

BUILDING THE NEXT BULL RUN IN 'GREEN' INVESTMENTS

We are now looking back on over a decade of artificially low interest rates put in place by developed country central banks, sparked by the financial crisis and a battle against deflation, thanks to China exporting low prices as globalisation took off. This period of easy money culminated in 2021 with unprecedented levels of monetary stimulus during the pandemic. There were suggestions that inflation was 'dead', amid an 'everything rally' where assets with little actual intrinsic value (such as speculative cryptocurrencies; non-fungible tokens (those strange pictures of apes if you remember); meme stocks; and a selection of profitless companies) were the beneficiaries of swathes of speculative buying.

This time is different?! Unfortunately, not. With interest rates at zero, people could borrow money at minimal cost and obviously favoured the acquisition of assets over the tiny amount of interest accrued on their savings. Couple this with the onset of Covid, more free money in the US in the form of 'stimulus checks' and furlough payments in the UK where many people at home had nothing to do but watch stocks go up and pump their own savings into the market, these assets rose even higher.

Unfortunately, it was at this time that ESG, carbon reduction and sustainable stories really began to garner mainstream attention. These stocks felt like a 'no brainer' as everyone learned the consequences of not reducing carbon emissions and transitioning to a sustainable economy. Companies with an ESG product or story were viewed as a shoo-in to making a quick buck. Whilst starting to gain attention, the sustainable investing movement was not yet mainstream, and only a select few, such as TAM, who have been running ESG portfolios for ten years, spotted the opportunity. In the asset management industry, there were sustainable funds coming to the market, but they were all relatively concentrated in the same few companies.

These companies and the gains they made from 20-March-2020 to 31-Dec-2021 (the length of the Covid-rally) are listed below.

Amazon: 82% | Apple: 214% | Google: 173% | Meta (Facebook): 130% | Microsoft: 151% | Tesla: 1151

However, after years of essentially free money, the pandemic and the energy crisis following Russia's invasion of Ukraine the system finally broke leading to huge inflationary pressures. We were told by central banks that inflation would be temporary – a prediction that proved false, in spectacular fashion - and 2022 saw the narrative of these sustainable darlings unwind as people slowly got to grips with the idea that central banks now had a new challenge: the return of inflation. Interest rates rose, and long-dated investments which are particularly sensitive to interest rate rises, such as the mega-cap tech names and sustainable darlings all valued on their capabilities years into the future and a cost of capital of nearly zero, saw the ebullient narrative surrounding them unwind, and with it their valuations. Unfortunately, when everything comes as easily as gains did in growth stocks, investors are reluctant to give up a 'good thing'. TAM is not chasing the, in our view unsubstantiated, rally this year. (Tesla is now down only 47% in the last year, after a 76% rally so far in 2023).

This shakeout in valuations has coincided with a huge expansion in the ways in which you can invest in ESG products. When TAM started running ESG model portfolios vast majority of ESG funds invested 'responsibly' by screening out sectors like tobacco and alcohol. By 2020 there were established strategies which invested 'sustainably' leading them to high growth winners in a sustainable future. Now, the ESG universe has expanded to a point where we see a diverse range of opportunity set across countries, sectors, styles, and different asset classes.

The story has been built out to harness a greater portion of the investment opportunity. Below is an extract taken from my investment note in December - a salient point that needs to be repeated:

"Global emissions must fall by 33% from 2010 levels by 2030 to limit climate change to the 2°C limit agreed in the 2015 Paris Agreement. They are still increasing. Estimates of critically needed financing total $3-6 trillion per year, all the way to 2050. The current investment is a fractional $630 billion."

The market was correct in its view that the funding was a necessity, but wrong in thinking that it would be achieved by funding a small subset of companies and trends. The market has adapted to the view that to save our planet we need to invest across core diverse themes, which I believe are best outlined by the six

environmental objectives in the EU's Taxonomy:

1) Climate change mitigation
2) Climate change adaptation
3) Sustainable use and protection of water and marine resources
4) Transition to a circular economy
5) Pollution prevention and control
6) Protection and restoration of biodiversity

The EU Taxonomy remains difficult to map due to its incredibly stringent 'do no significant harm' (DNSH) criteria, but we see the environmental themes as a thematic guide. Alongside the broadened understanding of what is needed to save our planet, there is an increased understanding that you cannot just invest in an end result, you also in the transition to get there. There is now an acceptance that you cannot just build and invest in sustainable sectors, you must also make the unsustainable sectors sustainable.

There has been no panic on our part as markets have sold off, but rather we have been taking the opportunity to build a portfolio of quality companies benefitting from resilient themes, taking advantage of the expansion of the ESG story and aligning to a more diverse approach. In the last year we have added two equity funds to our ESG proposition which are specifically targeting EU taxonomy objectives 1 & 2, one specifically targeting 3 & 5, and one specifically targeting 4 and 6. All are at long-term discounted valuations and two are discounted share classes for our clients.

When others are fearful, be greedy.

TAM has not just taken the opportunity to invest in diversified themes within our ESG portfolios, but also to innovate and add asset class and style diversification into our portfolio. Returning to EU taxonomy objectives 1 and 2, we have added a market neutral climate fund which sees the opportunity to generate positive long-term returns by buying companies which are undervalued when you take into account their ability to contribute to and survive in a much warmer world, and by shorting companies the market overvalues in their ability to adapt and provide solutions. The result is a fund that is poised to benefit from a long-term theme and a wall of funding but does not always move in the same way as equity markets which are often driven by sentiment, inflation prints and rate announcements. As TAM were one of the first to invest in this innovative strategy, we can offer our clients a discounted share class as founder investors, consequently cheaper than many of our peers.

Not only are the opportunities for investing sustainably becoming more compelling because we can spread our exposure over a wider range of different themes which are, we believe, primed for substantial

capital investment - but these opportunities have become cheaper over the past 18 months while the investment case has actually strengthened. To protect our world and its climate, with every day that goes by without action, the speed at which we will need to act grows.

Legislation is finally coming round to the issue, with President Biden signing the historic Inflation Reduction Act in 2022, marking the most significant action Congress has taken on clean energy and climate change in the nation's history. The EU has now become concerned that the US is going to be the best place for green businesses to set up, so are responding with the similarly accommodative green deal industrial plan that sets the stage for
even more investment.

This feels like just the start.

We saw a broad rally in green stocks on announced legislation, but picking out which are going to truly benefit longterm – that's the job of TAM's investment team. We are now preparing our ESG portfolios for the next bull market to be led by the transition to a sustainable economy. In the meantime, our funds are still generating positive impact across many social and environmental themes coupled with market-leading engagement to create positive change, rain or shine

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