CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Candriam Sustainable Equity Climate Action

Market Overview

Despite a hesitant start, global equity markets ended the first month of the year with a positive performance. Investors welcomed decent economic figures in the US and digested changing interest-rate cut expectations by the Federal Reserve well. A first rate cut by the Fed in March is no longer expected, whereas the European Central Bank reiterated to remain data-dependent for future interest-rate decisions.
In this context, growth outperformed value and defensives outperformed cyclicals. From a sector perspective, Information Technology and Communication Services continued to outperform. They were the best performing sectors in the first month of the year. Health Care and Financials also outperformed in January. Materials, Utilities and Real Estate were the biggest underperformers. Both Utilities and Real Estate suffered from the 20 bps increase in the US 10Y yield.
With regards to the climate thematic, the year started on a false note. After the rebound at the end of last year on the back of lower long-term rates, the increase in long-term rates hurt performance. On this backdrop, the S&P Clean Energy Index lost more than 11% during the first month of the year.

Portfolio Highlights

In January, the fund returned -3.58%*, underperforming its benchmark by 417bp. The MSCI AC World NR© gained 0.59%**. In terms of absolute performance, our position in CERES POWER HOLDINGS PLC (Industrials) was the standout gainer, rising by 30.7%. With a positive impact of 39bp, the overweight of ASML (Information Technology) was the main contributor to relative performance. CERES POWER HOLDINGS PLC as well as WASTE CONNECTIONS INC (Industrials) were also strong contributors (18bp and 16bp respectively).
Our allocation within the Materials and Utilities sectors was the largest detractor from the excess portfolio return. In terms of absolute performance, our positions in AMERESCO (Industrials) and SUNRUN (Industrials) declined the most, losing 35.5% and 26.2% respectively. AMERESCO was the main detractor from relative performance with a negative contribution of -52bp. Ameresco amended its credit facility in early December, stipulating that if its battery storage projects with SCE aren't substantially completed by January 31, 2024, they would need to raise $100 million in equity or subordinated debt. This caused the stock to sell off over the month. Nevertheless, two of the three projects are in final testing stages. Consequently, Ameresco is now pursuing a $100 million debt subordinated issuance, avoiding equity issuance. While $250-300 million is tied up in the SCE project, which should be released upon completion, missing the milestone is viewed as a modest negative for the shares.
In January, we increased the positions of CRODA INTERNATIONAL (Materials) as well as QUANTA SERVICES INC (Industrials), from 1.0% to 1.6% and from 1.0% to 1.5% respectively. We sold ORSTED (Utilities) as well as CONTEMPORARY AMPEREX TECHN-A (Industrials) and WUXI LEAD INTELLIGENT EQUI-A (Industrials) (-1.5%, -1.4% and -0.65% respectively). ANSYS INC was sold completely as well on the takeover from Synopsis. It is bought at a big premium and turnover synergies will take time to kick in. We also reduced the portfolio weights of two American companies, SYNOPSYS INC and DARLING INGREDIENTS from 2.8% to 2.4% and from 2% to 1% respectively.

* net of fees in EUR terms
** net return in EUR terms

Fund Outlook

With the failure of a recession to materialise, 2023 has been a good year for equity indices. However, their rise was uneven, marked by strong selectivity among mega-caps in the US and underperformance by small and mid-caps, hit by the historic rise in interest rates. For 2024, we anticipate a continued soft landing for the developed economies and stabilisation of the Chinese economy.

Nevertheless, the future outlook for the climate change theme still remains highly positive, underpinned by compelling drivers. The escalating visibility of climate change, exemplified by extreme temperatures, highlights its urgency. The geopolitical situation, exemplified by the conflict in Ukraine, underscores the vulnerabilities of fossil fuel-dependent energy systems, emphasising the intertwined nature of sovereignty and energy transition. Moreover, the transition itself is poised to be a significant growth driver, particularly for Europe and the United States, offering opportunities for reindustrialisation. Looking ahead to 2024 and beyond, the energy transition is characterised by a shift from a low capital expenditure/high operating expenditure model to a high capital expenditure/low operating expenditure model. Although the transition is discount rate-sensitive, various factors counterbalance rate increases, including higher and more volatile energy prices, government support initiatives like the Green Deal in Europe and the IRA in the United States, the resolution of bottlenecks leading to a decline in solar module prices, and ongoing scale effects and learning curve benefits driving costs down. Despite negative sentiment, the fundamentals on the ground remain robust, with 2023 expected to be a record year for solar installations and electric vehicle penetration surpassing forecasts. The Climate theme not only promises visible growth but also boasts attractive valuations. As focus shifts towards recession risk and inflation cools, the market is likely to favour pockets of visible growth. Clarity from the IRS on eligibility rules for IRA tax credits is anticipated to unlock final investment decisions on clean energy projects, enabling companies to incorporate IRA assumptions into their 2024 guidance. 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.