Affin Hwang Aiiman Global Multi Thematic Fund

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Energy transition trends momentum continues

In Collaboration With Schroders

The energy ecosystem needs to change in order to meet global goals of reaching net zero emissions

Energy transition is about the complete change in our energy ecosystem, impacting the way we produce, distribute and consume power. This requires three key structural shifts that are creating exciting opportunities for investors across a number of sectors:

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The first of these shifts concerns the **decarbonisation of power generation**, replacing electricity produced by coal and gas with electricity generated from renewables such as wind and solar.

The second concerns the **electrification of energy,** boosting the overall electricity consumption through things like electric vehicles, electric heat pumps, and other key electrical commodities.

The third concerns **improving efficiency of energy consumption**, using distributed energy production to produce electricity at the point of use. We are also using better building controls in energy efficiency solutions to improve the efficiency with which we consume and distribute power.

All three of these structural shifts are required to reach our net zero goals within our energy system, and we have continued to see increased momentum of these shifts over the past six months. Costs continue to fall, not only in renewables, but also in items like batteries and hydrogen. Consumer demand for electric vehicles, heat pumps, residential solar and other applications continue to grow and policy support around the world is becoming a lot more aligned. For example, the US President, Joe Biden recently announced details of his US$2 trillion infrastructure plan to modernise and cut emissions from the power sector, with the eventual goal of producing 100% carbon-free electricity by 2035.

We are also starting to see some of the conventional oil majors accelerating their business shifts, driven primarily by climate change activists and active asset managers, like Schroders. We continue to believe that these existing energy companies accelerating the shift in their business models is ultimately very healthy for the broader energy transition ecosystem and those companies themselves.

Global energy transition investment strategy and outlook

Concerns around inflation were at the front of investor's minds over the last few months. With respect to energy transition sectors, inflation threats come in two distinct forms.

The first concerns **near term supply chain bottlenecks and the impact the rising input and logistics costs could have on company earnings**, both this year and beyond. We have already seen a significant increase in the cost of key raw materials, such as copper, steel and aluminium, as well as an even larger rise in the price that companies need to pay to ship goods around the world.

The second inflation threat concerns the potential for longer term, **more pervasive inflation**, and the **potential impact that this could have on interest rates** and subsequently, financing costs and growth company valuations across the energy transition landscape.

While we are concerned about these short-term inflation threats, our longer-term view about the energy transition opportunity continues to go from strength to strength, as the fundamental drivers behind the space grow ever stronger. Valuations have also pulled back from their lofty highs at the start of this year, presenting a number of attractive opportunities for investors.

The Schroders energy transition investment team remain focused on identifying companies across the different parts of the energy transition supply chain that should be better at withstanding any near-term inflation threats.

We are attracted to companies that have significant earnings and cash flow generation potential, improving and higher returns, as well as robust sustainable business models, which we continue to believe is critical for companies to capture and ultimately best benefit from the energy transition investment trends to come.

Watch:
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