fund performance for the December quarter.

Infineon is a leading German supplier of semiconductor solutions for automotive and industrial end markets. Spun out of Siemens, the company went public in 2000 before making a series of acquisitions enabling a leading position within power semiconductors, which has become critical in electric applications and specifically solves the obstruction of range relating to applications such as electric vehicles.

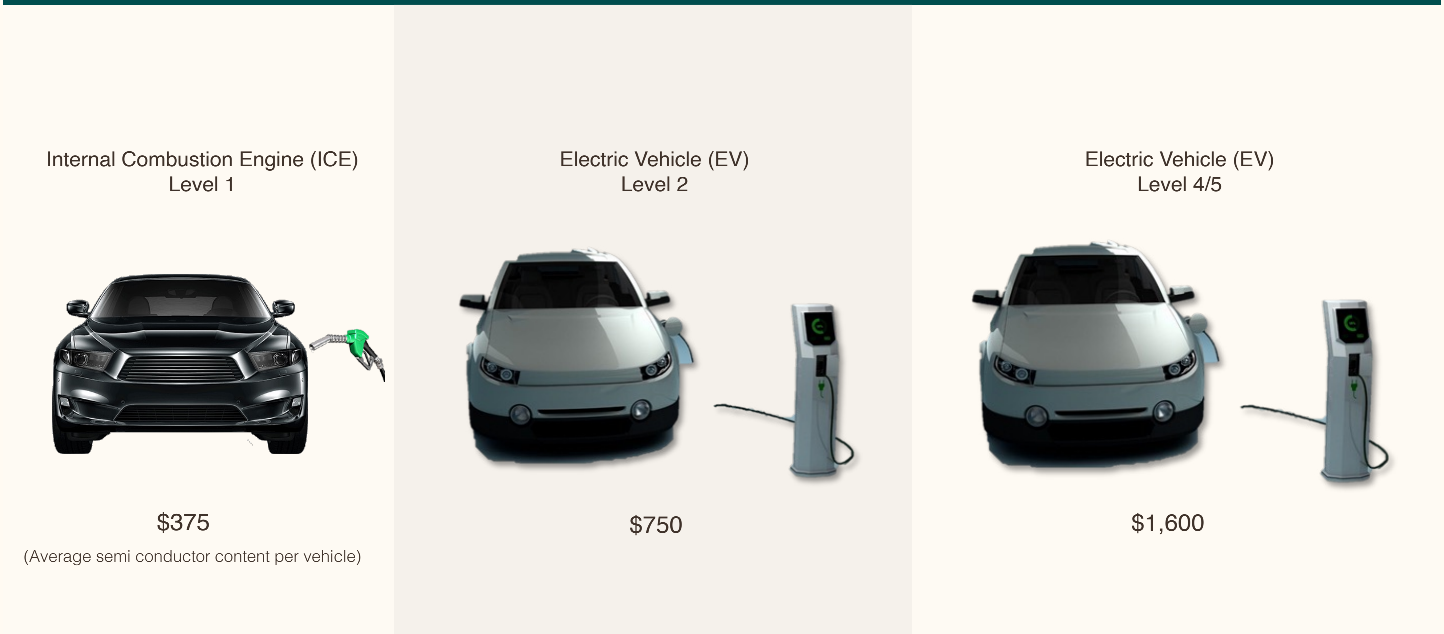
Automotive is Infineon's largest end-market and the stock sits in our 'Clean Transport' Climate sub Area of Interest as a key beneficiary of the structural shift from traditional combustion engines to electric vehicles (EVs). EVs contain approximately two times the average semiconductor content per vehicle when compared to the internal combustion engine (ICE) equivalent. When taking Advanced Driver Assist System (ADAS) sensors into account, the average semiconductor content per vehicle increases by greater than four times. This is because power semis are critical in managing electric flow, while sensors enable autonomous and connected driving. We believe this will support long-term automotive revenue growth in excess of 10%, in line with management's targets.

Beyond enabling global EV adoption, Infineon enables the decarbonisation of the industrial sector as processes continue to be electrified. Key areas of power semiconductor content growth include renewable energy infrastructure, EV charging infrastructure and robotic manufacturing processes.

We acknowledge that there's inherent cyclicality associated with semiconductor companies, however, content growth opportunities present a unique proposition for through the cycle growth. In the most recent quarter, management gave upbeat FY23 guidance and upgraded their long-term operating model which was a catalyst for the company's share price. They mentioned that inventories are starting to normalise and were also realising material pricing improvements that should result in stronger margins going forward, coupled with foreign exchange becoming a tailwind in 2023.

The shift to electric and autonomous cars requires semiconductors

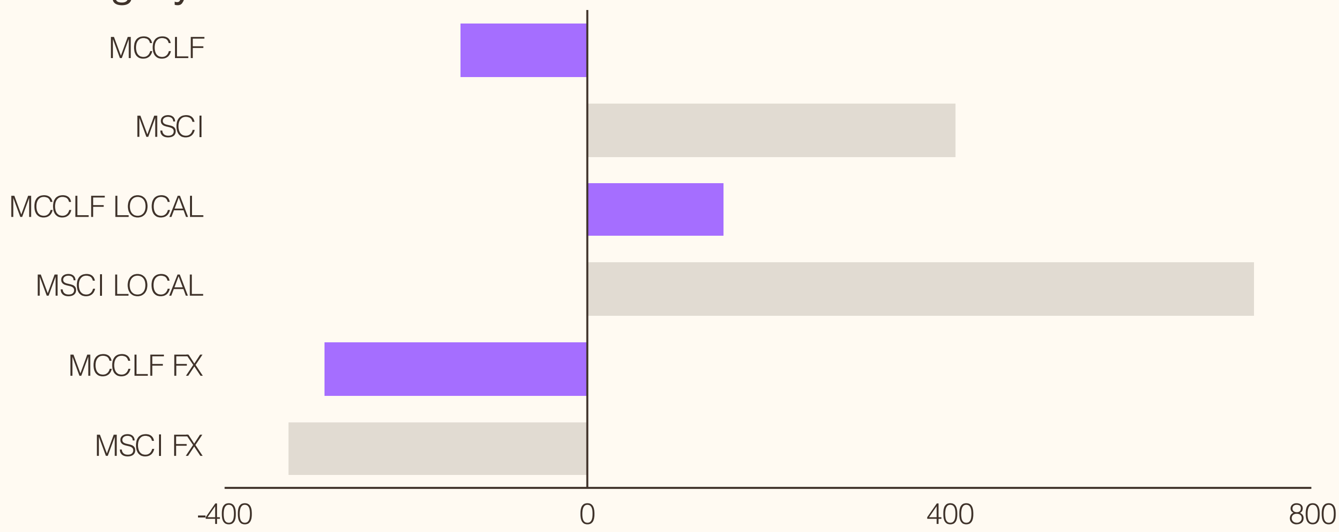
MUNRO



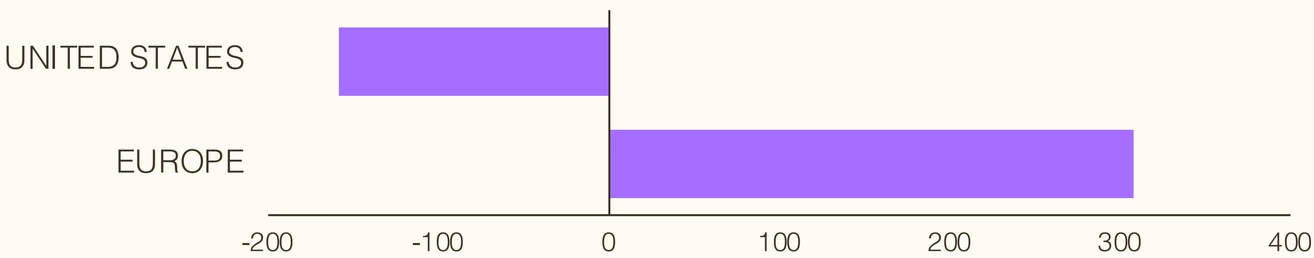
Source: ON Semiconductor (August 2021), New Street Research (January 2021)

QUARTERLY FUND ATTRIBUTION (BASIS POINTS)

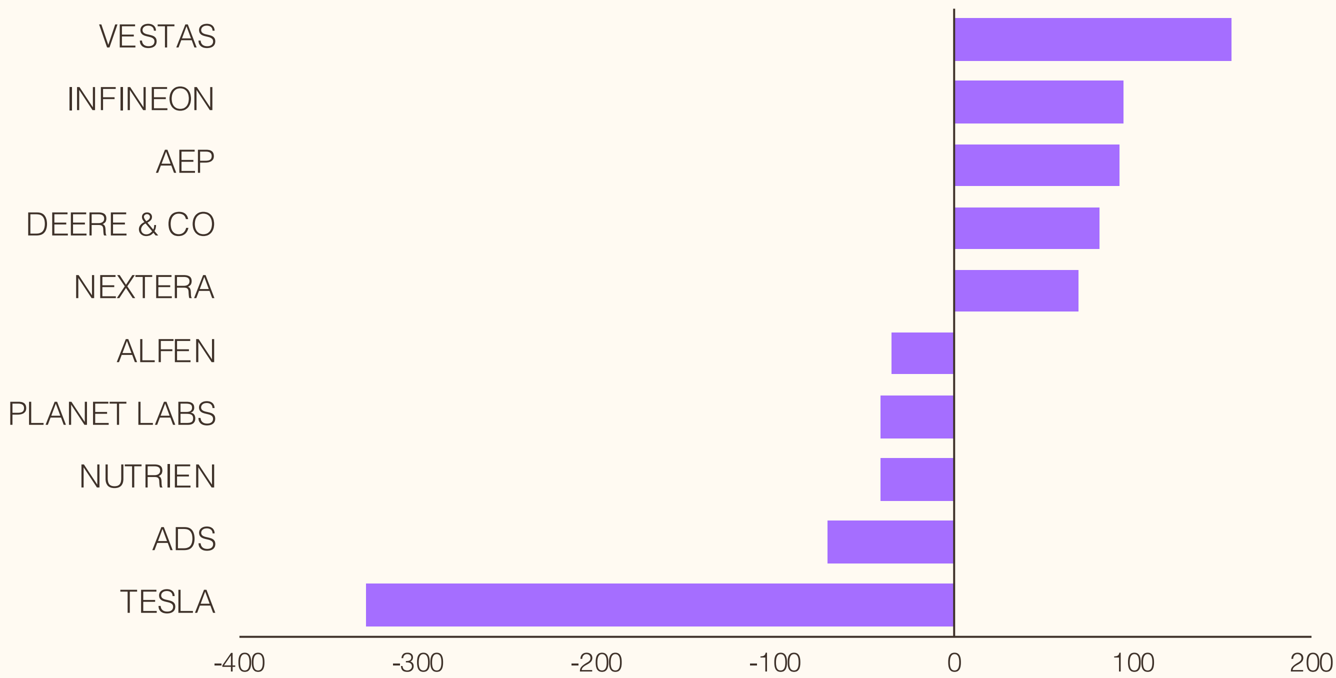
Category



Region (equities only)



Top & bottom contributors (equities only)



QUARTEREND EXPOSURE

Category

EQUITIES	92.8%
CASH	7.2%
NO. OF LONG POSITIONS	22

Sector

UTILITIES	39.3%
INDUSTRIALS	32.9%
INFORMATION TECHNOLOGY	11.1%
OTHER	9.6%

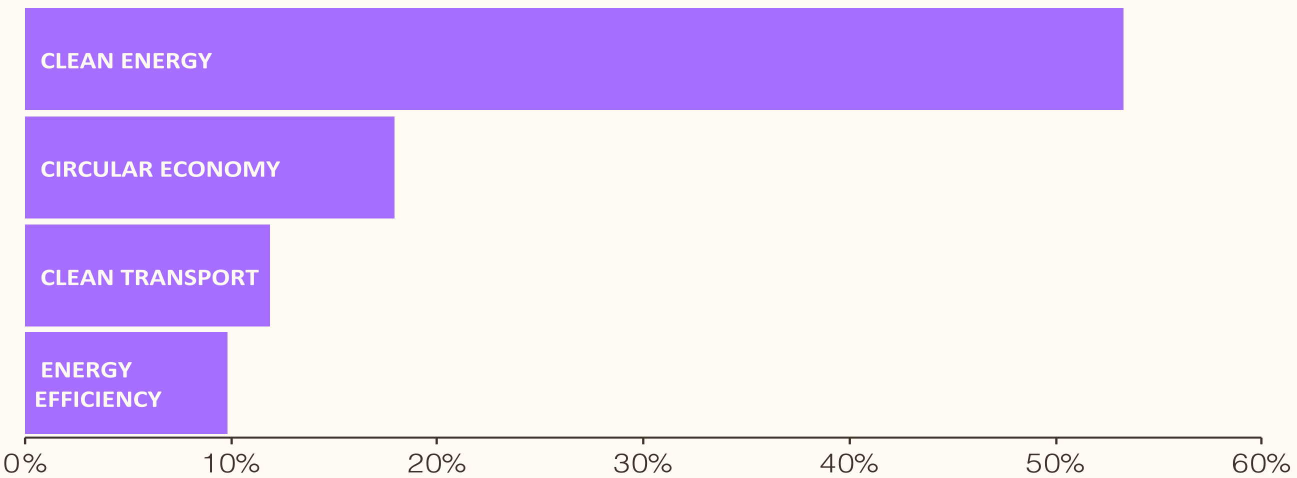
Region

	LONG
UNITED STATES	65.4%
EURO AREA	27.3%
DENMARK	5.8%
GERMANY	13.3%
IRELAND	4.8%
NETHERLANDS	3.3%
CASH	7.2%

Holdings

TOP 5 HOLDINGS	
NEXTERA ENERGY	9.8%
CONSTELLATION ENERGY	9.7%
AEP	9.4%
RWE	9.4%
WASTE MGT	8.8%

Sub-areas of interest



Net Performance - MCCL

	3MTHS	6MTHS	1YR	INCEPT P.A.	INCEPT CUM.
MUNRO CLIMATE CHANGE LEADERS FUND (AUD)	-1.4%	7.3%	-18.5%	-12.9%	-14.9%
MSCI ACWI TR INDEX (AUD)	4.1%	3.7%	-12.5%	-7.1%	-8.2%
EXCESS RETURN	-5.5%	3.5%	-6.0%	-5.8%	-6.7%

	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%
2023FY	10.6%	0.7%	-2.4%	3.3%	2.9%	-7.2%							7.3%

Net Performance - MCCL.ASX

	3MTHS	6MTHS	INCEPT CUM.
MCCL.ASX (AUD)	-1.4%	7.3%	-10.0%
MSCI ACWI TR INDEX (AUD)	4.1%	3.7%	-8.9%
EXCESS RETURN	-5.5%	3.5%	-1.1%

	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%
2023FY	10.6%	0.7%	-2.4%	3.3%	2.9%	-7.2%							7.3%

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.