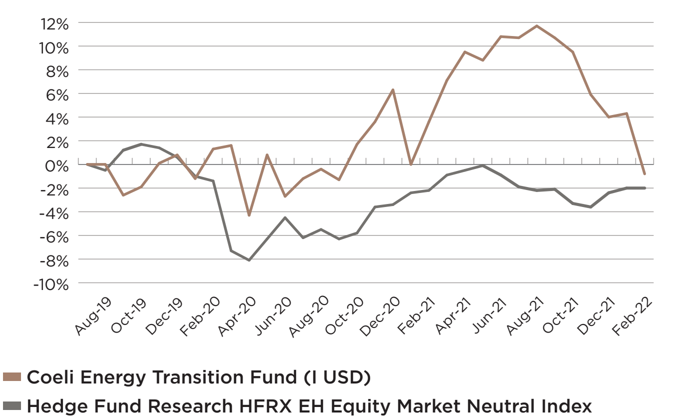
Coeli Energy Transition

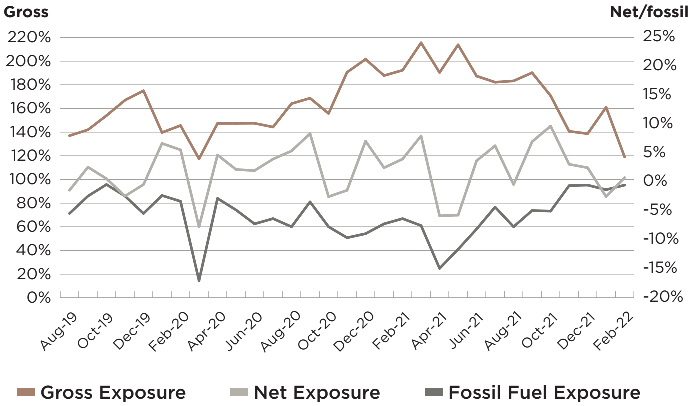
Monthly Letter

February 2022

PERFORMANCE, NET OF FEES



EXPOSURE



PERFORMANCE IN SHARE CLASS CURRENCY (%)[1]

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2019								0.0%	-2.6%	0.7%	2.0%	0.7%	0.8%
2020	-2.0%	2.5%	0.3%	-5.8%	5.3%	-3.5%	1.5%	0.8%	-0.9%	3.0%	1.9%	2.6%	5.5%
2021	-5.9%	3.6%	3.4%	2.2%	-0.6%	1.8%	-0.1%	0.9%	-0.9%	-1.1%	-3.3%	-1.8%	-2.2%
2022	0.3%	-4.9%											-4.6%

ATTRIBUTION FEB–22

Long attribution	3.1%
Short attribution	-7.9%
Net	-4.9%

MONTHLY PERFORMANCE PER THEME

TOP 3 ABSOLUTE P&L[1]

	Return on gross exposure of Theme	NAV Contribution
Solar	14%	1.6%
RES Developers	9%	0.7%
European Utilities	14%	0.5%

BOTTOM 3 ABSOLUTE P&L[1]

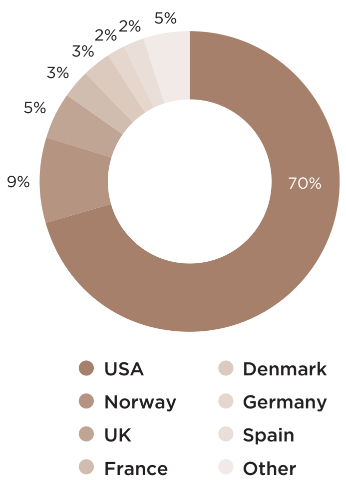
	Return on gross exposure of Theme	NAV Contribution
Majors	-8%	-2.0%
Integrated solutions	-19%	-1.9%
Hydrogen	-13%	-1.6%

MONTH END EXPOSURES

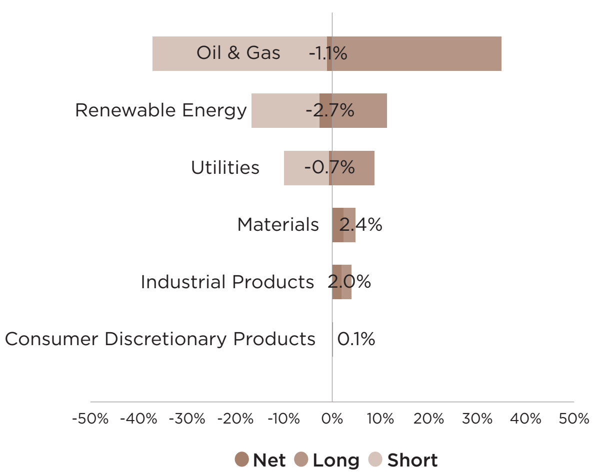
EXPOSURE, MONTH END[1]

No of long positions	32
No of short positions	31
Gross exposure	119%
Net exposure	0.2%
Net fossil fuel exposure	-1.1%
Largest long % NAV	5.2%
Largest short % NAV	5.0%
Top 5 longs % NAV	19%
Top 5 shorts % NAV	-18%
Liquidity (0-1 day, 20% participation)	94%

COUNTRY ALLOCATION[1]



SUB-SECTOR EXPOSURE[1]



1) Share Class I USD

Coeli

FUND MANAGER COMMENTARY

The fund returned -4.9% net of fees and expenses in February and it is down 4.6% year to date. The fund is down 0.8% since the inception in August 2019.

2022 has been a very challenging time to run a fund with a negative exposure to fossil fuels. During the first two months of the year, Brent oil rose by 24%, European 1m gas spiked by 122% and Coal increased by 62%. The extreme rallies got even worse into March, and we fear the risk might still be on the upside. We came into the year relatively optimistic that the high commodity price levels would incentivize supply and combined with a slowing economy, it would result in more balanced commodity markets.

This did not happen and clearly, Russia's ruthless invasion of Ukraine took us by surprise. To make matters worse, when the invasion was a fact, we positioned for relatively benign western sanctions. Although we are very pleased to be proven wrong by the West's strong response to the Russian aggression, we believe it is likely that the sanctions will have long lasting effects on the global commodity complex, in particular on oil and gas. The energy roadmap has most likely drastically changed, and we are adjusting the portfolio accordingly. It is, however, not done overnight.

The strongest companies with the highest free cash flows may no longer be the best performing stocks. Companies we previously thought had challenged business models and too much financial leverage could be getting a lifeline. The dislocations can be significant, and we are reworking the book to remain hedged.

As we have no edge in predicting what happens next in Ukraine, we grossed down the book to 120% by the end of February. We are feverishly updating our supply and demand models and we will in the short to medium-term run fewer, more hedged themes. This will allow us to quickly skew exposure net long or short between themes to take advantage of the volatility and the dislocations. Although the markets have somewhat adjusted to the new situation, we believe there are significant opportunities both on the long and short side of both fossil and renewable energy in this new environment.

FOSSIL FUELS – THE MAPS ARE BEING REDRAWN

Russia is the world's second largest commodity producer, crucially important in both energy, metals, and grains. Dislocations in these markets can have profound implications for the global economy, in particular on Europe, which is a net importer relying on Russia for a significant part of its supply. The uncertainty is very high.

Brent oil rallied 12% in February and continued to rally into March, reaching USD 140 per barrel at one point, up 82% since the start of the year.

At the time of writing, only the US and the UK have banned the import of Russian oil and oil products into their markets. However, there is still risk of more comprehensive sanctions and more companies initiating self-sanctioning. There is also a chance that Putin prohibits export to Western nations supporting Ukraine. This would sound counterproductive as oil revenues is Russia's largest source of capital, but if Russia would curtail export to only serve "friendly" nations, it might collect higher overall revenues as the oil price would skyrocket.

A ban on Russian export to the West would obviously wreak havoc in the oil market, although since most of the Russian export is shipped, the barrels not bought by the West could and likely would be sent to China, India, and other countries in Asia. However, this would add significantly to logistical costs, and it will take time to build up a supply chain that can work around western sanctions. Currently, about 3 million barrels (m b/d) of daily exports are estimated to not be finding a buyer. This is out of Russia's total 11m b/d production and 7m b/d export.

Russia is one of the world's top 3 producers, but for its size, it has limited inventory capacity and it will not manage many months of significantly reduced export before it will have to shut-in producing wells. Even if these logistical problems could somehow get quickly sorted out, Russian production is likely to decline as its oil and gas companies will no longer have access to western technology and experts. This is one of our longer-term concerns. When and if Russia's production start declining, the world could face a prolonged period of undersupply.

The global spare capacity was already at historically low levels. OECD inventories are well below their pre-Covid five-year average and OPEC's spare capacity is shrinking quickly as OPEC+ continues to add back 400k b/d a month. Disruptions from Russia will only make the inventory situation worse.

Where can we find the oil barrels to balance the market?

OPEC: Optimistic forecasts assume 4m b/d of spare capacity in Q1/22 declining to 3m b/d by the end of the year. However, as most OPEC members are struggling to produce their current quotas, it is reasonable to believe that its capacity is less than the official numbers, maybe only half. Most likely, it is only Saudi Arabia, Iraq and UAE that have significant spare capacity that can be produced in relatively short term, the timing is important though. Also, Saudi increased its pricing to Asia to the biggest premium ever last week, so we can assume Saudi has no intention, yet at least, to add incremental supply.

Without extra production from Saudi, the largest near-term relief would be Iranian oil if there would be a new Iranian nuclear deal. Iran could probably export 0.5-1m b/d relatively quickly and maybe much more as a one-off with a release from storage. Production increases would take some time.

Venezuela: The Biden administration has also travelled to Caracas to try to negotiate with the Maduro administration about lifting sanctions on Venezuelan oil. Venezuela has the biggest oil reserves in the world, and it was producing more than 2m barrels a day before it was sanctioned some 5-6 years ago. Today the production is less than 0.7m b/d, but it will likely take a lot of capital and time to increase production. However, we can imagine the US is keen on replacing the barrels of heavy oil it normally imports from Russia with similar crude from Venezuela. This might seem like small fish, but when the petrol price in the US is about to skyrocket, the lack of heavy crude would add significantly to the input costs for many refineries.

Shale: President Biden has promised to do everything he can to halt the increase in gasoline prices. This means that he will need to also ask the domestic shale industry for help. While the private E&Ps and the oil majors have already scaled up spending significantly, the large public E&Ps have only recently started signaling that they might increase spending if Russian barrels are sanctioned. They can of course increase activity, and this might be our biggest hope in the medium term. In the short term though, there is a lack of workers, equipment, and raw materials. They also need the blessing from their shareholders, which during the previous ten years grew weary of the sole focus on growth and no returns. The shale companies are finally generating free cash flows and shareholders do not want to rock the boat. However, we expect their attitude to shift if the Russia sanctions take hold. Still, even though most forecasters are increasing their shale production numbers for 2022, the oil market still look tight.

Unfortunately, except for the possible barrels from Iran, we doubt there will be much incremental production the next 6 months to replace Russian export if it is directly or indirectly sanctioned. This implies that the market will have to balance through demand destruction as the price reaches levels where activity is no longer affordable or profitable. Rystad Energy has calculated that demand destruction commences at about USD 130 dollars, while Morgan Stanley expect USD 150 to be a trigger for demand destruction as the oil burden in the world would equal ~6% of GDP, like it did at the peak in 1979.

We believe that as in the 1970s and in 2007/08, the oil price could possibly significantly overshoot these levels until demand adjusts to supply. How high oil will go in the near term will depend on the severity of the sanctions, but demand destruction might also be triggered at a higher price point if we see political intervention to shield citizens from the price spikes. This has already happened in the power market in many European countries after the gas price spiked this winter.

Although we strongly support trying to deny Putin a war chest that can be applied in Ukraine, we must have in mind that if half of Russia's export is sanctioned, but the rest is bought by China, and oil balances at around USD 150-160, Putin's oil revenues would be about equal to December last year when the oil price was about USD 75-80. At the same time, an oil price of USD 150 or higher will cause an economic slowdown that might end in a recession in Europe.

Gas is the bigger problem

When it comes to the risk of a recession, we are the most concerned about sanctions on Russian gas rather than oil, though. Europe imports about 175-200 billion cubic meters of natural gas a year from Russia, i.e. about 45% of EU's total gas imports. If this would be sanctioned or Russia would halt export to Europe, this energy shortfall simply cannot be replaced in the short term and the risk of a recession in Europe will be looming.

Different organisations have come up with suggestions how Europe can reduce its dependency on Russian gas by more than 30% within a year (IEA: https://www.iea.org/reports/a-10-point-plan-to-reduce-the-european-unions-reliance-on-russian-natural-gas). IEA's comprehensive plan is even consistent with the EU's climate ambitions and the European Green Deal, but IEA also presents suggestions that would not be compliant with climate targets but would cut reliance on Russian gas by more than 50% within a year.

EU has also announced an even more ambitious plan where it within the year would cut up to two thirds of Russian gas imports. We will not go through the details of these plans, but it is fair to say that some of the assumptions are highly optimistic and seem to have been made in a somewhat static world where there is no lack of production capacity or raw materials, nor any supply chain issues and competition from outside of Europe for the same resources.

The conclusion is either way that a hard stop on all import of Russian gas into Europe, triggered by Russia or Europe itself, would leave a huge imbalance in the European energy system. The only solution would be demand destruction on a scale we have not seen before. There would have to be rationing for households, which account for about a quarter of European gas consumption, while many industries would have to mothball or at least curtail their operations. The economic consequences would obviously be severe as inflation would rise steeply and economic growth would grind to a halt.

RENEWABLE ENERGY – LONG TERM BENEFICIARY OF THE ENERGY CRISIS

At the start of February, the renewable energy indices were down about 40-45% since the recent peak in November. The key driver was fear of higher interest rates, but as the tightening concerns receded with the increased risk for conflict in Ukraine, the stocks found a bottom and then rallied into the month end as the war broke out.

The risk of curtailed Russian energy export and higher fossil fuel prices were the first triggers for the rally. However, stocks have continued to appreciate as the EU has presented ambitious plans to accelerate the energy transition due to the need for energy safety from Russia.

The European Commission this week published a report called 'REPowerEU' that outlines three goals: 1) to make Europe independent of Russian gas well before 2030, 2) introduce temporary measures to limit the pain from higher energy prices on the consumers, and 3) accelerate the clean energy transition. (https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1511)

As the order of the points might give away, climate change is still a key target for the EU, but energy safety might have become the priority while at least temporarily, consumer protection has made it on the agenda.

We will refer to the document for more details, but as already mentioned, we find the target to reduce EU demand for Russian gas by two thirds before the end of the year to be ambitious. Even if the EU could remove all permitting matters, which is one of the things they can 'control', the supply chains in renewables are already very stretched and struggling with cost inflation.

We are huge fans of the EU pushing energy efficiency measures. Heat pumps and better insulations are relatively low hanging fruits, although we are quite sure the measure with the best effect this year will be to ask households to turn down the thermostat by 1-2 degrees Celsius to lower the energy heating consumption by approximately 10-20%.

EU also want to introduce temporary measures to limit the impact of the energy prices on the households. We find this reasonable, although we would prefer that these are financed by lower government taxes on energy instead of so called 'windfall profits' from the power companies. Higher taxes on the power companies might reduce capital that is needed to accelerate the energy transition. This, combined with subsidies to energy consumers, who will be able to consume more energy at higher market prices, goes against the ultimate goal of the energy transition, i.e. less burning of fossil fuels and more investment in renewable energy.

FUND PERFORMANCE

The fund did not trade the Ukraine/Russia risk well. A small net short in fossil fuels quickly created large losses. Not only were we not well enough hedged for such an event, but as Russia recognized the independence of the separatists in Ukraine ordering Russian 'peacekeeping forces' into Donetsk and Luhansk, we assumed Putin had made his face-saving move and he could gradually withdraw his main forces without any bloodshed. We assumed Russia risk would slowly be priced out as the threat of war and western sanctions would recede.

We were wrong on both accounts, but as much as we despair over the ruthless invasion, we are sincerely proud and positively surprised by the strong reaction and harsh sanctions imposed by the West on Russia. Unfortunately, we had not foreseen any of them and to make matter worse, the first round of sanctions was as toothless as we had feared and made us not cut all our companies with some Russia exposure right away.

When we finally realized that the western oil and gas industry would not work in Russia for years to come, we cut our exposure to zero and booked the rest of our losses. However, the sanctions on Russia will likely have huge ramifications for the global energy industry and we have realized that we have to rework every demand and supply model in our fossil universe.

To add to the misery, our renewable themes which had worked reasonably well during February booked significant losses into month end as everything rallied off the likelihood of more accelerated government funding to renewables in Europe. Despite the large dislocations that were not in our favour, the renewable themes ended the month in green. The increased fossil fuel prices and more ambitious roll out in Europe is undoubtedly positive for the renewable universe, but we doubt we are going back to the unhinged race to 'buy anything green' that we saw in the second half of 2020 and into 2021. Back then inflation was non-existent, interest rates were firmly at the bottom, Central Banks were busy buying Government bonds and large fiscal programs for Covid-19 and Green Energy were promoted around the world. It was an excellent time for the riskiest equity investments.

This time around, inflation is skyrocketing, Central banks have stopped buying government bonds and are planning interest rate hikes, while many of the fiscal programs have not materialized and/or it has become apparent how slow and selective the distribution of the funds is. Still, focus on the energy crisis in Europe is likely to give the sector a solid momentum and will outweigh some of the pain higher base rates have on companies with no revenues and profit far into the future.

The biggest losing themes of the month were 'Majors' and 'Integrated Solutions', deducting 2.0% and 1.9% from NAV, respectively. Both were hit by exposure to Russia in the form of **BP (BP/ LN)** and **Technip (TE FP)**, respectively. The former owns 20% of Rosneft, which accounted for about 10% of Earnings before tax and more importantly, about 15-20% of **BP's** dividends. The stake is probably close to worthless today. The latter company is one of the energy transition champions, but its exposure to Russia is significant. Its largest project was in Russia and would have accounted for a big chunk of profit in 2022 and 2023. However, a large part of its growth pipeline was also in Russia and although there will be more LNG in the rest of the world as Russia is closed for business, TE's competitive advantage in Russia was quite substantial. The company has so far not pulled out of Russia, but we think it is unlikely that it will do any work there for years to come and we exited our position.

The best performing theme was 'Solar' contributing 1.6% to NAV with names like **Enphase (ENPH US)** and **Solaredge (SEDG US)** doing well. However, the hydrogen theme almost equalized the gain in 'Solar' due to strong recovery in some of the hydrogen names with the worst share price performance before the war.

OUTLOOK

Managing capital can certainly be one of the most stressful and frustrating endeavors, however it is hard to complain when Europe is at war and millions are suffering every day. We try our best to understand the markets we are dealt, but we must admit that we have struggled recently.

The energy roadmap is changing. As such, we are adjusting our book to be even more US centric (from 60-70% pre-war), something we have done in the past. It makes even more sense now with the enormous uncertainties in Europe.

There are also several other benefits; we will have a full day to focus on analysis with limited market disruptions during European hours, it is easier to hedge exposures of our favourite positions which we expect to outperform, it removes the fund's foreign exchange exposure and improves the overall liquidity of the portfolio.

We will continue to run the portfolio with a lower gross exposure until this process is finalized as we believe it is risky to make a bet on the direction of this war. With dislocations also come opportunities and we believe with the themes we are now adjusting; we will be better placed to take advantage of them.

As the world is in dire need to replace oil barrels, we believe there are some great opportunities to own high quality, short-cycle exposed oil service companies and hedge with longer cycle companies that will not see any near-term benefit. Many of these companies are also in the forefront when it comes to advancing technologies in the energy transition and have made ambitious targets to reduce the emission intensity.

On the renewable side, we believe Europe will be perceived to be the growth engine of the world, at least for some time. Solar will be first to see the benefit of order uptick as improvements in permitting processes, government incentives and the desire for people to wane themselves off Russian gas and high utility bills will drive demand. Many of our solar companies, for instance **Enphase** and **Solaredge** are well placed to capitalize on this acceleration in demand.

Wind should see an improved regulatory landscape and onshore wind could see an acceleration in orders, however offshore wind is longer cycle and will likely see only incremental benefits near term. Onshore wind installations are probably the most challenged by supply chain issues in the short term and these could get worse.

EU set out even more ambitious target for hydrogen to replace Russian gas, and we believe the initial benefactors will be electrolyser manufacturers and companies developing infrastructure, for instance in storage and transportation. Application of fuel cells in the transportation sector is still a question mark for the European market and although it is a more concentrated market from the OEM perspective, it will likely show meagre growth the next five years.

It is hard to stay optimistic while there is a horrible war raging in Europe, however we have to stay focused on what we can control. With that in mind, we are quite excited about the trading opportunities ahead.

Sincerely,
Vidar Kalvoy & Joel Etzler

About The Fund

THE TEAM

Vidar Kalvoy

Portfolio Manager

Vidar Kalvoy is the lead Portfolio Manager and Founder of Coeli Energy Transition. He has more than 20 years' experience from portfolio management and equity research. For nine years, he was responsible for the energy investments at Horizon Asset in London, a market neutral hedge fund. Kalvoy also has experience from energy investments at another hedge fund in London and equity research within the technology sector in Frankfurt and Oslo.

Joel Etzler

Portfolio Manager

Joel Etzler is Portfolio Manager and Founder of the Coeli Energy Transition fund and has more than 14 years in the industry, with investment experience from both the public and private equity side. Etzler joined Kalvoy at Horizon Asset in London in 2012 and spent five years before that within Private Equity at Morgan Stanley. Etzler started his investment career within the technology sector at Swedbank Robur in Stockholm, 2006.

MARKET NEUTRAL ENERGY EQUITY FUND FOCUSED ON THE ENERGY TRANSITION

Coeli Energy Transition is a market neutral energy equity fund seeking to produce high risk-adjusted returns that are uncorrelated to both market and commodity price risk. It aims to take advantage of the increased volatility and dispersion in the energy sector caused by the disruption from alternative energy and the shift in public opinion against the fossil fuel industry. The fund is committed to have a negative exposure to the fossil fuel industry at all times.

The investment universe consists of energy equities as well as companies in other sectors that are impacted by the ongoing energy transition. Geographic focus is North America and Western Europe. The fund's research process is centered around a top-down analysis of supply and demand in the sub-sectors, complemented with detailed bottom-up analysis to identify winners and losers within the many sub-sectors of the energy sector. The portfolio is generally composed of 60-80 single name equities divided into investment themes and pair trades. It targets a net exposure of +/-10%.

FUND DETAILS

Assets	USD 48m
Inception	16-aug-19
Fund type / Strategy	UCITS / Market Neutral equities
Net Exposure Target	+/-10%
Liquidity	Daily
Target assets	Listed equities
Geographical mix	~50% North America, ~50% Europe
Benchmark	No benchmark
Management fee	1% p.a. institutional share class / 1.5% retail
Performance fee	20% with high-water mark (yearly crystallization)
Expected TER	0.2-0.4%
Cut-off	14:00 CET
Pricing	Closing price end of day
Share classes	SICAV share classes (institutional; GBP, USD and SEK / Retail; SEK)
Minimum investment	Institutional USD 1,000,000 / Retail SEK 100
ISIN Code / Bloomberg ticker	I USD - COENTIU LX / R SEK - COENTRS LX
Prime Brokers	Morgan Stanley & Co. International plc / Skandinaviska Enskilda Banken (SEB)
Custodian, Listing Agent, Central Administration, Registrar and Transfer Agent	RBC Investor Services Bank S.A

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RISK INFORMATION

The information provided here does not constitute professional financial advice. Past performance is not a guarantee of future returns. The price of the investment may go up or down and an investor may not get back the amount originally invested.

An investment decision should be based on information in current prospectus, Key Investor Information Document ("KIID"), and most recent published annual and semi-annual reports. These are available at www.coeli.com and can be acquired directly from Coeli. For advice regarding investments suitable for your specific situation, please contact your financial advisor.

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