

Earth Day 2021: Investing in Climate Change Winners

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Going green has been never ‘cooler’ in today’s investment climate with more investors conscious about aligning purpose with profits. As the world pivots towards renewable energy sources and green infrastructure, the landscape is ripe with opportunities for investors. Simon Webber, Fund Manager at Schroders speaks to us more about his investment strategy behind picking climate change winners and outlook.

*Simon Webber
Fund Manager, Schroders*



The COVID-19 pandemic has been a wakeup call for investors surrounding sustainability issues, with pollution levels noticeably falling during the pandemic as economic activities were shuttered. What has the pandemic taught us about addressing climate change?

There are several parallels between COVID-19 and the climate change crisis. Most significantly, low income countries and population groups have been the hardest hit. In human terms, the impact of unmitigated climate change will be comparable to a permanent COVID-19 crisis. A study published in UK medical journal *The Lancet* concluded that the impact of climate change just on global food production could cause more than 500,000 deaths by 2050.

However, there is also one very important difference. There were few economic models and little public discussion that predicted the economic devastation a pandemic would bring. With climate change, we know a great deal about the devastating impact of inaction, that they will occur year after year, and that they can only be avoided by consistently investing to create a decarbonised economy. COVID-19 could provide an example of the significant impact that nature can have on our way of life, which will help generate more of the required political will to make these investments.

The pandemic also holds important lessons for financial markets. Market participants are increasingly likely to analyse the political response to climate change, with asset prices moving accordingly. If investment to decarbonise the economy remains insufficient, asset prices will likely increasingly move to price in risks of adverse climate events, increased risk premiums on the worst affected parts of the world, and a premium for climate change hedges. Conversely and more hopefully, if investment in a low emission economy can be accelerated, markets will likely reduce risk premiums. They may also widen the valuation dispersion between assets that benefit from a low emission economy, and those where asset lives need to be curtailed. Whichever path we eventually go down, climate change will likely have a much bigger impact on financial markets.



Walk us through the investment process of Schroder's climate change investment strategy. How are stocks identified and what qualitative/quantitative factors are used before they are included in a portfolio?

Underpinning the fund's investment strategy is a belief that the impact of climate change on the global economy and on individual companies will be far reaching and profound. We believe that companies that recognise the threats and embrace the challenges early, or that form part of the solution to the problems linked to climate change, will ultimately outperform the broader market.

Stock selection is the primary driver of performance and the fund typically invests in 40-70 stocks of companies exposed to five main sub-themes: Energy efficiency, sustainable transport, clean energy, environmental resources and low carbon leaders. Nevertheless, what is distinctive about our philosophy is our appreciation that climate change is going to impact every company and industry, so we look for opportunities across a global and diverse opportunity set rather than limit ourselves to particular sectors. This way, we are able to construct a well-diversified portfolio of different companies across different sectors, all linked to climate change.

As one of the pioneers of climate change investing, we don't believe in relying on traditional measures like carbon footprint and instead use proprietary tools and analysis to build a more detailed and accurate picture of how companies and industries will evolve and adapt. We look at how climate change will affect revenue, margins, running costs, valuations and the impact on the entire value chain.

This gives us the best opportunity to pick companies that will flourish as part of a low-carbon economy. Within the climate change investment universe, the team seeks to identify companies with a positive “growth gap” i.e. stocks we expect to deliver forward earnings growth that will exceed the market's expectations, and that screen well according to their view of the most relevant valuation metrics for each sector.

Outthink. Outperform.



This year saw the US officially re-join the Paris Climate Agreement. Are you expecting renewed commitment by countries globally to fight global warming and increase fiscal spending? How will that translate in terms of investment opportunities?

There is no single silver bullet to the threat climate change poses. It requires aggressive policies, rapid capital reallocation and strong financial incentives, amongst other measures. However, we believe that we may be on the brink of rapid change, not least with the US re-joining the Paris Agreement. Biden's pledge to rejoin and commit the US to a net zero emissions reduction target by 2050 is expected to mean significant investment into green industries and technologies. He has laid out a US\$2 trillion clean energy and infrastructure plan. It will also require tighter regulation of higher-emitting industries, including oil and gas, utilities and autos.

We see strong prospects for investments that are aligned with the energy transition – the growth outlook for electric vehicles, renewables, hydrogen power, battery storage and many more industries are expected to be turbocharged as a result.

We're seeing tougher and faster action to cut global greenhouse gas emissions in other regions as well. Most recently in Europe, the European Parliament and EU member states reached an agreement last year on a EUR1.8 trillion package, including a commitment that 30% will be spent fighting climate change – this is the largest share of the largest European budget ever. There have also been new net zero emissions pledges in Asia, with leaders in China, Japan and Korea having made net zero pledges in the last year. Finally, at the end of this year is an important United Nations summit that will bring countries together and strengthen their commitments under the Paris Agreement to tackle climate change.

We expect a lot of countries to introduce new policies and initiatives to increase the pace of their decarbonisation, and that should be a catalyst for action right across the climate change theme.



How have green or low-carbon investments generally fared throughout the pandemic? Are they more resilient compared to other thematic strategies?

In contrast to previous economic slowdowns, climate change and energy transition investments have performed strongly so far in the COVID-19 crisis. There are several reasons for this, most notably the continued improvement in economics across the sustainable energy space. During the 2008 crisis, wind and solar projects were still very expensive compared to conventional coal and gas, and as a result, renewable projects were often the first investments to be cut.

Today, renewable economics are far stronger and it is conventional power projects that are seeing cuts. Additionally, the financing environment for renewables has continued to be robust on the back of hugely significant green fiscal stimulus that will provide a further underpinning of capital – we've highlighted some of the commitments above. End-market demand for energy transition technologies has also been very resilient; the most obvious reflection of this is in the global electric vehicles market where sales of hybrids and battery vehicles have surged, while conventional sales have dropped aggressively. Alongside electric vehicles, similarly robust demand has been seen in the US residential solar market.

This is partly reflective of a broader uptick in the home improvement market, but also the underlying economic benefits that residential solar now presents.



With economies rebooting now and the narrative shifting towards that of jumpstarting growth with a focus on cyclicals, do you think there's still appetite amongst investors for ESG-themed solutions? Have investor's mind-sets changed?

Amidst further positive vaccine news as well as continued support from both central bankers and politicians, we do anticipate a strong global economic recovery in 2021 and expect the market recovery to broaden out over a wider range of sectors, presenting opportunities in areas which still have ground to make up after a challenging year.

Nevertheless, we believe that the focus on sustainability will last. The pandemic has caused a lot of people to consider their values and what is most important to them. For example, our latest Global Investor Study found that 77% of retail investors won't invest in something if it's against their personal beliefs. The relative success of sustainable funds in 2020 is very important because it was their first big test. This shows that sustainability isn't a 'luxury' that investors can only afford to think about in the good times; it's crucial in tough economic times too. There's also a misconception that there's a narrow audience for sustainable products, or that only young people are concerned about sustainability. More traditional investors like insurance companies also care about sustainability and are starting to drive the conversation. This has big implications for investing.

As the economy re-opens up however, we think that the interest for climate change investing is going to shift from 2020 where it was all about energy sub-themes. Sustainable food and fashion, and sustainable consumption will become very powerful themes. Home renovation will also fare well – there is a huge need to improve energy efficiency of houses around the world and to decarbonise heating. The major risk for investors in 2021 for low-carbon investments is actually valuations. After very strong performance last year, valuations across a number of sub-themes like clean energy and electric vehicles are now much higher.

We've made the portfolio more cautiously positioned with regards to valuations, and are only focused on companies that have clear competitive advantage and real leadership in their field, strong cash generation. We still have huge confidence in the theme in the long run, we just want to be a bit cautious in some parts of the market where there has been a lot of exuberance.

A Purpose-Driven Solution

Affin Hwang AM recently launched the Affin Hwang World Series – Global Climate Change Fund ("the Fund") in partnership with Schroders which provides access to opportunities in global equities as the world transitions into a low-carbon economy. By tapping into climate change winners, investors can benefit from a sustainable portfolio which has impact beyond just financial returns.

Investors who are keen to learn more can contact us at 1800 88 7080 or visit <https://affinhwangam.com> and invest through any of Affin Hwang AM sales offices. Investors are advised to read and understand the contents of the Fund's Product Highlights Sheet, Information Memorandum dated 25 March 2021 before investing.

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