Clean Economy strategy

Persistent inflation and growing energy crisis continue to weigh on markets

• Global equity markets declined in August
• The Inflation Reduction Act provides a welcome boost to energy transition companies
• The 'Low Carbon Transport' and 'Smart Energy' themes performed positively

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What's happening?

Global equity markets declined in August in US dollar terms as central banks reiterated their commitment to reduce inflation despite the risk of an economic slowdown. The UK and Europe fell the most while the US and Asia performed better. On a sector basis, information technology and healthcare were hardest hit while energy and utilities were supported by rising energy prices. Growth underperformed value during the month.

The combination of lower gas supplies from Russia and exceptionally warm weather conditions has led to a sharp increase in energy prices. Storage levels of gas in Europe have improved due to aggressive liquified natural gas buying and lower industrial activity but may not be enough meet winter demand. Meanwhile, several European countries are trying to protect consumers from rising energy prices by socialising the cost through windfall taxes or special mechanisms.

Despite broader macroeconomic concerns, however, the impetus behind the Energy Transition continues to build. The Ukraine conflict has brought energy independence into focus and become a key strategic priority for nations globally. The EU has strengthened policy commitments to the energy transition and we expect further easing of permitting and process bottlenecks which have limited the pace of investment to date. In the US, the recently passed Inflation Reduction Act provides a welcome boost to energy transition companies while putting the US on a much closer path to achieving its climate targets. The bill dedicates almost $400bn over the next 10 years to address energy security and climate change.

Protracted lockdowns in China have weighed on certain areas of production and continue to disrupt supply chains. Although measures have been relaxed slightly over recent months, the "zero covid" policy remains in place so we continue to monitor the situation closely given the implications for clean tech supply chains and inflation more broadly.

Portfolio positioning and performance

The strategy performed in line with the broader equity market (MSCI All Country World Index) in August led by holdings in 'Low Carbon Transport' and 'Smart Energy' while 'Agriculture & Food Industry" trailed the broader strategy.

In 'Low Carbon Transport', our position in Wolfspeed rose sharply after it reported results that were well ahead of expectations and significantly raised its long-term revenue target. Wolfspeed develops and manufactures semiconductor materials and devices used for high-power applications in the automotive, industrial and radio frequency infrastructure sectors. It is a leading producer of silicon carbide material which is seeing strong demand due to more efficient power conversion in battery powered electric vehicles and charging infrastructure. The company recorded $2.4bn of new business in the quarter, with around 70% from autos, taking the overall pipeline to over $35bn.

Returns in 'Smart Energy' were boosted by First Solar, which is a leading provider of utility-scale photovoltaic solar systems. The Inflation Reduction Act bill has provided a strong tailwind to renewable equipment manufacturers, particularly those with operations in the US, and First Solar announced plans to add another 4.4GW of new capacity during the month which would take its total US capacity to over 10GW. The company's technology is competitive with Asian peers and has a strong project backlog with no availability for the next 2.5 years.

On the negative side, within 'Agriculture & Sustainable Food', our position in nutritional products company DSM weighed on performance as high raw material, energy and logistics costs, along with further disruption due to lockdowns in China, continue to weigh on earnings. Following the intended sale of its Materials business, the company will focus solely on Health, Nutrition and Bioscience, where it offers best-in-class growth and profitability, which could lead to a rerating in company valuation.

Trade activity was limited during the month.

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 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.

Achieving these goals requires significant investment in the areas of 'Smart Energy' and 'Low Carbon Transport'. New energy infrastructure requires smart grids and interconnect capacity between regions, renewable energy generation, and energy storage solutions, while transportation systems will move away from fossil fuels towards a combination of solutions including electric vehicles, biofuels and green hydrogen. Within 'Agriculture & Sustainable Food', high crop prices and rising input costs are supporting demand for agritech solutions which improve yield and farming efficiency. Meanwhile, companies in the area of 'Natural Resource Preservation' which facilitate recycling and reusing, along with better management of resources, are helping to mitigate environmental damage while meeting the needs of a growing population.

The 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. 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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