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Clean Economy strategy

We see an increased emphasis in Europe on the importance of shifting to a circular economy

- Global equity markets continued their strong performance through July
- Performance spread across all four themes
- Quarterly earnings and outlook statements demonstrate the resilience of business models across the Clean Economy

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What's happening?

Global equity markets continued their strong performance through July. Growth has continued to outperform Value during the month, and investors continue to reward those sectors which appear to benefit from either secular growth or near term opportunities. Businesses with healthy balance sheets continue to outperform the broader market.

For Sustainable Transport, second quarter earnings have confirmed recent data pointing to a recovery in auto production in Europe and North America, with management broadly indicating greater optimism for the second half of the year, supported by low inventory levels and pent up demand. The electrification of vehicle sales continues, led by Europe where new energy vehicle penetration of new car sales year to date has more than doubled compared to 2019¹. The US market is also showing penetration of new energy vehicles in auto sales up 30% compared to 2019². Whilst we continue to expect significant weakness in broader auto sales throughout 2020 and into 2021, we remain optimistic for the ongoing electrification of the vehicle fleet. This is supported by strong new mass market model launches from the second half of 2020 and the expanded commitment to charging infrastructure investment.

In Smart Energy, we note the ongoing commitment to utility scale renewable developments globally and to the increased focus by corporates on the procurement of green power. The Next Generation EU plan sets out a green EU recovery package which is intended to accelerate the Energy Transition in Europe. Large corporates are becoming increasingly vocal

¹ Clean Technica – June 2020

² Jefferies, Auto Tech & Connected Mobility – July 2020

about their commitment to sustainable growth underpinned by Net Zero targets. We have seen a notable pick up in interest in Green Hydrogen pilot projects

In Responsible Nutrition, food ingredients companies continue to support their customers as they capitalise on the sharp move from food service to food retail, whilst looking forward to serving the continued shift toward a cleaner, more sustainable food supply chain. These businesses have demonstrated resilience thus far and we remain optimistic in their ability to support the longer term drive toward resource efficiency and sustainability in the food supply chain.

In Recycling and Waste reduction, we are seeing evidence of a sustained recovery in commercial volumes as developed market economies gradually re-open. Hygiene considerations have increased the proportion of single use packaging in many settings, presenting an opportunity for those businesses able to create more readily recyclable single use items and to recycle them efficiently. We note an increased emphasis in Europe on the importance of shifting to a circular economy, with single use plastics a particular focus.

Portfolio positioning and performance

The Clean Economy strategy outperformed the broader equity market (MSCI All Country World) during June, with positive contribution spread across all four themes.

In 'Smart Energy', TSMC, Hannon Armstrong, Nextera all performed well. TSMC responded well to solid quarterly earnings at which management raised full year guidance in response to improving end market outlook. NextEra also reported strong earnings and an investment in a Green Hydrogen pilot project. Hannon Armstrong performed well as confidence in second quarter earnings rose. Within 'Sustainable Transport', Tesla continues to outperform as a result of both strong execution on its expansion plans, and to improved sentiment toward the electric vehicle market. More broadly, the theme responded well to increased confidence in the outlook for the auto sector. In 'Responsible Nutrition', Thermo Fisher, Danaher, Xylem and Deere all performed well in response to earnings and outlook statements which surprised positively. 'Recycling and Waste Reduction' contributed the least during June, despite a sequential improvement in volumes and earnings for the theme. We made no material changes to the portfolio during July.

Outlook

US Green policy under a Trump presidency remains unclear, and the primary focus for the presidential election will be healthcare. However, both the EU and its member states have underlined their commitment to Net Zero 2050 and set the framework for a green recovery in Europe. China has also indicated that EV charging infrastructure and rail will be beneficiaries of stimulus measures. In addition to existing consumer trends and cost effective technologies, this represents accelerated opportunity for the Clean Economy.

We retain the view that high quality management teams, operating businesses with a sustainable competitive advantage in their markets and with the benefit of secular tailwinds are best placed to weather the current storm and to seize opportunities for growth. The portfolio is therefore well positioned to benefit from the secular growth opportunities we see within the Clean Economy.

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