
LO Funds

Future Electrification

Newsletter

Sustainable Equities • Equities

30 November 2024

MARKET REVIEW

November was marked by the US presidential election. The outcome has delivered a clear Republican victory, giving US voters a path to unimpeded “America first” policies. Republicans are now expected to take control of all four levers of US authority—the White House, both chambers of Congress, and the already-conservative Supreme Court. This shift is likely to usher in policies that focus on deregulating key industries, lowering personal and corporate taxes, and introducing tariffs likely detrimental to China, Europe or Mexico. Domestically, this may lead to higher US nominal growth, inflation and interest rates, albeit gradually normalising from current elevated levels. For example, increased tariffs could encourage domestic US production, especially if combined with potential reductions in corporate tax rates from 21% to 15% for companies producing domestically. This policy direction aligns with the continuation of the “reshoring” theme and restoring critical supply chains to the US. Overall, while specifics are yet to be detailed, market dynamics have aligned with this initial perception. US equities, in particular US small caps, drove the global equity market strongly higher, while European and emerging equities ended November effectively down. US Consumer Discretionary, boosted by Tesla and Retail, and Financials, boosted by the perception of more favourable regulation and a steepening yield curve, were all key outliers globally over the month.

PERFORMANCE COMMENT

Future Electrification was up in November but lagged the MSCI All Countries World due to strong thematic headwinds. A third of the lag was due to negative sector allocation effects in Materials, Information Technology and Utilities. Stock selection was also weak, mostly within Information Technology and Utilities, which was not fully offset by good stock selection within Industrials.

At the stock level, the biggest detractors in November were companies impacted by political headwinds, i.e. the decline of BYD, reacting to news of US tariffs that could affect its Mexican plant. Furthermore, clean-power related stocks declined, with Enphase (inverters for solar panels) and AES (transitioning power producer) impacted by expectations of potential rollbacks in US renewables policies. Finally, the

shares of Wheaton Precious Metals came under pressure after profit-taking following a strong rally YTD.

On a positive note, the top contributors in November were Quanta and Aecom, both of which delivered positive performance, with expectations that the new government will be supportive of infrastructure spending in the US. Tesla demonstrated strong performance, driven both by expectations that a roll back in EV credits will see it gain market share given its industry-leading profitability and also that deregulation could drive a faster rollout of self-driving car technologies.

FUND ACTIVITY

During November, no new positions were entered. However, we reduced our exposure to large technology companies like Microsoft and Alphabet while increasing our position in Amazon, where we see a greater risk reward potential. Additionally, profits were captured in some of our previous metals exposure where we felt valuations became less compelling. These proceeds were used, for example, to top-up some of our renewable power exposure, e.g. Enel and HA Sustainable Infra. Capital now seems more attractive after having been under pressure recently. Finally, we have been slowly raising the weighting in our lithium exposure as we believe that the market is operating at the bottom of its cost curve with very low expectations of a rebound.

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 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 growth of the clean-energy sector in the US. 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 European Community announced the establishment of the Strategic Technologies for Europe Platform, aimed at promoting and increasing

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investment in critical technologies across Europe.

Despite the challenging performance of our key investment themes in 2023, we maintain a positive outlook on their long-term prospects. As interest rates are being lowered globally, apart from Japan, the narrative of an economic soft landing has started to take shape, favouring a broadening of the equity market performance into the second part of 2024 and potentially 2025. Our portfolio delivers superior growth and higher returns compared to the index, all 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 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 encompass demand-side electrification, including mobility, building and industrial sectors. We also focus on green power supply, encompassing 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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