LOMBARD ODIER
INVESTMENT MANAGERS

LO Funds
Future Electrification
Newsletter

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MARKET REVIEW

In Q3 2024, global equity markets experienced a dynamic mix of progress on inflation, monetary policy shifts, and rising volatility. Early in the quarter, US inflation data surprised positively as housing costs decelerated, marking a return to pre-pandemic levels. This development, coupled with dovish comments from the Federal Reserve, fuelled expectations for upcoming rate cuts. US growth remained resilient, with strong retail sales and robust capacity utilisation, while the eurozone economy stagnated due to weak manufacturing, particularly in Germany. In China, disappointing outcomes from the Politburo meeting hinted at the need for more substantial stimulus, but only moderate policy adjustments were made by the central bank. August was particularly volatile for equity markets. A sharp early-month selloff, driven by concerns over AI monetisation, weakening US economic data, and a surprise rate hike by the Bank of Japan, rattled investors. However, the market quickly recovered by mid-month, supported by a strong corporate earnings season, where US companies largely beat earnings expectations, despite weaker sales numbers from mega-cap tech firms like Alphabet and Tesla. Concerns about US-China tensions over chip export controls added to the uncertainty, but volatility subsided as the month progressed. September marked a pivotal moment as the Federal Reserve initiated a larger-than-expected 50 basis point rate cut, signalling a shift in focus from inflation control to labour market support. This was followed by further easing from European central banks, while China announced a coordinated package of stimulus measures aimed at stabilising its economy, supporting its housing market and boosting liquidity. These accommodative moves across major economies provided a tailwind for risk assets, leading to a broad rally in global equities by the end of the quarter.

PERFORMANCE COMMENT

In the month of September, the Future Electrification Fund outperformed its index, the MSCI ACWI ND. This was largely driven by strong allocation, particularly in Utilities, and a lack of exposure to Healthcare. Selection in the month was slightly negative. At a stock level, the key performers were Vertiv (power equipment for data centres, +18.5%), AES (renewable developer +17%, with strong exposure to powering data centres), and BYD (EV and battery manufacturer +18%, continuing to roll out a compelling product set). The main detractors to performance were Samsung (memory and electronics producer -15%, suffering from cyclical rather than structural memory pricing), SOITEC (semiconductor materials -19%, continuing to struggle in light of inventory corrections), and ST Micro (industrial semiconductor producer -13%, with concerns particularly in the auto segment). On a quarterly perspective, we saw a moderately positive allocation effect driven by our holdings in Utilities and Healthcare. Selection during the quarter was slightly negative. From a stock perspective, BYD had a strong quarterly performance, up 23%, as did Vertiv, which delivered +29%. Accenture also had a positive period as growth leveraged to AI rollouts began to come through. On the negative side, Cadence (-12%) and St Micro (-28%) both suffered from concerns over the industrial and computing recovery being pushed out. As discussed below, we decided to exit St Micro.

FUND ACTIVITY

In the month of September, the Future Electrification Fund made an investment is ASML, a Dutch company that is a global leader in building advanced semiconductor manufacturing equipment, particularly lithography machines used in the production of computer chips. These lithography machines are critical for the ongoing miniaturisation and increased performance of semiconductor devices. By enabling the continued scaling and miniaturisation of semiconductors through its cutting-edge lithography equipment, ASML contributes significantly to improving the energy efficiency of a wide range of electronic products, from smartphones and laptops to data centre servers and electric vehicles. Smaller, more power-efficient transistors reduce the energy needs of the devices they power, which is crucial for driving down global electricity usage and carbon emissions. We see near-term weakness in the share price as a compelling entry point for what is ultimately a critical product at the forefront of driving semiconductor efficiency. This was funded by selling Vertiv, where we had valuation concerns, and by exiting St Micro, where the auto downcycle exceeded our expectations to the downside.

OUTLOOK FOR THE STRATEGY

Despite facing cyclical headwinds, the secular trends driving the global electrification movement remain firmly intact. Over the last couple of years, numerous regulators and governments have implemented climate-related legislation. The US introduced the Inflation Reduction Act (IRA) in 2022, which was further clarified in 2023 through guidance issued by the US Treasury. These measures are expected to accelerate the US clean energy sector's growth. In response, Europe introduced the Green Deal Industrial Plan in February 2023, followed by the NZIA in March 2023, with the goal of enhancing Europe's net-zero industry and supporting a rapid transition to climate neutrality. In late June 2023, the EU announced the establishment of the Strategic Technologies for Europe Platform, aimed at promoting and increasing investment in critical technologies across the continent.

Despite the uneven performance of our key investment themes in 2023, we maintained a positive outlook on their long-term prospects. As interest rates decline globally (apart from the specific case of Japan), a narrative for an economic soft landing is starting to take shape, potentially favouring a broadening of the equity market performance in the second part of 2024 and into 2025. Our portfolio delivers superior growth and higher returns compared to the index, while maintaining an attractive valuation. We believe that our diversified exposure to the global power system transition provides robust growth opportunities, while mitigating downside volatility.

FUND STRATEGY

Electrification is poised to become one of the most transformative system changes in the history of capitalism, presenting one of the largest investment opportunities to date. The convergence of falling costs, significant efficiency improvements and widespread accessibility is paving the way for numerous electrification tipping points. An estimated USD 24.5 trillion in capital expenditure is projected to be deployed over the course of this decade. We anticipate a substantial shift in revenue streams across various aspects of energy demand, supply and enabling solutions.

Our investment strategy revolves around capitalising on the opportunities arising from regulations, innovations, services and products that align with the transition to a more environmentally friendly, circular, leaner, inclusive and cleaner world. The key themes of our investment strategy revolve around demand-side electrification, including mobility, building and industrial sectors. We also focus on green power supply, which encompasses renewables, battery technology and related infrastructure such as cables. Additionally, we target electrification enablers, including critical components such as infrastructure, semiconductors and materials that support the electrification ecosystem.

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