Green Future Fund

Q3 2023 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	ITD*
Fund Performance (B Class)	-2.9%	-2.7%	6.5%	0.0%
FTSE World TR GBP	0.7%	4.6%	12.2%	8.2%
IA Global	-1.1%	1.3%	7.7%	1.4%
Sector Quartile	3	4	3	3

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

MARKET REVIEW

The modest 0.7% rise in the FTSE World TR index over the quarter belies a strained period in markets. Central banks retained a hawkish stance with core inflation proving hard to tackle. Bond yields ticked higher and the prospect of "higher for longer" interest rate policies raised the spectre of recession. Economic activity in the UK appeared to flatline just on the right side of growth, while Germany's export-dominated economy already appeared to be in recession, in part due to its exposure to China's economic woes. In contrast, the economies of the US and Japan appeared more vibrant, with labour conditions notably tight in the former, sustaining hopes of a soft-landing, while the end of deflation and a reform-led revival in Japan has spurred the domestic stock market to a 33-year high. Moreover, earnings expectations also remained resilient in the face of gloomier macroeconomic expectations.

In terms of market activity, Japan's Topix outperformed, gaining 3.0%, and the UK's FTSE All-Share added 1.8% with large cap energy stocks benefiting from a sharp rise in the oil price. Major markets in the US ended lower in local currency terms (the S&P500 index returned -3.3%) but saw positive returns for sterling investors due to the strength of the US dollar. Earlier excitement about AI, which initially propped up the Nasdaq, gave way to concerns about the valuations of long-duration assets in a higher interest rate environment. Europe's bourses generally lost ground (with minor exceptions) with the Deutsche Bourse AG German index return of -3.8% a notable laggard. Reflecting a tougher interest rate and economic outlook, large caps generally outperformed smaller caps.

It was also a quarter in which record high land and sea temperatures presented a stark warning about the urgent need to rapidly decarbonise the global economy. The average global surface temperature in September was around 1.75C above that of the pre-industrial reference period[1]. Ahead of September's meeting of the UN in New York during Climate Week, UN Secretary-General Antonio Guterres provided a searing assessment: "The dog days of summer are not just barking, they are biting…Surging temperatures demand a surge in action."[2] It was a sentiment echoed by world leaders throughout the UN talks, although with ongoing differences about the shape that action should take, which are likely to play out at the COP28 conference in the UAE in November and December.

PERFORMANCE & ACTIVITY

The EdenTree Green Future Fund lost ground in absolute and relative terms during the quarter. The Fund faced many of the headwinds we highlighted last quarter, with the prospect of a rates plateau rather than pivot creating a more risk averse

[1] https://public.wmo.int/en/media/news/september-smashes-monthly-temperature-record

[2] https://press.un.org/en/2023/sgsm21926.doc.htm#:~:text=The%20following%20statement%20by%20UN,Climate%20breakdown%20has%20begun.

mood towards smaller and mid-cap stocks to which the Fund tends to have a natural bias. That said, the Fund's breadth and diversification across themes, sectors and geographies means it generally performed well against more concentrated peers in the environmental and climate solutions space.

Holdings from our Alternative Energy theme faced the fiercest headwinds, with clean energy stocks in general coming under pressure from concerns about weaker macroeconomic demand, high interest rates and increasingly hostile political rhetoric ahead of the election cycle next year. The sector in the US has been particularly impacted by concerns that the US Government shutdown would stall the deployment of clean energy funds from President Biden's climate bill. Rooftop solar and home energy storage business SolarEdge Technologies was a notable detractor from this theme. Closer to home, the Fund's exposure to listed Green Infrastructure companies, which continued to see record low discounts to NAV despite solid underlying asset values and the benefits of inflation-linked income, also impeded relative returns. Meanwhile relative performance was crimped by weakness in Water Management holdings Mueller Water (earning undershoot) and Xylem (pullback after decent performance).

Performance highlights during the quarter included strong performances from holdings in our Circular Economy theme. These included Renewi (UK), which received a conditional takeover offer from Macquarie Asset Management at 775 pence per share, a premium of 50% on the previous close. The offer has been rejected by Renewi's board, which we believe is appropriate as the business has far greater embedded value. Clean Harbours (US) and DS Smith (UK) were other highlights from the Circular Economy theme with both businesses unveiling solid quarterly results. Elsewhere, Acuity Brands (US: Energy Efficiency) and Stantec (US: Environmental Services) also gained ground on the back of solid results.

OUTLOOK

The horrific events in the Middle East in early October have added significant uncertainty to the backdrop for geopolitics, the global economy and financial markets. The conflict has already influenced the stance of the US Federal Reserve, which has indicated a pause in its rate hike cycle, taking some of the heat out of the bond market. However, tighter rate policies are already crimping demand in the UK and Europe, and potentially higher oil prices caused by the Israel-Hamas conflict are likely to be a further drag on economic activity. The response by central banks must be watched closely. For investors, the risks of further bouts of volatility remain high, and we continue to maintain an elevated cash buffer in the Fund that will provide a level of optionality should assets become mispriced.

We are also monitoring the possible fallout of the political uncertainty in the US on the delivery of Biden's flagship IRA policy, as well as the politicization of environmental initiatives in the UK, where the Government's green policy U-turns appear irresponsible. Moreover, we do not expect meaningful progress at the forthcoming COP28 conference in UAE, with debate likely to centre on what a "phase-out" of fossil fuels might actually involve. The term "unfettered" has become more entrenched in discussion about the future of fossil fuels on the back of strong industry lobbying for great reliance on yet-to-be proven carbon capture and removal technology. The glacial progress on loss and damage will also be a key subject of debate at the climate talks.

This backdrop has provided a reminder that the green revolution will be far from linear, but it remains firm, in our view. There will be policy backtracks, economic challenges and bottlenecks. Indeed, one of the major transition hurdles lies in the area of transmission. According to Berkley Lab, the current backlog of wind and solar projects awaiting connectivity is the US stands at around 120% of the total installed capacity of the US power system. Grids around the world are grappling with similar connectivity issues – due in large part to the rapid pace of growth in renewable energy which has been underpinned by the powerful force of cost competitiveness, which hasn't been diminished despite cost pressures across industry. These are issues that need to be worked through with significant investment, which is what the Green Future Fund is all about.

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

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