
LO Funds

Future Electrification

Newsletter

Sustainable Equities • Equities

31 October 2024

MARKET REVIEW

In October, the US constructive narrative continued amid solid economic growth and a resilient labour market. Most economic data released added support to the soft-landing narrative, or even a no-landing one, helping to push back against recession fears. It is worth noting that the stronger-than-expected US job data led to a sharp uplift in US yields and the USD versus most major currencies. The economic backdrop in the EU stands in stark contrast to that of the US, with recent weak Eurozone data, including contracting PMIs, softening inflation figures (below ECB target) and deteriorating consumer sentiment. In China, the various announcements in October were perceived as insufficient and fell short of the major stimulus expected from previous months' indications. In parallel, China-EU tensions escalated as China imposed anti-dumping measures on imports of brandy in a tit-for-tat response to the EU duty tax imposed on Chinese EV vehicles.

On the corporate front, the quarterly reporting season started. In terms of earnings surprises, Communication Services (driven by Alphabet), Financials (driven by diversified Banks) and Healthcare (driven by large traditional pharmaceuticals) were the strongest sectors. The Information Technology sector was, in general, "just" in line with expectations due to soft figures from semiconductor and IT hardware companies. Among the top 10 companies in the equity market (c. 25% weight), while Amazon and Alphabet were strong, Microsoft was under pressure as it forecast slower growth in its cloud business. Meta shares slid after it indicated "significant" growth in capital expenditure next year.

PERFORMANCE COMMENT

In the month of October, the Future Electrification Strategy lagged its reference index. Sector allocation was a slight negative drag and stock selection made up the rest of the drag. In general, our thematic focus on electrification was the key driver of the lag, but we remain convinced in its longer-term structural investment appeal. From a selection perspective, we saw Enphase's share price dropping 26%, with the market penalising its push for the solar market recovery, particularly in Europe. AES' shares were also weak (-18%), with an EBITDA miss at the recent results overshadowing the robust renewables pipeline.

Finally, ASML downgraded 2025 guidance, which saw the stock fall 20% as tough comps in China continue to be rebased by the market. On the positive side, we saw our precious metals exposure perform strongly considering higher interest rates, and we continue to believe the demand profile for silver is underestimated given its use in the solar and broader industrial market. Furthermore, NVENT (+8%) was strong, with this high-quality business rewarded for its portfolio rationalisation around key electrification markets despite some initial dilution.

FUND ACTIVITY

The Future Electrification Strategy initiated two new positions during the month. The first is in Albemarle, which we previously owned, where we have increasing conviction in the bottoming of lithium market dynamics, with the company still commanding an industry-leading position on the cost curve. We also added Delta Electronics, which we believe is an undervalued play on the theme of powering AI – despite a very compelling product portfolio, we believe embedded expectations are very modest for the business. To fund these new positions, we largely reduced our Utility holdings, such as Nextera and CMS, which had performed very strongly this year.

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 United States 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 investment in critical technologies across Europe.

Despite the challenging performance of our key investment themes in

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2023, we maintain a positive outlook on their long-term prospects. As interest rates are being lowered globally, apart from the specific case of Japan, the narrative of an economic soft landing is starting to take shape, potentially favouring a broadening of the equity market performance into the second part of 2024 and 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 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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