



MARKET COMMENTARY

Performance commentary – August 2023

Whilst August is proving to be a tough month for most asset classes, it has become particularly tough, from a relative and absolute term, for companies focused on clean energy and energy transition solutions. On top of this, higher yields have further impacted asset classes such as infrastructure, which has also seen weakness. Even before the summer, portfolios had been lagging from a relative perspective given the outperformance of large tech names, or those which fall under the ‘FAANG’ label. Given these issues, and the likely concern over near term performance, we have provided some commentary below given the likely increased questions our adviser audience may face in the coming weeks.

Yields higher for longer – impacting real assets

As we head into this week’s Jackson Hole Symposium, a global central bank meeting, the market has its focus firmly on the ‘higher for longer’ stance when it comes to interest rates, with many expecting the US Federal Reserve Chair, Jerome Powell, to confirm this when he talks on Friday.

This has sent yields to multiyear highs in August, continuing the upward momentum we have seen over the last two years, as reflected in the UK ten-year gilt below:



UK Ten year Gilt, Source: Bloomberg

This rise in yields has placed pressure on equity markets in general, with the all-country world index declining 5.24% in dollar terms so far in August. Property and infrastructure have declined given their interest rate sensitivity; although the declines seen are largely in line with general equities.

We commented in our previous report that the path of interest rate expectations will largely determine the turning point for these assets. Whilst we have seen these expectations move a little further, we maintain our thinking that

many of these assets are attractively cheap. Whilst attractively cheap to us, they will also be attractively cheap to private equity, which we feel will come into the market at some point.

In the near term, asset sales will provide comfort in the valuations (if close to the perceived value), and we have already seen evidence of this. For example, TRIG, the Renewables Infrastructure Group, has recently sold a small collection of wind farms from their portfolio at a 26% premium to their valuation from December 2022. Having spoken to alternative investment specialists in this space, who we hold within the model portfolios, they expect further events which will support a re-rating over time.

Given the discounts and unlikely ability to raise funds in the near term, share buybacks or mergers will provide some support, and again, we have some examples of mergers in sub-scale investment trusts in recent weeks. Many of these assets are still providing a healthy income level of between 5-8% yield. We know that expectations can turn back very quickly, we see this as increasingly likely and are positioned for it.

AI Rally & Big Tech

The first half of the year has been associated with the big tech rally, notably due to the euphoria around Artificial Intelligence which has captured investment meetings by storm, as well as investment flows into financially strong companies and the safety this offers. This has been reflected in the share price returns of many of the so-called FAANGs or 'magnificent seven' which make up a large part of many conventional benchmarks, but which largely do not form part of our investment universe. This is reflected in the FAANG index below:



FAANG Index, Source: Bloomberg

As mentioned, a number of these large cap tech names, such as Alphabet or Amazon, do not form part of our universe at this moment in time, largely due to the social concerns over labour, supply chains, corporate citizenship (taxation) and data privacy. This has meant portfolios have lagged versus the wider market as well as those 'lighter ESG' portfolios.

Having said this, portfolios have been exposed to a number of companies which have benefited from this AI-focused rally, predominantly through Semiconductor manufacturers given the increased demand required for generative AI models. Depending on the portfolio, Nvidia or Taiwan Semiconductor are held in a small handful of funds. Their H1 23 returns have been 189.54% and a more modest 36.74%.

Global clean energy and Energy Transition solutions

The recent sell-off in equity markets has been particularly painful for a number of clean energy and energy transition names, but this follows the trend we have witnessed over the last eighteen months. Companies providing solutions to these themes have faced significant cyclical pressures, whilst more specific issues have plagued electric mobility equipment companies and US residential solar. Whilst the volatility and drawdown in some of the companies/funds with this exposure has been concerning, we still believe in the long-term prospects given the focus and need to transition to a cleaner way of operating across various industries. The weakness in this theme is seen below in the clean energy index, which is down 24.19% year to date (21/08/23):



Clean Energy index, Source: Bloomberg

Looking forward, the catalysts of the Inflation Reduction Act and the Green Deal Industrial Plan are two examples of support that will, amongst other positives, increase funding. This has been well represented in the table below from a presentation we recently received from Rize ETF:

Relevant clause/commitment of the IRA	Environmental Subsector likely to benefit
\$USD 369 billion of clean energy tax credits. Examples include credits relating to components for wind, solar and battery technologies, carbon capture, utilization, sequestration, clean hydrogen production and clean fuel production.	Renewable Energy Generation Renewable Energy Equipment Hydrogen and Alternative Fuels Energy Efficiency Solutions Electric Vehicles & Green Transport
Direct consumer incentives could subsidize energy upgrades and include \$USD 9 billion for consumer home energy rebate programmes for both purchasing and retrofitting new electric appliances.	Energy Efficiency Solutions
Consumers can claim a \$USD 4,000 tax credit for purchasing a used EV and this jumps to \$USD 7,500 for purchasing a new vehicle.	Electric Vehicles & Green Transport
Advanced Industrial Facilities Deployment Program includes \$USD 5.8 billion for projects aimed at reducing GHG emissions through advanced industrial technologies in emission-intensive sectors such as the iron, steel, aluminum, cement, glass, paper, and chemicals sectors.	Pollution Control Energy Efficiency
Advanced Energy Project Credit supports projects involving low-carbon heat systems, carbon capture systems, energy efficiency measures, and other pollution reduction technologies and practices.	

Relevant clause/commitment of the GDIP	Environmental Subsector likely to benefit
A simplified regulatory framework will increase the production capacity of Net Zero products such as batteries, windmills, heat pumps, solar, carbon capture and storage.	Renewable Energy Generation Renewable Energy Equipment Hydrogen and Alternative Fuels Energy Efficiency Solutions Electric Vehicles & Green Transport
The Critical Raw Materials Act will introduce measures designed to secure supply, from an extraction, refining and recycling perspective, of the raw materials that form the building blocks of the energy transition.	
A relaxation of State Aid Rules and acceleration of existing financing schemes (such as the EUR 250 billion RePowerEU, Invest EU and the Innovation Fund) will provide loans and grants for the net zero industry.	Broadly impacting the full spectrum of Environmental Subsectors
The establishment of Net Zero industry academies to roll out upskilling programmes as well as increasing the EU's network of trade agreements will ensure everything is in place for the green transition. This should also benefit all the companies within the strategy.	

Source: Rize ETF (Presentation on Rize Environmental 100 ETF)

The War in Ukraine saw energy prices spike and it was laid bare how reliant Europe was on gas from the Russian regime. We have previously written about the importance of reliable energy for social and economic progress, and a focus on energy security shot up in the wake of the invasion. Despite concerns over the Chinese economy and global growth in general, supply restrictions put in place by OPEC+ producing nations have seen oil & gas rally this summer, with oil moving from around \$75 a barrel in June to \$85 a barrel in August. As reflected in the front month contract of Brent Crude below:



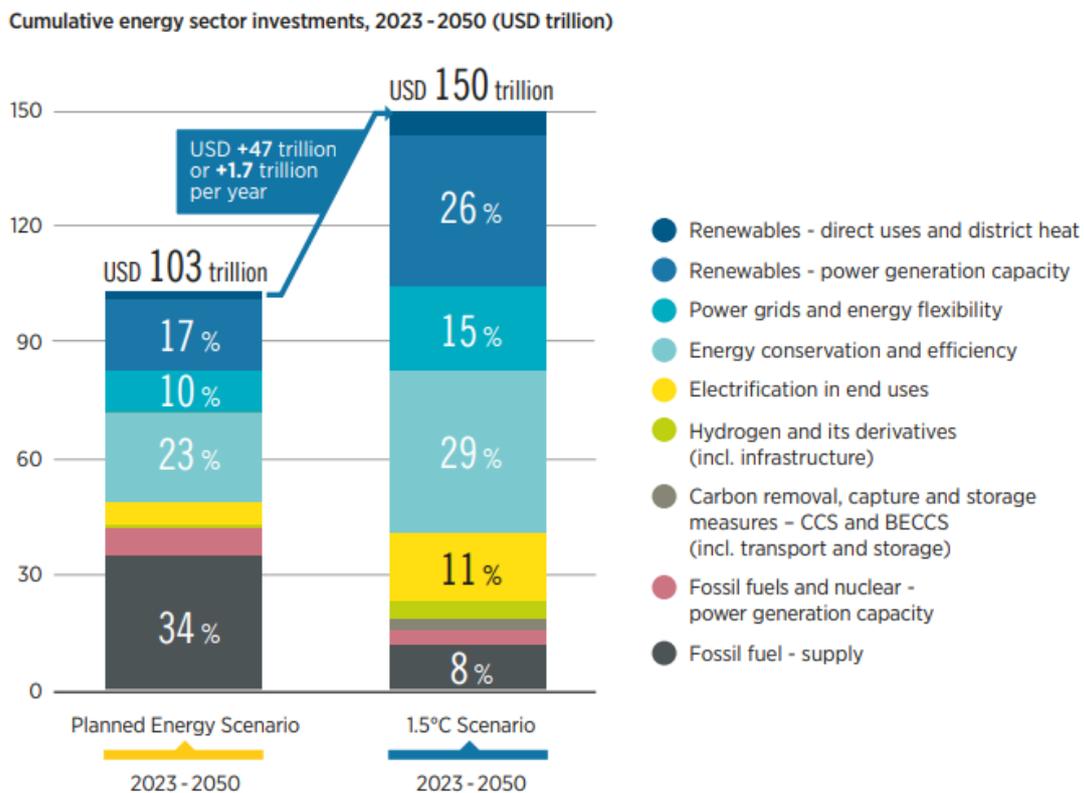
Brent Oil Price, Source: Bloomberg

Whilst concerns eased as we witnessed a mild winter last year, a rising gas price will once again shift the focus back onto the energy transition, which comes at a time when inflationary pressures in areas such as steel and certain rare earths have eased. This is a plus for companies such as Vestas Wind Systems, who we have favoured over its peer Siemens Gamesa, who has experienced quality issues with their wind turbines to the tune of billions of €s to rectify. Steel is a key commodity used in wind turbines, and makes up around 80% of the turbines' weight. With a sharp rise in the steel price in the post-covid recovery, companies such as Vestas Wind Systems saw their margins collapse. However, with steel falling well below the 2021 peak, as seen in the chart below, and coupled with higher turbine selling prices and economic sense to transition from gas, margins at Vestas and peers are expected to improve in the year ahead.



Morgan Stanley strategists expect it will cost €5 trillion to reach the European Union’s goal of lowering CO2 emissions by 55% by 2030, which is an eye-watering level of investment, particularly given the rapid rise in the cost of debt we have witnessed. Fiscal support will ease the burden, whilst the rapid tightening in monetary policy is expected to lead to a slowing economy and an eventual pivot by central banks. However, the shortfall of investment capital is worrying. On a longer term and global scale, data from the International Renewable Energy Agency in their World Energy Transitions Outlook 2023, has shown that we are currently projected to fall short of \$1.7 trillion in investment to reach the 1.5-degree scenario by 2050, as highlighted below:

Global investment by technological avenue: Planner Energy Scenario and 1.5-degree Scenario, 2023-2050



Notes: BECCS = bioenergy, carbon capture and storage; CCS = carbon capture and storage.

World Energy Transitions Outlook 2023, Source: International Renewable Energy Agency

With many investors focusing on areas such as Tech (AI) and other momentum trades, at some point the growth story will be fully priced in and a rotation back will take place. The weakness over the last couple of years has meant companies are much more attractive from a valuation perspective and will assist in seeing capital flow to companies focused on longer-term themes such as our energy transition.

Disclaimer

Please remember that the value of investments and the income arising from them may fall as well as rise and is not guaranteed. All information contained in this document has been prepared by King & Shaxson Asset Management. All opinions and estimates constitute our judgement as of the date of publication and do not constitute general or specific investment advice. Nothing in this document constitutes an offer to buy or sell securities of any type or should be construed as an offer or the solicitation of an offer to purchase or subscribe or sell any investment or to engage in any other transaction. The information contained in this document is for general information purposes only and should not be considered a personal recommendation or specific investment advice.

King and Shaxson Asset Management Ltd. (Reg. No. 3870667) has its registered office at 155 Fenchurch Street, London, EC3M 6AL. The Company is registered in England and Wales and is part of the PhillipCapital Group. King and Shaxson Asset Management Ltd. (FCA Reg. No. 823315) is authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN.