

PERFORMANCE

	3 Months	6 Months	1 Year
Fund Performance (B Class)	0.2%	6.1%	13.4%
FTSE World TR GBP	3.9%	8.9%	13.5%
IA Global	2.4%	6.6%	10.8%
Sector Quartile	4	3	2

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested. *Inception: 24 Jan 2022

MARKET REVIEW

Against the backdrop of another tumultuous quarter in markets, investors could be forgiven for adopting the adage “sell in May and go away”. While further fallout from the mini crisis in the US banking sector was contained, the inflation dilemma remained front and centre for central banks. However, despite a darkening economic mood, a narrow group of US mega-cap tech names, led by Nvidia, surged to new highs on excitement about the potential for AI to underpin a technology revolution – albeit with caveats about AI’s potential risks. A relatively confident 3.7% gain in the FTSE All World Index during the quarter was driven by gains in the US, with the NASDAQ and S&P500 Indexes climbing 9.8% and 5.6% respectively. Japan’s Nikkei225 gained 5.8%, with investors attracted to the country’s economic strength, improving corporate governance and unique geopolitical position as an alternative route to growth in China and the wider Asia Pacific region. Returns for bourses elsewhere in the world were more lacklustre. The FTSE World Europe Index ex UK returned a meagre 0.4%, while the FTSE All-Share eased 0.6%, with the latter particularly troubled by persistent core inflation. Emerging market indices ended the quarter weaker, with China’s economic reopening stalling.

On the Green Revolution front, it was encouraging to see the first steps towards a global plastic treaty with some 180 nations backing a pathway towards a binding global agreement, which could come into force by 2025. This agreement has already been dubbed the Paris of Plastics and appears a logical next step amid wider policy initiative aimed at reducing plastic waste and hastening the move away from a linear “take-make-waste” economic model to a circular economy. Lastly, we note that the 4th of July, soon after the end of the quarter, saw the hottest day for the planet on record, with the average global air temperature reaching 17.18C, once again underscoring the need the take urgent action to tackle the causes of climate change and adapt to its effects.

PERFORMANCE & ACTIVITY

The EdenTree Green Future Fund made modest progress in absolute terms but underperformed both the FTSE World TR Index and IA Global peer group during the quarter.

Superficially, the underperformance looked significant, but it was driven by short-term external factors rather than stock or thematic news within the portfolio. The major cause of the underperformance was an increase in market risk aversion towards smaller companies due to ongoing pressures in the US mid-sized banking sector following the collapse of Silicon Valley Bank. The derating of the small and mid-cap areas of the market has been indiscriminate and has included holdings in the fund despite their strong longer-term fundamental merits. For example, Volution, a UK-listed global specialist in fans which is seeing structural demand increase as global temperatures rise, has seen its market rating drift lower on concern about a short-term weakness in the property sector, especially in the UK.

Meanwhile, rising interest rates had an unduly large impact on the Fund's green infrastructure holdings, despite the positive impact of high inflation on the returns of underlying assets. Lastly, the Fund's relative returns were held back by the market distortion created the rally in a narrow group of US technology mega caps not held in the fund, including Nvidia, Microsoft and Apple. Combined, the strength of these stocks created a 2% drag on relative performance.

Despite these short-term performance headwinds there were several highlights. These included safety equipment company MSA, which continues to benefit from tight labour markets and ongoing efforts to improve workplace safety, as well as Advanced Drainage Systems and Mueller Water Products from our Water theme, both of which made solid progress. Notable transactions during the quarter included new positions in Analog (Energy Efficiency), a leading semiconductor business with solutions for digitising analogue data that help improve efficiency for the industrial, mobility and healthcare sectors. We also added a position in Autodesk (Environmental Services), which provides software solutions for the built environment and NextEnergy Solar (Alternative Energy), an attractively valued solar and battery storage infrastructure company that invests in operating solar power plants in the UK, mainly on agricultural, industrial and commercial sites.

OUTLOOK

While recent US inflation data has been encouraging, the economic backdrop for the second half of the year remains challenging. Central banks remain steadfast in their commitments to bringing inflation down, even if this involves a period of recession. Indeed, some sectors already appear to be heading in that direction – manufacturing in the US, for example – and we are seeing bifurcation in terms of economic cycles and policies between the US, Europe and UK, with the latter now likely to see a more protracted period of monetary tightening. China's underwhelming economic reopening has added further complexity to the backdrop and investors will be watching policy makers closely for potential measures to stimulate the economy. As mentioned last quarter, persistent inflation and materially higher bond yields could lead to further multiple compression within risk assets. While this has unwound to some degree in recent months – with markets responding strongly to the recent US inflation data – we do still see vulnerability to a further normalisation in interest rates for those companies where profitability remains a distant potential and where valuation is not underpinned by cash flow expectations.

While we are tactically cautious over the near-term, reflective in a larger-than-usual cash balance on the Fund, we remain constructive on the long-term outlook for environmental solutions globally and continue to selectively deploy capital in opportunities that appear mispriced on a longer-term view. During the quarter, the International Energy Agency (IEA) forecast solar power investment alone will eclipse investment in oil for the first time, with \$1.7trillion expected to be spent on clean technologies overall. Clean energy investment broke through the \$1trillion barrier for the first-time last year with 90% of this split roughly 50-50 between renewable energy and electric vehicles. To demonstrate just how quickly the green revolution has emerged, solar and wind barely existed as industries at the start of the century. Today, they account for about 15% of global electricity supply. Indeed, solar is now the fastest-growing energy technology in history.

Green Future Fund

Q2 2023 Commentary



Performance
with principles®

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