

August 28, 2021

Pendragon Climate Impact Strategy

Mid-Year 2021 Letter to Clients

This year has been a challenging one for “green” investors. After an outstanding return of approximately 40% in 2020, our portfolio is essentially flat in 2021, to date. While our portfolio companies have continued to accelerate the energy transition and reduce carbon emissions this year, their share prices have not reflected these achievements. In particular, shares of wind and solar manufacturers and green project developers have seen a difficult year so far, with the typical market indices for solar companies falling -17%, renewables-focused utilities dropping -11%, and global clean energy companies down -20% through July 31. Despite the headwinds, our strategy was able to achieve superior financial returns compared to these indices given our hedging strategies in the long-short funds and positive stock selection/trading in both the long-only and hedged strategies.

First Half 2021 Developments

There were several factors that created the first half difficulties for the group. The first was the success of 2020. Investors anticipated a robust reopening from the COVID-induced global recession, and with a new US administration that made climate a top policy priority, “green” stocks rallied to where some valuations became stretched. While we reduced exposure to several high-quality but relatively expensive names, we take a longer-term view that focuses on both the positive impact the companies are making on the environment, as well as their company fundamentals and share price valuations. Second, as has been well documented, COVID caused supply-chain disruptions and price inflation across industries and renewable energy was not immune. From electric vehicles to solar panels, semiconductors are required and inadequate

supplies have become a new constraining factor. This not only restricts the amount of goods that can be produced, shortages also increase the costs of what is actually made. Third, the struggle of getting products from the factory floor to the final sales point has become much more expensive as shipping across oceans or on the roadways has hurt near term margins for producers, including our portfolio companies. Fourth, there is the ongoing deterioration in US-China relations. The vast majority of the solar panel supply chain is in China. Regulatory uncertainty surrounding solar tariffs in the US, as well as fears of the government potentially limiting Chinese solar firms’ access to US markets has weighed on the shares of several solar equipment producers, compounding the challenges of higher steel and other commodities costs.

Having said this, not all areas of the “green energy” ecosystem have been as challenged. Our portfolio is well-diversified across industries and various parts of the carbon-reduction space. Our investments in engineering companies, transportation, materials, and construction have done well. These tend to be “old economy” companies that are providing goods and services that focus on energy efficiency and lower-carbon products. About half of the portfolio is invested in new technology high growth-oriented names and half in more traditional, value-oriented companies. As active managers, we have been “blocking and tackling” to maximize returns given the opportunities available in the market. This entails allocating the portfolio to parts of the climate market that are working and trimming exposure to the companies that we like, but may be vulnerable to a period of negative sentiment. For our long-short accounts, we have deployed hedges to dampen volatility.

At July 31, 2021, the top 5 holdings were:

Position	% of Model Portfolio	Description
Eaton	4%	Global electrical equipment manufacturer
NextEra Energy	4%	Largest US renewables-focused utility
First Solar	3%	Solar panel manufacturer
Trane Technologies	3%	HVAC and cold chain equipment
Vestas Wind Systems	3%	Wind turbine producer

Eaton is one of the largest companies that produce electrical equipment components, with high exposure to the energy transition including grid modernization, EV powertrains, distributed generation, and the deeper electrification (and decarbonization) of the global economy.

First Solar and Vestas are leaders in renewable energy equipment production. **First Solar** is the leading US solar panel manufacturer and employs a proprietary thin film photovoltaic technology that does not use silicon or the Chinese supply chain. **Vestas**, a Danish firm, is a leader in wind turbines, the lowest cost technology for power production. In many cases, it is now cheaper to build a completely new onshore wind farm than continue running an existing coal or natural gas-fired fossil power plant.

Trane Technologies produces high efficiency HVAC equipment for commercial and residential buildings and refrigeration units for delivery trucks and ocean-going containers. The company has a goal called its “Gigaton Challenge” which is to reduce its customer greenhouse gas emissions by 1 billion metric tons by 2030.

The industry composition of our holdings by Sector at June 30, 2021 is:

	Percent of Model Portfolio
Utilities	21%
Building/Construction/Materials	21%
Auto/Electric Vehicles	13%
Solar & Wind	15%
Lithium/Batteries	13%
Recycling, Agriculture & Other	17%

The renewable energy sector is a global market. There are leading companies domiciled all over the world. Our portfolio is very global in nature.

Our model portfolio has holdings that are domiciled in the following countries:

Countries
United States, China, Japan, Denmark, Netherlands
France, Germany, Norway, Belgium
Canada, Chile, India

Outlook:

While many of the challenges facing the global economy persist, we believe the pullback in certain green energy names has reopened several opportunities in the sector with attractive valuations, with much of the bad news already reflected in company share prices. The long-term fundamentals and global demand for companies and products that facilitate the transition to a lower carbon world remain extremely strong and are in fact accelerating as more countries make carbon-neutral pledges such as China and the US. Moreover, many green technologies are the low-cost solution regardless of what governments decide to target. For example, onshore wind and solar are the lowest cost providers of power in much of the world already, even without subsidies, and even with effect of recent commodity inflation cost pressures.

Despite 2021’s sluggish share price performance we believe that the renewable energy sector has a positive long-term runway for growth. Countries are well-below their stated renewable energy targets. China has set a goal of producing zero net carbon by 2060. At present, China’s electricity production from “green” sources is about 30%, and that is well ahead of other carbon emitting sectors such as vehicles or industry. Within the US, states like California and New York have stated renewable energy goals as well. California has stated that its goal is to have 100% of its power generated by renewables by 2045 versus around 50% currently. There is a long way to go. Solar and wind power needs to increase significantly to meet the targets. India needs to significantly ramp up renewable energy production and infrastructure. Today, India’s “green energy” capabilities only generate about 22% of its rapidly growing power needs. Their goal is to increase renewables capacity to five times the current level by 2030. We are very excited by the green opportunities in India. Currently we are invested in a leading Indian developer of solar and wind power generation, **ReNew Power**. We are

searching for other investible situations in India where the bulk of their power generation is still produced by coal.

We hope this letter gives you a better understanding of your portfolio. We are active managers so the composition changes. Not every investor has their account in the exact same proportions as we have outlined here. Newer accounts are being carefully moved towards our model characteristics. This may take a little time.

As always, we appreciate your trust. We look forward to reporting our year-end results. If you have questions or concerns, please call us at 917-837-2287. Please stay healthy and well.

Sincerely yours,

Andrew Fairbanks / Ian Green
Portfolio Managers

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