Candriam Sustainable Equity Climate Action

Market Overview

In August, the global stock market closed the month with a modest gain, despite experiencing a significant correction the first week. This downturn was primarily driven by a sharp decline in the Japanese stock market, as the BoJ adopted a more hawkish stance. As a consequence, the carry trade unwind pushed the Japanese market to plunge roughly 20% in 2 days. However, the stock market recouped the full loss toward the end of the month, driven by expectations that the Fed might cut interest rates more quickly as inflation continues to ease and unemployed rises, partly due to increased labour force participation. Despite this optimism, the manufacturing PMI remains in contracting territory, suggesting ongoing weakness, while the services PMI saw a slight rebound. Overall, the current macro environment is signalling slowing growth and investors are still evaluating the potential impact of the significant rise in interest rates over the past 3 years. As a result, the market narrative is shifting quickly and we observe a return to the dynamic where good news is good for the market and bad news is negative, as investors react more directly to economic data.

Sector-wise, IT and Communication Services performed the worst as the market continue to transition from year-to-date winners to laggards. Investors were selling the AI bucket in August while earnings were good. Conversely, rate-sensitive sectors such as Utilities, Financials and Real Estate led the market, driven by lower rates and increased expectations that the Fed will start cutting rates in September.

The S&P Global Clean Energy index is up 1.66% during the month. As a result, year-to-date performance stands at -10%.

Portfolio Highlights

In August, the fund returned 1.51%, underperforming its benchmark by 103bp. The MSCI AC World NR© ended the month up by 2.54%. Year-to-date, the fund underperforms its benchmark by 752bp, despite a positive absolute performance of 8.45%.

In terms of absolute performance, our position in SUNRUN (Industrials) was the standout gainer, rising by 16.6%. With a positive impact of 22bp, TETRA TECH (Industrials) was the main contributor to the excess portfolio return. NEXTERA ENERGY (Utilities) as well as TRANE TECHNOLOGIES (Industrials) were also strong contributors (13bp and 12bp respectively).

SUNRUN is a US provider of residential solar leases. The Q2 results have shown strong cash generation improvement validating the management strategy as well as the benefit from the IRA related tax adders. The company is well positioned to benefit from a move down in rates as it would raise both the growth prospects of residential solar and the value creation per customer.

TETRA TECH provides high-end engineering and especially environmental consulting services across water, environment, sustainable infrastructure, renewable energy, and international development. With initial roots as more of a US government think-thank and its resulting tremendous technical expertise – Tetra Tech is winning more than its fair share of upfront design, planning and research contracts related to significant programs such as the IIJA, IRA, PFAS remediation, etc. This is also reflected by its high backlog and strong order intake, which we expect will continue.

NEXTERA ENERGY is a US Electric Utility. The company is the biggest renewables developer in the US and is leveraging its position to benefit from the datacentre related electricity demand. Nextera had an analyst day in July dedicated to this opportunity and highlighted a pipeline of 7GW of capacity linked to Data Centre customers.

Last month's worst absolute performers were TOPBUILD CORP (Consumer Discretionary) and SPIRAX-SARCO (Industrials), which returned -17.9% and -13.1% respectively. TOPBUILD CORP was the main detractor from relative performance with a negative contribution of -37bp. After a 24% rally in July, TopBuild gave up most of that performance in the tumultuous first week of August on the back of weaker than expected job market data, stalling housing starts and weak PMIs. Its Q2 results disappointed somewhat as commercial & industrial customers delayed projects. Spirax underwhelmed with its Q2 results and downgraded medium term guidance, acknowledging that the recovery in biopharma and wafer fab equipment will not materialize as expected in H2 but more importantly that its hitherto robust Steam business had disproportionately benefitted from Chinese industrial capacity buildouts, which have now stalled.

In August, we introduced NVENT ELECTRIC to our portfolio (+0.5%) and reinforced our exposure to SYNOPSYS and CADENCE DESIGN SYS, both belonging to the Information technology sector, from 2.5% to 2.8% and from 2.6% to 3.0% respectively. We sold our positions in SKF AB-B and decreased the positions in TOPBUILD and DANAHER, from 1.8% to 1.0% and from 2.3% to 1.9% respectively.

Fund Outlook

The investment landscape in 2023 had been marked by a positive year for equity indices, though with uneven performance. Investors went into the first quarter of 2024 optimistic that a soft landing was in store for the economy, whereby a recession would be avoided, inflation would continue to improve, and the Federal Reserve would start cutting interest rates in March. Not only has the economy avoided a recession, it has been stronger than expected. This economic strength, esp. in the US, has translated into inflation remaining higher than expected. In turns, the anticipated policy rate cuts from the Federal Reserve have continuously been pushed out since the start of the year. While investors were pricing in six rate cuts at the start of 2024, this has come down significantly on signs of continued economic strength. Looking ahead to the rest of 2024, a continued soft landing is anticipated for developed economies, with stabilization also expected in the Chinese market.

Next to these broader economic trends, the outlook for the climate change investment theme remains highly positive, underpinned by a confluence of powerful forces that are making renewable technologies increasingly cost-competitive and indispensable.

In the utility-scale power sector, the economics of clean energy have reached a tipping point. It is now cheaper to build new onshore wind and solar projects than to operate existing fossil fuel power plants in most parts of the world. This has led to a surge in renewable energy deployment, with global clean energy investment reaching a record $1.8 trillion in 2023, up 17% from the previous year. Analysts expect this momentum to continue, with battery storage capacity projected to grow by 82% and solar capacity by 40% in 2024 in the United States alone.

Importantly, the clean energy transition is being driven not just by economics, but also by a growing sense of energy security and industrial competitiveness. The global energy crisis of 2022 has underscored the vulnerabilities of fossil fuel-dependent systems, while China's dominance in clean energy supply chains has heightened the strategic imperative for other countries to accelerate their own transitions.

Looking ahead, the commitments made at the COP28 climate summit in 2023 – including the goals of tripling global renewable energy capacity by 2030 and accelerating the phase-out of fossil fuels – are expected to further catalyse the clean energy transformation. Governments, businesses, and citizens are increasingly aligned in their demand for climate action, making the clean energy transition an unstoppable force in the years to come. Overall, the positive trajectory of the Climate theme is driven by both environmental imperatives and compelling economic opportunities.

We remain convinced that the orchestrated efforts between regulators, companies and investors to reach the climate goals provide a multi-decade investment opportunity and that finding the right pockets of the value chains and selecting the right companies within them will lead to alpha generation over time.

* net of fees in USD terms
** net return in USD terms