As wildfires tore across the west of North America and Siberia, and devastating flooding shocked Northern Europe, the EU launched a package of twelve environmental legislative initiatives with the headline that this is the “make-or-break decade”. The aim of the legislation is to achieve the goals of the Green Deal. By 2030 they want to have reduced carbon emissions by 55% from 1990 levels, and they want Europe to be the first carbon neutral continent. Whilst question marks remain over whether the EU’s targets are achievable, this blog post will take a look at some of the measures and how our portfolios are already contributing to a more sustainable way of life in Europe.

Carbon pricing is a core theme running through the proposals which is designed to make heavy polluters pay in a bid to switch to alternative clean energy. In particular, the existing emissions trading scheme (ETS) is being expanded to include transport and buildings. These sectors will have separate systems to counteract the lack of progress seen in reducing CO2 emissions. As part of this, there will be binding targets to boost energy efficiency with the aim of renovating 3% of public buildings a year. Here we note Hoffman Green Cement, a holding in model & bespoke portfolios, which is a European based company that produces cement with a significantly lower carbon footprint. Through three innovative technologies, they reportedly reduce CO2 emissions by a factor of five. In France, new buildings that use this technology become eligible for construction bonuses.

When it comes to carbon pricing and offsets, we are hopeful they have the desired effect, although we are somewhat sceptical. “Whilst carbon pricing will play an important part in our transition, we hope polluters don’t view it as a way to justify ‘business as usual’”, said Harry Thompson, portfolio manager at King & Shaxson Ethical.

On top of this, stricter CO2 emission standards for cars and vans will result in an effective phase-out of internal combustion engines. By 2035 the EU would expect CO2 emissions from new cars to be zero. To facilitate this, there will be requirements upon national governments to accelerate the installation of charging and refuelling points for non-fossil fuel powered cars. The EU has set targets of having an electrical charging point every 60km and hydrogen every 150km. It will be interesting to see how European carmakers adapt and transition. Many have already begun producing electric vehicles, and this will accelerate as the cost differential moves in favour of EVs due to the new measures imposed. Developments in infrastructure will be vital and many questions will remain over whether the project can succeed.

In 2020 Tesla (held in model & bespoke portfolios) outsold its closest competitor, Volkswagen, in worldwide EV sales by 127%. In Europe its Model 3 was the second most sold EV behind the Renault Zoe. Given the reputation of European carmakers, once a significant proportion of their business has transitioned into non-fossil fuel production they are likely to pose much stronger competition to Tesla’s dominance both in Europe and globally. Equally, the transition will come at great cost for these companies whilst generating increasing demand for existing technology.

Further expansion of the emissions systems will see airlines, which have been subject to emissions trading since 2012, lose their free carbon allowances by 2027. Also, ships that are larger than 5000 tonnes will be required to purchase pollution permits to dock at EU ports. Green hydrogen, which many commentators see as vital for the future, is a potential solution for shipping and much more. ITM Power (held in model & bespoke portfolios) have been ramping up the manufacture of hydrogen electrolysis equipment, having developed the technology over a number of years, and are now seeing increasing acceptance of its viability. A bigger name who are making strides using this technology is Linde (held in model portfolios). They have recently formed a joint venture with ITM and as a result have installed 200 hydrogen fuelling stations and 80 hydrogen electrolysis plants worldwide.

Perhaps the most controversial inclusion in the proposals is the Carbon Border Adjustment Mechanism (CBAM). This mechanism is a tariff system on the greenhouse gas emissions of imports. Foreign companies will have to pay for the pollution their products produce to sell them within the EU. The idea behind this is to maintain the competitiveness of EU companies against companies that are based in countries with less restrictive emissions policies. There has been talk that the policy may contravene WTO rules on protectionism. However, EU officials are confident that this is fair. EU firms will face the same constraints as foreign ones, and credits for foreign companies will mirror prices paid by Europeans.

This legislation should only serve to improve our investment outlook. We are exposed to several companies within our bespoke portfolios, where we are able to select direct holdings, who are at the forefront of the drive towards net-zero on the continent. In the transport space we favour several train companies, the demand for which is likely to increase given it naturally produces less CO_2 emissions, and the advancement of alternative energy will see this form of transport become even cleaner. On average, if you are travelling alone you use 95% less greenhouse gases taking a train than if you drive. The operators we favour are also at the forefront of renewable powered trains. SNCF, for example, aim to start deploying hydrogen-powered trains from 2022 and have renewable energy as the main provider of power for trains from 2025.

Our model portfolios are also exposed to a number of companies that will benefit from the continents shift to cleaner transport. Within them there are several companies that produce microchips, a set of electronic circuits on a small piece of silicon, which forms the heart of many devices we use. The one with the highest revenue exposure to Europe, at 19%, is Microchip Technology, for whom the automotive industry also forms an important part of their business. Their technology allows for the electrification of critical functions which the successful development of powertrains for electric vehicles depends upon. Fuel storage is another critical element. Plug Power are a leading provider of hydrogen fuel cell solutions and they have already targeted Europe as an area for expansion due to the continents' ambitious targets. A joint venture has recently been announced with Renault to build hydrogen-fuelled delivery vans in Europe. Companies that can provide technological solutions are going to become increasingly important for Europeans to meet the ambitious targets of the EU's Green Deal.

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