Wellington Climate Strategy Fund

WELLINGTON MANAGEMENT®

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MARKET REVIEW

Global equities rose in July. Political developments, central bank policy, and an escalating conflict in the Middle East were key themes in the month. Sir Keir Starmer became the UK's prime minister after the Labour Party secured a landslide victory in the general election, bringing more stability to the government. The final round of France's legislative elections ended with an alliance of left-wing parties gaining the most seats. However, no party won an absolute majority, and a fragmented political landscape left the country with an unclear path to a new government. US Vice President Kamala Harris will likely become the Democratic nominee for president after Joe Biden relinquished his bid for a second term, following pressure from the Democratic party and greater support for Republican candidate Donald Trump in the wake of an attempted assassination. On the monetary front, the Bank of Japan hiked interest rates, sending the yen sharply higher, while the US Federal Reserve signaled an increased likelihood of a September rate cut and the Bank of Canada lowered its policy rate. Following a subdued market response from China's Third Plenum, the People's Bank of China delivered modest rate cuts to spur economic activity. Israel and Iran edged closer to a broader clash after an Israeli strike in Beirut killed Hezbollah leader Fuad Shukr, and Hamas accused Israel of assassinating its political leader Ismail Haniyeh in Tehran.

FUND PERFORMANCE AND ATTRIBUTION

- On an estimated net basis, Climate Strategy was up in July and outperformed relative to the benchmark. YTD, Climate Strategy is up in absolute terms but has underperformed relative to the benchmark.
- On an absolute basis, all but one climate theme contributed to this month's return. Contribution by theme sorted from highest to lowest:
    - Energy Efficiency
    - Climate Resilient Infrastructure
    - Low Carbon Electricity
    - Water and Resource Management
    - Low Carbon Transport
- Among our top absolute contributors:
    - TopBuild – part of our energy efficiency theme. They are a leading supplier and installer of insulation and building materials, which helps reduce carbon footprint, improve energy efficiency, and conserve natural resources. Building insulation is benefitting from more stringent regulation, which is driving replacement, and is a crucial part of energy conservation as buildings account for 38% of global CO_2 emissions. Both growth and building-products stocks saw significant gains in July as signs of potentially slowing inflation led investors to contend that borrowing costs may come down in the near term, benefitting TopBuild this month. We believe the company is well positioned, with active acquisition activity and significant growth potential in the insulation market.
    - Ferguson – part of our energy efficiency theme. They are a leading distributor of plumbing and heating products. Ferguson helps its customers save water, energy, and money by offering products and services that improve efficiency, performance, and sustainability. Ferguson saw positive stock movement in July for similar reasons to TopBuild. Some sell-side analysts pointed out that Ferguson is also well positioned to weather potential volatility associated with the recent upswing as they have worked strategically to limit cyclicality in recent quarters.
    - American Water Works – part of our water and resource management theme. They are focused on sourcing and providing a sufficient and safe water supply as the largest water and wastewater utility company in the US. The stock benefited from positive sentiment derived from charitable contributions via their American Water Charitable Foundation, a top score on the Disability Equity Index for the sixth consecutive year, their recently updated Sustainability Report, and the anticipation of positive earnings to be published in early August.
- Among our top absolute detractors:
    - Vertiv – part of our energy efficiency theme. They are an electrical equipment provider specializing in providing immersive cooling systems for data center and other heavy compute environments. Their technologies are used by customers to help drive energy efficiency and resilience given the critical workloads running on increasingly more intense compute requirements. While Vertiv reported positive Q2 earnings this month, particularly with strengths in orders and margins, a sector-wide sell-off of AI led to challenged stock performance. The broader sector performance was related to investor uncertainty given signs of a potentially slowing US economy and fears of an AI-bubble. However, we believe that while Vertiv has benefited from its AI exposure, the increase in electricity demand is broadly encompassed within the transition to a decarbonized economy, which remains to be an unwavering central tenant of our philosophy.
    - Synopsys – part of our energy efficiency theme. They are a leading engineering simulation and design software company. Their data-driven, analytical, and AI-powered solutions enhance productivity, quality, and sustainability by optimizing resource utilization. The AI and technology sell-off in July also affected Synopsys. Additionally, a competitor, Cadence Design Systems, reduced their FY24 guidance, leading to further investor apprehension. However, recent reports of strong and resilient demand across its electronic design automation (EDA) and intellectual property (IP) portfolio could, as we contend, result in continued upside.
    - Aspen Technology – part of our low carbon electricity theme. They are a leading industrial software company that uses technology and digitalization to help capital intensive companies reduce waste, increase efficiency, decarbonize, and contribute to the circular economy. Aspen was similarly affected by the AI and technology sell-off this month, although it was slightly buffered by predicted positive earnings, to be published in early August.

PAST PERFORMANCE DOES NOT PREDICT FUTURE RETURNS. AN INVESTMENT CAN LOSE VALUE.

Fund performance is based on USD S Acc share class and are net of fees and expenses. Other share class performance may differ.| Index used in the calculation of attribution data: MSCI All Country World.| Fund performance is net of actual (but not necessarily maximum) withholding and capital gains tax but are not otherwise adjusted for the effects of taxation and assume reinvestment of dividends and capital gains.| If an investor's own currency is different from the currency in which the fund is denominated, the investment return may increase or decrease as a result of currency fluctuations.| The views expressed are in the context of the investment objective of the Fund only and should not be considered a recommendation or advice.

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FUND POSITIONING AND OUTLOOK

As discussed last month, we have strong conviction in several sectors and have been adding to them recently. We believe housing demand will significantly outstrip supply for years to come, creating a favorable environment for select housing companies focused on efficiency and resiliency. Consequently, we added a position in a leading energy-efficient climate-control solutions company for both residential and nonresidential markets.

In the near term, we see valuations and attractive industry dynamics inflecting for select renewables, leading us to increase our position in a leading renewables financer. Additionally, we are leaning into waste and resource management, which we view as an underappreciated opportunity tied to secular trends. We recently added positions in a leading water treatment and management company and increased our position in a waste and environmental services company.

We have also been increasing our exposure to utilities. After significantly decreasing our utilities exposure in Q1 and much of Q2, we believe it is helpful to explain our thesis. We find investments in utilities increasingly attractive due to several factors. The transition to electrification, driven by climate goals and AI demand, necessitates more power, highlighting the need to modernize outdated grid infrastructure. Most US and European grids, built post-WWII, are over 50 years old and require significant upgrades to handle today's green, intermittent, and bi-directional energy technologies. Additionally, utilities have underperformed the broader market over the past 18 months, making their valuations appealing relative to their growth prospects. We also believe that economic and industrial indicators (e.g., ISM manufacturing, Dodge index, Architectural billings index) suggest a slowdown, but not a recession, making steady growth companies like select utilities more attractive.

As we have for over a decade, we maintain our philosophy that select companies across sectors and regions that are materially focused on solving for climate change mitigation and adaptation offer an attractive return opportunity while having a positive real-world impact.

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