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Exclusion will not solve climate crisis

Nordea Asset Management's Paul Malpas says it is vital for investors to engage with heavy emitting companies (page 2)

Gresham House acquires fourth Anesco solar farm

Gresham House has acquired a 20MW solar farm in Devon from Anesco, as part of a £100m three-year development and construction partnership.

The Beavor Grange solar farm is the fourth site to transact under the 200MW ground mount solar partnership. It follows the acquisition of two 20MW solar farms in Gloucestershire and Derbyshire earlier this year, as well as a 50MW site in Lincolnshire last August.

Beavor Grange will be capable of generating enough clean energy to power about 5,000 homes – while helping to save approximately 4,500 tonnes of carbon emissions annually. The site will have a lifespan of 40 years, after which time it will be returned to its natural state.

Wayne Cranstone, investment director at Gresham House, says: "We continue to support new build solar to increase the UK's drive towards self-sufficiency in renewable energy, and so we were particularly delighted to have been awarded three Contracts for Difference on three of the solar parks under this partnership in the government's recent CFD auction round, AR4.

"This site has been sensitively developed with attention to biodiversity enhancement, as well as ensuring quality construction and efficient operation."

Engagement is key to transition

Paul Malpas
Nordea

"Like it or not, today's heavy emitters will play a crucial role in our transition"

Climate awareness has intensified in recent years, leading to a significant flight of capital from heavy emitting companies.

The rapid growth of ESG has been a key factor in this investor exodus, as asset managers seek to demonstrate strong sustainability credentials.

However, simply steering clear of high-emitting stocks and sectors is not the right approach for investors to take. While there will always be companies to avoid, many businesses just need a nudge in the right direction.

It is important for investors to engage with these largely forgotten companies, as like it or not, today's heavy emitters will play a crucial role in our transition to a more sustainable future. The expertise capital allocators can impart on corporates will be invaluable in efforts to curb real-world emissions.

Also, many environmental laggards are trading at historically cheap valuations, so the value that can be unlocked by helping high emitters decarbonise over the coming years is immense.

In order to enact meaningful change through corporate engagement, investors are best served by focusing on a number of primary sustainability factors. Unsurprisingly, the first key consideration is greenhouse gas emissions. Next, as economic production requires substantial energy inputs, energy management is paramount for successful climate action.

Water and waste management is another vital issue. The world's limited resources cannot meet growing demand, which creates long-term uncertainty for companies highly dependent on natural assets.

Similarly, companies need guidance on natural resource management. This includes using recycled and renewable materials, reducing the use of key supplies, and maximising resource efficiency in manufacturing.

Finally, corporate management teams must be willing to reposition businesses to be resilient to the transition and physical risks of climate change. Sustainable long-term value creation will be almost impossible if corporates are not responsive to the permanent migration to a low-carbon and climate-constrained economy.

US bargain buys in turbulent H1

Jacob Mitchell
Antipodes

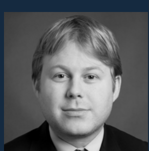
Leading pharma company Merck is a quality business not facing the same inflation pressures as other defensive parts of the market.

Almost one-third of its earnings are generated from vaccines and animal health – which have higher profitability relative to traditional drug development.

Merck manufactures the HPV vaccine Gardasil, which has been proven to prevent a variety of cancers and has a long runway for growth – while the animal health business has high brand equity.

In pharma, Merck's Keytruda is the most successful immuno-oncology drug. While the patent cliff begins at the end of 2028, Merck is preparing itself via combination studies with next generation immuno-oncology drugs that could extend Keytruda's dominance.

"Merck is not facing the same inflation pressures as other defensive parts of the market"



Gabe Solomon
T. Rowe Price

In our US Large Cap Value Equity portfolio, we have reduced our aggregate semiconductor exposure over the past nine months.

This was due to concerns supply chain challenges may have led to over-ordering, likely creating an air-pocket for demand and an inventory correction.

However, some companies were excessively penalised during the recent downturn. A good example is Qualcomm, which has been caught up in the sell-off affecting many of the higher multiple names within the information technology sector.

Near term, we expect Qualcomm to continue capitalising on the 5G rollout. Longer-term, it will benefit from its industry-leading cellular connectivity equipment, in what we anticipate will be an increasingly connected world.

"Some companies were excessively penalised during the recent downturn"

Paul Middleton
Mirabaud

In general, we do not hunt for bargains, but the market has clearly derated significantly from the highs, and there are some attractive opportunities in secular growth names. We would not be adding any cyclicality at the moment.

One secular growth opportunity we have recently added to the Mirabaud - Sustainable Global Focus Fund is Quanta Services, an engineering and construction company focusing on electrical grid building, maintenance, and repair. It is the clear market leader in this space, with 60% share.

This fits into our decarbonisation theme, as electricity networks need to be substantially rebuilt to withstand climate change and to join renewable power assets, which are highly geographically distributed.

"Electricity networks need to be substantially rebuilt to withstand climate change"

Evenlode climate targets accepted by NZAM

Evenlode Investment's interim climate targets have been accepted by the Net Zero Asset Managers (NZAM) initiative.

The independent Oxfordshire-based investment manager committed to its targets within 12 months of its joining NZAM last June.

Evenlode's targets are in line with its goal of achieving net zero by 2050 or earlier for 100% of its AUM. Importantly, these targets cover 100% of the group's scope 1, 2 and 3 portfolio emissions.

Charlie Freitag, stewardship analyst at Evenlode, says:

"We are able to do this because we have sufficient high-quality scope 3 data for our holding companies through our annual portfolio emissions analysis. Scope 3 data is derived from the CDP, as well as company reports and our own modelling and quality-checked in detail."

In support of these targets, Evenlode recently published a Net Zero Engagement & Voting Policy, which outlines its stewardship actions it will take to achieve its engagement and decarbonisation target.

Ben Peters, portfolio manager at Evenlode, adds: "The policy clearly sets out our engagement objectives for portfolio companies depending on their net zero alignment journey, as well as the steps we will take should these objectives not be met within the set timeframe."

Energy spike hits Europe growth

Katharine Neiss
PGIM Fixed Income

The risk of weaker growth and higher inflation in the euro area has grown in the past few months.

While many countries have made better-than-expected progress in refilling gas storage, pockets of vulnerability remain in certain parts of central and eastern Europe, where a lack of infrastructure means energy supply will be particularly constrained.

With wholesale prices doubling in Europe, the US has promised to fill some of the LNG supply left by Russia, but any meaningful increase in US capacity will take a few years to come online – leaving Europeans vulnerable.

We see inflation peaking at around 10% in Q4, roughly in line with consensus, but see further upside risk from the energy shortage. A 10% further increase in energy prices will likely push up headline inflation by around 0.5ppt, potentially delaying and lifting the peak of inflation to early 2023.

In terms of economic growth, our base case now assumes Europe will experience a mild recession this winter, bringing down 2023 GDP to 0.7% from 1.3%. Our updated forecast also includes a severe scenario, in which growth will contract as much as 2% next year.

Facing all these acute challenges, the ECB will likely have to raise rates throughout this and next year. Under an orderly rationing scenario, on which we place around 50% likelihood, we expect the target rate to be raised to 0.75% by year-end and reach around 1.5% next year – our estimate of the euro area's neutral rate.

There is a 30% chance the energy shortage will beget further rationing, and the ECB will have no choice but to hike rates even more aggressively to about 2% to guide demand lower to meet the constrained supply.

"The ECB will likely have to raise rates throughout this and next year"

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Palisade Real Assets acquires Malaby Biogas

Palisade Real Assets has acquired 100% of Malaby Biogas, a UK-based organic waste anaerobic digestion technology plant located in Wiltshire.

Malaby, which has been operating since 2012, processes between 500-600 tonnes of organic waste per week and provides about 2,500 houses with renewable power.

Malaby is part of the wider bioeconomy set to help the UK achieve its target of net zero emissions by 2050.

The acquisition of Malaby is the first investment for BioticNRG Ltd, Palisade Real Assets' dedicated UK bioenergy platform.

Stephen Burns, CEO of Palisade Real Assets, comments: "We are pleased to secure this high-quality bioenergy investment on behalf of our clients and BioticNRG. Led by Thomas Minter, the Malaby team are industry pioneers – leading the way in providing local, distributed renewable energy, integrated development and driving practical innovation into the sector.

"As part of the transaction, we are delighted Thomas has joined the Palisade Real Assets team. We look forward to working with Thomas to optimise the performance of Malaby and to pursue other high-quality bioenergy infrastructure investments and innovations for BioticNRG."

Yu Shimizu
SPARX

Abe impacts will live on

The assassination of Shinzo Abe will be remembered as a deeply sad day for Japanese politics.

Aside from his many other accomplishments, Abe's move to reform corporate governance within Japan was particularly well received by the global investment community, providing much-needed stability. We believe his tragic death will not mark the end of the positive transformation he set in motion.

Abe's successors have already signalled their intent to extend the former prime minister's popular market reforms, a clear cause for optimism around the country's investment outlook.

One of the major issues corporate Japan has grappled with over recent decades has been the lack of external and independent oversight at the board level. However, this has changed significantly over the past several years.

Looking at companies listed on the prime market of the Tokyo Stock Exchange – the market with the strictest standards – the percentage of businesses with boards composed of at least one-third independent external directors rose from 6.4% in 2014 to 58.8% in 2020, and this figure is expected to improve further.

The Corporate Governance Code previously stated senior management teams should feature at least two outside directors, but this was changed to 'at least one-third for companies listed on the prime market' in the 2021 revision.

"A deeply sad day for Japanese politics"

Barry Norris
Argonaut

Tiresome disaster movie

Observing the demise of Cineworld has been like watching a tiresome disaster movie populated by B-list actors with an entirely predictable ending.

Yet even after presiding over such a box office bomb, the Greidinger family management team still clings to the Cineworld wreckage, desperately hoping for a sequel and one last pay day.

At Argonaut Capital, we have been short Cineworld for more than four years. The forthcoming bankruptcy is entirely the fault of the Cineworld management team and its strategy of using too much financial debt to acquire other movie theatre chains, eager to build an empire in a sunset industry.

Cinema audiences have been in secular decline given competition from streaming, narrower exclusivity windows, and Hollywood films that cannot hold a candle to those made by previous generations.

Movie theatre owners have responded by raising ticket prices – making attendance unaffordable for many families – and promoting the sale of ancillaries. However, this is not an industry able to be saved by sales of popcorn and slush puppies.

Cineworld will now seek protection from its creditors, which will allow operations to carry on almost as normal. But since the company owns so little in the way of tangible assets, much of its debt will be unrecoverable and its equity holders will be wiped out.

"We have been short Cineworld for more than four years"

Bond market flexibility crucial

Arif Husain
T. Rowe Price

"Bond investors will need to think differently and adopt a broader, more flexible approach"

Bond market volatility is set to continue as markets prepare for life without central bank support.

After more than a decade of stimulus measures, central banks are withdrawing liquidity and hiking interest rates in response to multi-decade high inflation. This withdrawal is likely to be highly disruptive – and will ultimately have a much bigger impact on markets than economic growth forecasts.

Faced with rising rates and volatile markets, bond investors will need to think differently and adopt a broader, more flexible approach – emphasising active duration management and volatility management. Below, we explore three key risks, as well as mitigation ideas.

Risk 1 – rising bond yields. This year's sharp rise in bond yields has left many investors questioning how much longer the rout can continue. Although it is difficult to envisage further moves of the same magnitude, this rising rate environment is likely to continue until we see material signs of inflation receding.

We expect the environment to remain challenging for the foreseeable future, but at some point, there is likely to be an inflection point when valuations turn attractive and potentially great opportunities emerge in rates markets. Managing duration actively will be critical to navigating this environment. It also gives investors the flexibility to take advantage of any pricing anomalies and dislocations. A broad approach with the scope to invest in different markets across the globe may also be beneficial.

Risk 2 – volatility in credit markets to continue. The environment of slower growth and high inflation is likely to cause credit fundamentals to deteriorate, which we believe will lead to further volatility in this space. Furthermore, credit markets are sensitive to interest rate volatility – although the cushion to absorb this has improved this year. Over the past decade, the duration of corporate bonds has been extended, so investors may have become much more exposed to interest rate risks than in the past.

However, similar to rates, a potential great buying opportunity could emerge in credit. We are not there just yet, but valuations have improved. A defensive approach may work well in this environment, as deploying hedging strategies can help to navigate volatility. Managing duration actively is also important, given the duration risks to which credit portfolios may be exposed.

Risk 3 – stock/bond correlations are changing. Fixed income markets are going through a period of strategic change as central banks retreat. At multiple times this year, stocks and bonds have both sold off simultaneously, demonstrating the stock/bond relationship is not always constant and can change, especially in the current climate.

A broad approach deploying the full toolkit, including currency and derivatives markets, may help to balance and mitigate risks in a portfolio.