RESPONSIBLE AND SUSTAINABLE GLOBAL EQUITY FUND

COMMENTARY FOR QUARTER TO END SEPTEMBER 2021

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	3.38%	9.40%	28.68%	36.80%	66.54%	172.25%
FTSE World TR GBP	2.0%	9.68%	23.99%	40.85%	85.60%	284.91%
IA Global	1.85%	8.81%	23.13%	39.20%	78.50%	222.95%
Sector Quartile	1	2	1	3	3	4

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

REVIEW

Global equities generated a 2% total return (on a Sterling basis) in the third quarter, as economies continued to rebound. Within developed markets, vaccinations appear to have successfully decoupled rising infections with hospitalisations and deaths. As the quarter progressed equities retraced as concerns of peaked economic growth, dislocated supply chains and inflation built. As developed economies bounced back, pent-up demand from consumers endowed with savings and stimulus, met a challenged supply chain with depleted inventory in the channel, as chronic labour shortages impaired manufacturing and logistical operations. Globally commodities were the best performing asset class over the quarter, up 6.6% in dollar terms, which supported the "cost-push inflation" narrative. A less transitory, more protracted inflationary environment also increased expectations of tightening by central banks.

From an environmental perspective there were several developments of note in Q3. The UN's Intergovernmental Panel on Climate Change delivered a sobering message through its 6th Climate Assessment Report, predicting an increase in heatwaves, heavy precipitation, droughts and tropical cyclones in the coming decades, regardless of mitigation trajectories. In July, the European Commission adopted a range of proposals, coined "Fit for 55", to support the goal of reducing net greenhouse gas emissions by at least 55% against 1990 levels by 2030. Highlights included an increase in the bloc's energy efficiency savings target, an expansion of the Emissions Trading Scheme (ETS) to cover the automotive and buildings sectors and a new social climate fund to help citizens finance investments in energy efficiency, new heating and cooling systems, and cleaner mobility. In the US, the Senate passed $550bn in new federal funding as part of a US infrastructure package, notably including cleaner energy, water infrastructure and resilience. As governments weigh increasingly frequent natural disasters and look ahead to reduction targets, we find policy backdrops are becoming increasingly supportive of our sustainable solutions holdings.

Looking to equity market performance, US equities were nearly flat for the third quarter with the S&P 500 returning 0.6% in dollar terms, although returns were boosted by the Dollar's appreciation, to 3.1% on a Sterling basis. The more infectious delta strain of COVID-19, swept through US states with lower vaccination rates but so far infections have not translated to the levels of hospitalisation and disruption seen in prior waves. The new wave prompted a further uptake of the vaccine albeit vaccination levels remain lower than some other developed countries. Macroeconomic data over the period signalled a slowing of growth following a speedy economic recovery with supply constraints, inflation and Delta cases touching the brakes. Earlier in the period treasury yields slumped, leading growth equities higher however commentary from the Fed in September raised the expected pace of interest rate rises pulled growth equities downward. Tapering is also on the horizon but given the Fed could experience a fair amount of personnel change over the coming 12 months, the policy path has become increasingly uncertain.

In continental Europe, the FTSE Europe ex UK gained 0.6% in Euro terms, or 0.8% in Sterling terms with energy price rises stoking inflation concerns. Mainland European equities started the quarter positively, with COVID-19 vaccination rates exceeding 75% across many countries supporting lockdown easing and economic recovery. However, inflationary pressures built as the quarter progressed with Eurozone inflation at 3.4% in September, the highest in 13 years. One particular inflationary concern was around natural gas as a perfect storm of factors emerged: a weak wind season reduced renewably generated energy, reduction in heavily polluting fossil fuel investments, global competition for resources and lower natural gas reserves in the bloc than

edentree investment management

normal heading into the winter. These energy price rises were met by price caps in some southern European countries.

In the UK, the FTSE All Share rose 2.2% with energy particularly performing strongly benefitting from price rises. Notably, the UK natural gas for November delivery on the ICE rose 91.5% in September, or just under 175% for Q3. By the end of the quarter, shortages dominated headlines, with the underlying pressure on global supply chains exacerbated by shortages in HGV drivers. The combination of shortages and rising prices fuelled inflation concerns, leading the Bank of England to take a more hawkish tone to the benefit of financial equity performance.

Equity markets in Asia Pacific ex Japan delivered negative returns of -3.2% in sterling terms, making the region the global laggard. The region was impacted by a sell-off in Chinese equities sparked by slowing growth and concerns of the government's willingness to protect capital markets. In September, China reported the first contraction in manufacturing activity since February 2020 when pandemic effects first hit numbers. Moreover, the significant policy shift in China clamping down on sectors including education and technology to encourage the goal of common prosperity, supporting the narrative of slowing growth in China further. Another shock followed from property market contagion that spread across regional equities as developer Evergrande, which is the world's most indebted real estate company, was expected to default on several large upcoming payments.

Japanese equities were the best performing within a global context, rising 7% in Sterling terms. After a slow start to its vaccination program, levels caught up in the quarter, and while there was a spike in infections in August post-Olympics, cases plummeted in September. The third quarter also delivered a political surprise, following growing unpopularity Prime Minister Suga announced his intention to resign leading Fumio Kishida to be elected as party leader and the 100th Prime Minister of Japan.

PERFORMANCE & ACTIVITY

The Edentree Responsible & Sustainable Global Fund rose 3.4% in Sterling terms for the third quarter, outperforming the FTSE World benchmark total return of 2%. Against the IA sector group, the fund is ranked first quartile on both a three month and year-to-date basis.

Stock picking was the key driver of outperformance for the period, particular standouts being the UK and Japan with relative outperformance of 5.5% and 4.9% respectively. Our holding in UK listed intellectual property commercialisation specialist **IP Group**, rose 18.4% over the period as largest holding, **Oxford Nanopore** enjoyed a highly successful IPO rising 40% on its first day of trading. The funds US holdings also outperformed the market with notable stock picking within technology, outperforming by 4.0%, following a series of positive earnings reports under our Disruptive Innovation theme. A highlight individual contributor being our "Digital Resilience" holding **Palo Alto**, up over 30% for the quarter with robust results and outlook we feel evidences the company's enormous opportunity to consolidate cybersecurity industry spend. From an allocation perspective, Japan was the best performer gaining 7% however the funds modest 2.4% underweight was a minor drag, although offset by the fund's holdings gaining 12.2%. Overall, the impact of regional allocation was flat.

In terms of sectors, we noted growth continued to outperform value equities overall although trends reversed towards the end of the quarter. Financials were the best performing sector, buoyed by the US and UK central banks taking a more hawkish stance. Those financials, including Hong Kong-based **Dah Sing Bank**, with exposure to China however were negatively impacted from the deterioration in sentiment around China/HK property arising from Evergrande default speculation. Although the fund holds a modest underweight in financials, our selection more than compensating with the funds financials outperforming the index by 5.8%. Whilst a traditional bond proxy sector, Utilities in the US also performed well given rising energy prices although this was not universal with **Enel** off 13.5% given political intervention in Spain & Italy capping pass-through of high gas and electricity. It was also a strong month for several Cleaner Safer Circular holdings including sustainable biochemicals company **Borregaard** (+14%) and UK waste specialist **Biffa** (+10.6%).

In terms of investment activity, we increased our position in **IP Group** reflecting the strong investor appetite during the IPO of IP's key asset Oxford Nanopore, resulting in IP Group trading at a material discount to hard NAV while still retaining a significant stake in Nanopore. We also added materially to our holding in **Koninklijke Philips** after productive engagement with the company on a product recall that has weighed on sentiment. We felt the company is managing the situation responsibly, our long term thesis remains unchanged and the market reaction created an opportunity to increase position in an enabler of efficient healthcare.

OUTLOOK

The short-term outlook remains dominated by the extent and transitory nature of inflationary pressures within the global economy. How these two factors influences the path of monetary policy tightening and tapering activity that the Fed undertakes is arguably only part of the equation, as should the market consider the Fed is too reactionary, shifts in the yield curve may ultimately predate any action. The extent to which the underlying inflationary pressures are "demand pull", vs. "cost push" further complicates the policy response, reflecting the blunt nature of monetary policy tools in addressing long-term underinvestment and the need to debottleneck logistics and replenish supply chains. A further wrinkle with respect to predicting central bank policy lies in the potential personnel change at the Fed, with the recent ethics-led departures potentially damaging the leadership's credibility.

The market's focus on central bank actions has essentially been prevalent since 2008-09's global financial crisis and underlined during the COVID-19 crisis, masking some of the longer-term economic fragilities. This has made liquidity the key underpinning and driver of share prices since 2008, and particularly long duration assets such as high-growth equities which have outperformed value peers by 280% since end of 2008. As central banks look to wind down their asset purchase programmes, equity markets will need new supports and real economic drivers, which could lead to a degree of mean reversion to the more cyclically oriented market sectors.

Another developing risk we note is the growing social inequity, in part elevated by central bank policies boosting asset prices, raising costs and ownership barriers to those without assets. As the pandemic accelerated digitalisation, a digital disadvantage in the labour force compounded and as we look ahead we see a widening skills mismatch between workforce and available jobs.

Despite these short-term risks, we continue to retain the view that the environment for sustainable investing has never been more supportive. From a fiscal stimulus perspective, most major economic powers have enacted stimulus directed to enabling a lower carbon economy. Clearly, there remains significant work to meet the long-term goals set out in the Paris Agreement but it appears the broader population are increasingly supportive of climate action, which should play out particularly in the upcoming COP26. As significant incremental capital is channelled towards sustainable challenges, we remain acutely aware that we must retain a healthy valuation discipline while recognising the scarcity context.

To obtain further information please speak to your normal EdenTree representative, visit **www.edentreeim.com or call** our support team on **0800 011 3821**