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Monthly Perspectives
AXA IM Equity

Clean Economy strategy

Current natural gas supplies disruption into Europe highlights the risk to Energy Security

- Global equity markets declined as markets adjusted to higher rate expectations
- Precision agriculture solutions benefit from rising natural gas cost
- We increased our exposure to National Grid

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What's happening?

Global equity markets declined during February as markets adjusted to higher rate expectations, and then began to recognise the unfolding situation in Ukraine. As a result of this adjustment, long duration growth stocks underperformed the broader market.

Full year earnings season is almost over and has demonstrated continuing strength in the addressable markets of the clean economy, with order books largely expanding and a strong outlook for demand. Supply chain disruption and input cost inflation remains an issue in many areas of the economy. Those businesses with strong competitive positioning are best equipped to pass this through, demonstrating the resilience of their business models. Companies with pricing power but long order books and exposure to cost inflation will take longer to reprice their offering and this is to be reflected in near term margin compression. We expect disruption and cost inflation to continue at least through the first half of this year and are mindful of this in our positioning, as we continue to focus on businesses with the ability to pass through cost pressure and manage disruption.

Despite these near term challenges, we see many reasons for optimism. Corporate customers of the Clean Economy continue to work toward their ambitious climate targets, adopting clean technologies to do so. Governments remain committed to the Energy Transition and we are witnessing an increasing focus on land preservation and biodiversity particularly. The current situation in Ukraine has disrupted natural gas supplies into Europe, highlighting the risk to Energy Security. Renewable Energy, supported by energy storage and smart grid solutions are well placed to mitigate this risk – a consideration which has already prompted Germany to accelerate the passage of the Renewable Energy Sources Act through parliament.

Natural gas is a component in the cost of fertilisers. Coupled with disruption to the global supply of potash, where Russia is the number 2 supplier, this is likely to increase the cost of fertilisers; and therefore reduce the payback period of precision agriculture solutions which save on the application of increasingly expensive chemicals. This is supportive of parts of the Agriculture and Food Industry theme.

Clearly natural gas is also an input in the production of grey hydrogen. Elevated gas prices coupled with concerns over security of supply make green hydrogen solutions relatively more attractive than has historically been the case. This is supportive of the best technologies in this part of Smart Energy.

Portfolio positioning and performance

The portfolio outperformed the broader equity market (MSCI All Country World) during February, partly as market expectations for rate rises pared in response to the Ukraine crisis. Both influences were most notable in Smart Energy where we saw broad based strength, notably from Ameresco, Alfen, Orsted and Hannon Armstrong. These stocks have all produced good earnings and a strong outlook but outperformance was partly a reversal of weakness in January.

Stocks which performed least well during February were the semi-conductor suppliers including Infineon Technologies which had displayed relatively strength earlier in the quarter.

During February, we increased our exposure to National Grid which benefits from some inflation linkage in its earnings and which is leveraged to the need to invest in smart grid as well as renewables. We reduced our exposure to TE Connectivity following a period of strength.

Outlook

The EU and its member states have underlined their commitment to Net Zero 2050, set the framework for a green recovery in Europe and continue to advance longer term environmental policy. 2022 is an important year for the 'Fit for 55' regulations within European Climate Law and for progress with the EU Green Taxonomy. China has made a commitment to net zero by 2060, a significant move which came sooner than many expected and continues to demonstrate commitment to the Energy Transition. The US has pledged to half emissions by 2030 on its path to Net Zero 2050 and progress with policy is becoming evident. Despite disappointment around the Build Back Better bill, low carbon tax credit extensions offer positive support. Corporates are also increasingly committed to Net Zero targets and are investing accordingly, seeking clean energy, storage and energy efficiency services. Delivering these commitments will require considerable investment in Clean Technology solutions, adding to the multi decade growth opportunities already evident for the Clean Economy. This strong and resilient demand for clean technology solutions, now further underpinned by energy security considerations, encourages further innovation underpinned which continues to enhance the investment potential within the clean economy.

We retain the view that high quality management teams, operating businesses with a sustainable competitive advantage in their markets and with the benefit of secular tailwinds are best placed to weather the current storm and to seize opportunities for growth. The portfolio is therefore well positioned to benefit from the secular growth opportunities we see within the Clean Economy and we will seek to add to the best of these where valuations are becoming increasingly attractive.

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