Clean Economy strategy

Despite broader macroeconomic concerns, the impetus behind the Energy Transition continues to build

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• Waste management names contributed positively
• We initiated a position in Vulcan Energy Resources

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What's happening?

Global equity markets declined sharply in dollar terms during June due to growing concerns of weakening macroeconomic conditions. Rising energy costs and significant broader inflationary pressure has weighed on consumer sentiment and prompted the Fed to raise rates by 75 basis points during June. The market continues to reflect expectations of further rate rises. Coupled with ongoing geopolitical risk, supply chain disruption, deteriorating consumer sentiment, this is driving weakness in equity markets.

Despite broader macroeconomic concerns, the impetus behind the Energy Transition continues to build. The situation in Ukraine has pushed Energy Independence into focus as a key strategic priority for Europe. Achieving this goal requires significant investment in the areas of Smart Energy and Low Carbon Transport. New energy infrastructure requires smart grid and greater interconnect capacity between countries, renewable generation capacity, energy efficiency and storage. Transportation systems will move away from fossil fuels towards a combination of solutions including electric vehicles, biofuels and green hydrogen. The technology exists to enable this transition and investment in capacity means scale and cost considerations are less inhibitive than in the past.

We have already seen a strengthening of policy commitment to the Energy Transition from the European Union and expect to see an easing of permitting and process bottlenecks which has limited the pace of investment in the transition. Smart Energy businesses are already reporting strengthening demand for energy efficiency solutions, residential and commercial scale renewables and storage projects. Electric vehicles continue to increase their penetration of new car sales as manufacturers prioritise their production under constrained supply chains and consumers switch in response to high fuel prices. This further strengthens the outlook for Smart Energy and Low Carbon Transport solutions and is reflected in the strength of demand and order books across these areas.

Protracted lockdowns in China have weighted on areas of production and therefore creating further disruption for global supply chains. Whilst measures have been marginally relaxed, the "zero covid" policy remains in place and we therefore continue to monitor the situation closely given the implications for verticals including Low Carbon Transport as well as a potential release of some inflationary pressures.

Portfolio positioning and performance

The strategy underperformed the MSCI All Country World Index in June led by holdings in ‘Smart Energy’ and ‘Natural Resource Preservation’.

In ‘Smart Energy’, our positions in renewable energy solutions companies Ameresco detracted most from performance. This followed a strong share price performance during the prior month in response to positive quarterly earnings and guidance. Siemens also underperformed due to concerns over near term headwinds. In particular, management indicated that supply chain disruption due to China lockdowns and Russia related write downs would impact quarterly margins in the mobility business. Nevertheless the medium term outlook for this part of the business remains strong and the opportunities associated with smart infrastructure are also attractive. Management guidance remains intact and we remain optimistic for the medium and longer term.

Returns in ‘Natural Resource Preservation’ were supported by relative strength from waste management businesses Waste Connection and Republic Services which benefit from inflation linkage in parts of their revenue. This was offset by weakness from Darling Ingredients as it gave back some earlier outperformance

During June, we initiated a holding in Vulcan Energy Resources, a company which holds exploration licenses for green lithium in the Upper Rhine Valley of Germany and which has a pilot project and plans to reach commercial production by 2024, with offtake contracts secured from a range of key players in the electric vehicles (EVs) and battery supply chain.

Outlook

2022 was already set to be an important year for the Energy Transition in all regions due to ‘Fit for 55’ regulations within European Climate Law and for progress with the EU Green Taxonomy; China’s goal of 2030 peak carbon emissions followed by a goal of net zero by 2060; and a significant step up from corporates across the globe, with notable progress in the US. The current Russia-Ukraine crisis has served to underscore the need for Energy Independence and has therefore strengthened the resolve of both policy makers and those for whom energy security and uptime is critical. Delivering the necessary transition requires 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 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.

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