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Investing for a
world of change

Global Environment 2023 review

February 2024

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Contents

General risks. The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Investment objectives and performance targets are subject to change and may not necessarily be achieved, losses may be made. Target returns are hypothetical returns and do not represent actual performance. Actual returns may differ significantly. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

1 Summary

We are pleased to provide the 2023 Annual Review of the Global Environment Fund. We believe investors should judge the performance of the Fund over a long time-horizon, given the multi-decade decarbonisation structural-growth opportunity we are targeting.

However, we recognise that shorter-term context can be important. This report provides commentary on our financial performance and portfolio activity in 2023, as well as our outlook for 2024.

The Annual Review follows the publication of our Annual Impact Report in July last year and a paper in October 2023 revisiting the decarbonisation structural-growth theme.

For details on Global Environment's sustainability attribution and the decarbonisation investment opportunity, please see those publications.

From this report, we would highlight the following:

Given the nature of the Global Environment investment approach, investors can expect the Fund's return signature to differ significantly to that of the MSCI ACWI, its reference benchmark, over short- and long-term periods. This was the case in 2023.

Over the full year, Global Environment delivered an approximately flat absolute return. On a relative basis, the Fund underperformed the MSCI ACWI Index. At the broad level, three factors contributed to the underperformance:

- Pessimism over China's economic recovery, which impacted our Chinese holdings.
- The rapid rise in interest rates , which resulted in a sell-off in interest-rate-sensitive utilities stocks.
- The fact that US mega-cap tech stocks, which we did not hold, drove market returns.

Past performance does not predict future returns; losses may be made.

We remain comfortable holding the companies that were the main detractors from relative returns in 2023. We have re-examined the investment cases for all of these holdings and we maintain a positive view on their prospects from here, increasing exposure in some instances.

Over the 12 months, we added three new companies to the portfolio, including our first Indian holding (Power Grid Corporation of India) and our first hydrogen-focused holding (Industrie de Nora)[1]. We sold two companies, maintaining our valuation discipline. We adjusted the sizes of several positions, based on the risk/reward of each investment and the strength of the structural growth trends underpinning the investment case.

We maintain conviction that the long-term structural growth opportunity for businesses that are positively exposed to decarbonisation is intact, and that it continues to be underappreciated by the market. Our research-intensive, fundamental, bottom-up idea-generation process is unchanged[2]. In addition, we continue to explore less well-understood areas of the decarbonisation opportunity set, such as biotech, green hydrogen and energy efficiency.

Negative sentiment has created opportunities to acquire shares in certain companies that are contributing to sustainable decarbonisation at what we regard as discounted valuations, and that we believe have positive growth and earnings outlooks, as well as healthy balance sheets.

We regard valuations in our portfolio as attractive, based on our conservative assessments of intrinsic value, even taking into account a recessionary scenario in the next 12 months. As at early January 2024, our estimated portfolio weighted upside was c.60%, compared to c.40% at the beginning of July 2023[3].

As ever, we are grateful for the support of our investors. We look forward to keeping you appraised of developments in the year ahead.

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1. This is not a buy, sell or hold recommendation for any particular security. Securities referenced as they were bought or sold during calendar year 2023. For further information on specific portfolio names, please see the Important information.
2. For further information on the investment process, please see the Important information.
3. Forecasts are inherently limited and are not a reliable indicator of future results. For further information on targeted returns, please see the Important information section.

2 Overview of performance in 2023

The Global Environment Fund is a high-conviction, concentrated, benchmark-agnostic global equity strategy focused on companies that we believe will benefit from decarbonisation.

A consequence of the investment approach is that the portfolio has certain structural sector biases (towards utilities, industrials and materials, and away from mega-cap tech, financials, energy and healthcare) and regional biases (towards China and emerging markets, and away from the US), and that individual stocks can have a material impact on the portfolio's performance. A high active share should be expected, and Global Environment's returns signature is likely to differ significantly from the MSCI ACWI (its reference benchmark) over short- and long-term periods. This was evident again in 2023.

Over 2023 as a whole, the portfolio generated an approximately flat absolute return of -0.09%, net of fees, and underperformed the MSCI ACWI index by 15.40%[4]. By quarter, the Fund meaningfully outperformed in Q1, saw the positive trend reverse in Q2, meaningfully underperformed in Q3, and partially recovered in Q4. As noted in the summary, three broad factors contributed to the underperformance over the calendar year.

Investors grew pessimistic over China's economic recovery

The stock-market rebound in China that followed the post-COVID re-opening in late 2022 was succeeded by a period of poor relative and absolute equity returns. This primarily reflected concerns over China's growth outlook, the property sector in particular, and levels of debt in the economy. Towards the end of last year, the prospect of greater regulatory intervention in certain sectors also weighed on Chinese equities.

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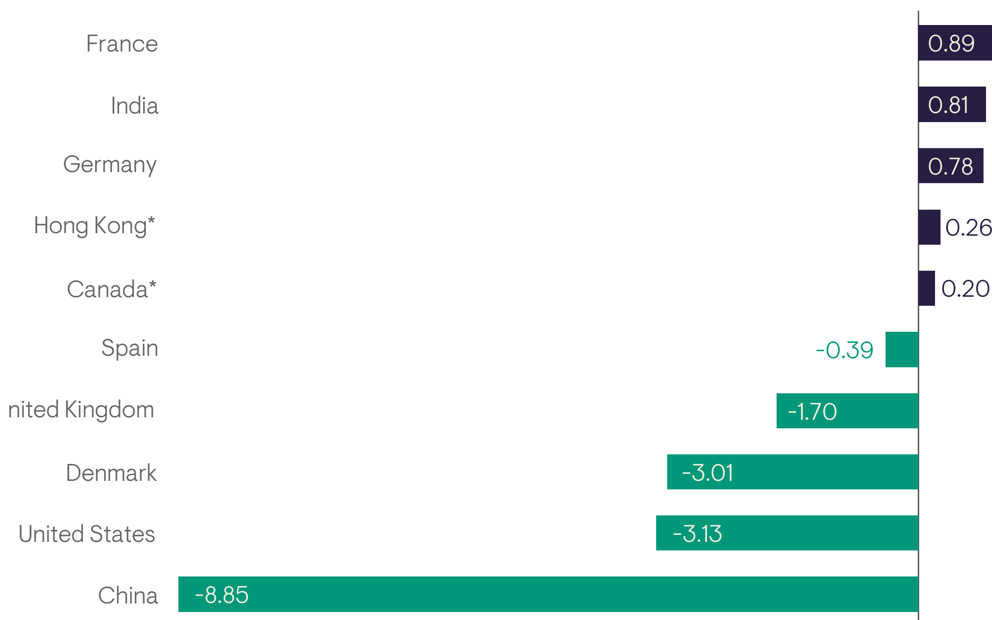
4. Performance is net of fees (NAV based, including ongoing charges), with net income reinvested where applicable, in GBP. For longer-term performance, please see the appendix.

As a consequence, our sizeable exposure to China (c.20% of the portfolio by weight as at 31 December 2023, across five companies) was a drag on relative returns in 2023. The shares of these companies underperformed despite strong growth in solar installations and electric vehicle (EV) sales in China, markets that our holdings directly address, and positive trends in the growth and return fundamentals reported by most of our Chinese holdings. The chart below shows the attribution of returns relative to the MSCI ACWI by region.

2023 regional attribution relative to MSCI ACWI



Past performance does not predict future returns; losses may be made.
Attribution is shown gross of fees in GBP. Fees are deducted at the portfolio level which is where their impact is shown. The portfolio investments are not individually offered by the manager. Calculating net figures could involve complex and potentially subjective assumptions regarding the allocation of portfolio-level fees, expenses, and adviser compensation between the realised and unrealised portions of the portfolio.
Source: Ninety One, Factset, 31 December 2023. *Denotes countries not owned in the portfolio.

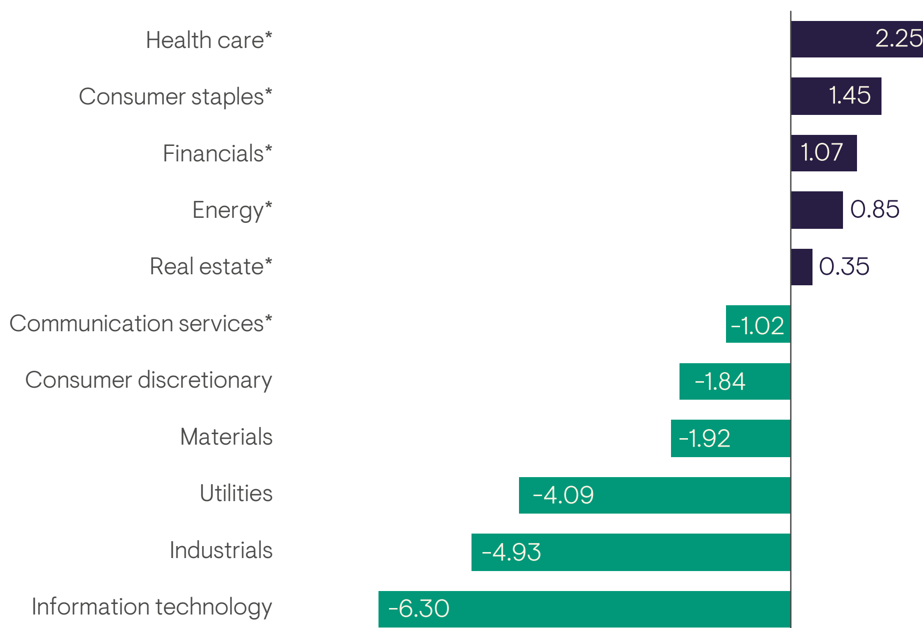
While we do not take short-term macro regional allocation views, from a longer-term perspective, the decarbonisation-linked opportunity set in China remains extremely broad, with a good number of companies that meet our criteria for sustainable returns, structural-growth potential and competitive advantages (for details on the longer-term growth drivers for the companies we own, please see our October 2023 paper on structural growth). We believe the de-rating of these holdings has exceeded any moderation in earnings growth that they may have experienced, supporting our view that these companies have been subject to indiscriminate selling largely detached from fundamentals.

Interest rates rose rapidly

Rising interest rates have negatively affected the shares of a number of the companies we own, given the long-duration nature of some of these businesses. Future profits are now discounted back at higher rates, reducing their present value. Utilities are particularly sensitive to this discounting effect as they own long-duration assets. Yield rises can also lead investors who buy utilities for their defensive and yielding properties to switch into other investments, such as government bonds.

Our sizeable exposure to utilities – 19.5% of the portfolio by weight as at 31 December 2023, with an average weight of c.17% over the year, compared to c.3% for the MSCI ACWI – was a drag on relative performance over 2023, most notably during Q3. Some company-specific factors impacting NextEra Energy and Orsted (detailed in the 'Individual company attribution' section) also affected the performance of our utilities exposure. The chart below shows portfolio returns relative to the MSCI ACWI by sector over 2023.

2023 sector attribution relative to MSCI ACWI



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*Denotes sectors not owned in the portfolio.

We test the investment cases for our holdings on an ongoing basis and have been reviewing the financial strength of our utilities in light of their share-price declines and a potentially 'higher for longer' interest-rate environment (at the time of writing, the market expects interest rate cuts in the US and Europe in 2024). We believe the equity market's reaction to higher interest rates exceeded the likely impact on companies. Further, several factors should help utilities absorb higher interest-rate costs, including: the US Inflation Reduction Act, falling raw material prices and increasing contract pricing for renewables. In our assessment, the utilities we own have healthy balance sheets, strong earnings and persistent profitability. We see significant potential upside from their current valuations.

US mega-cap tech stocks drove market returns

Not owning the strongly performing US mega-cap technology companies (particularly Nvidia, Apple, Amazon, Microsoft, Alphabet and Meta) was a headwind to relative returns, particularly during H1 2023. Zero weights in these companies resulted in a performance headwind of c.5.8% for our Fund over 2023. These companies are not part of our investment universe as they do not currently have decarbonisation as a material driver of the investment case, and we do not expect the majority of their future growth to be driven by climate solutions and products. Unless their business models evolve dramatically, we would not expect to ever own these stocks. Given their large weight in equity indices, periods of extreme outperformance by them will be a headwind for the Global Environment Fund's relative performance, and vice versa.

While these three broad factors were notable headwinds for the shares of a number of our holdings in 2023, other companies in the portfolio performed strongly after exceeding market expectations regarding growth and profitability. We provide detailed company level performance attribution commentary for 2023 in the 'Individual company attribution' section.

3 Portfolio activity

In 2023 we continued to apply our high-conviction, low-turnover, concentrated, benchmark-agnostic investment approach, constructing the portfolio from the bottom-up. The selection of new positions is based on in-depth fundamental analysis that may take months to complete[5].

Our hurdles for inclusion in the portfolio remain high: in addition to requiring that a company is positively contributing to sustainable decarbonisation and exhibiting a combination of structural growth, sustainable returns and competitive advantages, we must be satisfied that it has no material negative sustainability issues.

Positions are weighted according to our target prices, strength of competitive advantages and contribution to portfolio risk. The portfolio is then reviewed at a sub-sector level with regards to overall risk budget, subsector risks, stress tests and style-analytics metrics. Weightings may be adjusted accordingly.

We have a strict sell discipline, with a position typically sold when it has reached fair value, there is a change in company fundamentals, the investment case is no longer applicable, the regulatory/industry environment has changed, more attractive opportunities have emerged, and/or there is an adverse change in the company's sustainability, corporate governance or capital–allocation policies.

The table below provides an overview of portfolio turnover in the year. Three new companies were added, including our first Indian holding (Power Grid Corporation of India) and our first hydrogen-focused holding (Industrie de Nora). Our valuation discipline contributed to two companies being sold over the year. In addition, we evolved position sizing in a number of instances, based on our view of the risk/reward of the investment and the underlying structural growth trend in each case.

Summary of portfolio activity in 2023

	Buys	Sells
Q1 2023	Power Grid Corporation of India	Brambles
Q2 2023	Industrie De Nora	–
Q3 2023	Carlisle Companies	Analog Devices
Q4 2023	–	–

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No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided.

Source: Ninety One as at 31 December 2023.

This is not a buy, sell or hold recommendation for any particular security. The stocks shown are the top three largest trades in % terms over the relevant period. For further information on specific portfolio names and how the overall strategy performed, please see the Important information and standard performance slides.

5. For further information on specific portfolio names, please see the Important information.

Buys

As a leading national transmission operator, **Power Grid Corporation of India** plays a key role in decarbonising India's power-generation sector. India's progress towards its renewable-generation targets will need to be supported by the addition of transmission capacity at intra-state and inter-state levels. We believe PowerGrid benefits from a strong regulated capital-expenditure opportunity, while offering relatively predictable potential returns. It has competitive advantages in terms of scale, experience and government backing that help it achieve a lower cost of funds.

Industrie de Nora creates products that enable the hydrogen economy, as well as water-treatment solutions. The main structural growth driver for the company is manufacturing electrodes/cells for alkaline electrolysis, for use in green-hydrogen production. The company is a market leader across at least 85% of its revenue base, with >50% market share in key segments. It is a niche provider of mission-critical components, and has scale and cost leadership and leading technological capabilities. These enable the company to develop innovative products and solutions for a broad range of industries with a high degree of technological overlap.

Carlisle Companies is a market leader in US commercial roofing systems that improve energy efficiency. The company's leadership position in the most efficient insulation grade, combined with its broad, high-quality product suite, positions Carlisle to deliver reductions in emissions for its end-customers. It is the only company in the US to offer a full product suite covering the building envelope (the outer shell of a building that enables it to maintain a conditioned environment), from membranes and insulation to air-vapour barriers. Its incumbency, scale and good customer service also contribute to its competitive advantage.

Sells

Brambles operates the world's largest pool of reusable pallets, crates and containers. Pallets are used in the transportation of goods, particularly food and beverages. Brambles offers pooling solutions via its network of pallets, which means they are recycled, removing cost and complexity within the supply chain. Our decision to sell was based on lower upside according to our intrinsic value modelling and reduced conviction in the company's structural-growth linkage to decarbonisation.

Analog Devices is a leading global analog semiconductor supplier to the industrial, automotive, communications and consumer sectors. The company designs and produces critical components for end-markets directly driven by decarbonisation, such as: battery management systems used in electric vehicles, battery testing and formation solutions, and control and monitoring solutions used in industrial automation. The company was sold following its strong performance in the first half of the year, resulting in limited future upside based on our intrinsic value modelling.

Position sizing activity

We adjusted position weights significantly in 2023, adding to investments where we saw more intrinsic valuation upside and reducing weights where we saw limited future upside. Over the year, high-quality industrial business with energy-efficiency tailwinds performed particularly well, so we reduced some of these positions to fund additions to underperforming investments in the renewable-energy value chain and in China in particular. The biggest reduction was in Trane Technologies, which began the year as our single-largest holding at 5.6% of the portfolio and finished the year at 1.4%. The biggest weighting increase was in Vestas Wind Systems, which began the year at 2.5% of the portfolio and finished the year at 5.3%[6].

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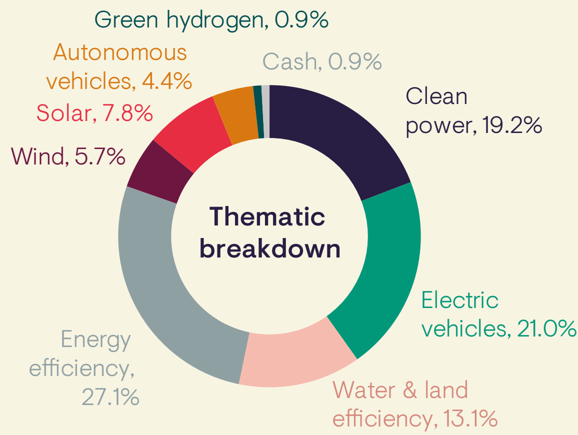
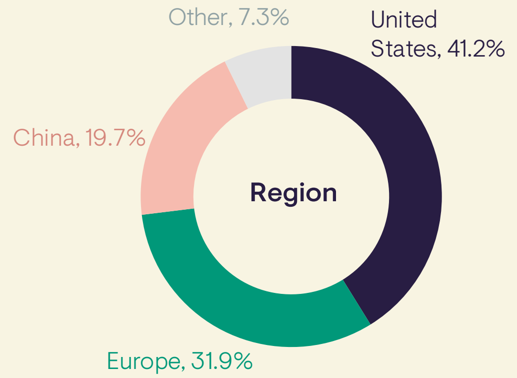
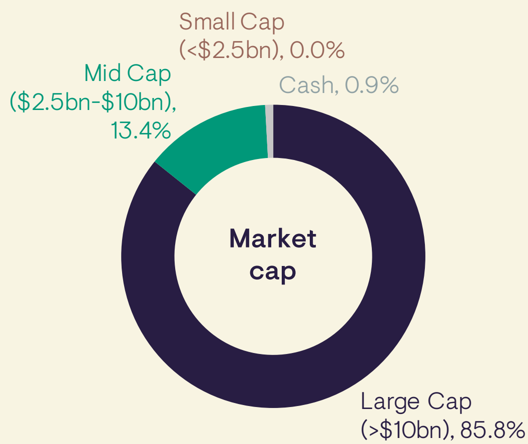
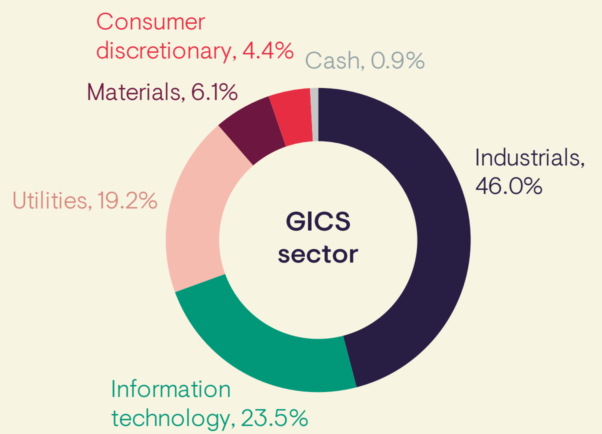
End December 2023 portfolio breakdown









For further information investment process, please see the Important Information section.
Source: Ninety One, 31 December 2023. This portfolio may change significantly over a short period of time.

4 Outlook

2023 saw the industry sectors most commonly recognised by the market as helping to drive decarbonisation facing a wave of negative sentiment, particularly as bond yields increased and central banks signalled limited near-term appetite to cut interest rates. The sentiment for renewables reached levels as negative as we have experienced in our investment careers, leading to a significant de-rating of many of our holdings.

We continue to believe the long-term structural case for businesses that are positively exposed to decarbonisation, including select renewables, remains very much intact, as we outlined in a recent paper. In our view, the market continues to underestimate the growth potential of decarbonisation companies in general. The negative sentiment has created opportunities to acquire shares in companies that are contributing to sustainable decarbonisation at discounted valuations, and that also have positive growth and earnings outlooks, as well as healthy balance sheets.

We see good opportunities in this market environment for a high-conviction active manager. Our focus remains on building a concentrated portfolio of companies that we believe not only have structural-growth potential from decarbonisation, but also competitive advantages over their peers and attractive, profitable businesses. In times like this, we spend significant time revisiting our investment cases for each company, interrogating our assumptions and the industry data, and ensuring our investment cases remain robust. As of today, we are very comfortable with the positioning of the portfolio overall and our individual holdings. We are confident that we are invested in attractively valued, profitable and cash-generative businesses that are well positioned to benefit from structural growth from decarbonisation over the long term, and that can withstand the current interest-rate environment.

We continue to explore interesting and less well-understood areas of the decarbonisation opportunity set. Biotech is a particularly fascinating sector for investors in decarbonisation, given the contribution it can make to decarbonising food production and the agriculture supply chain. Biotech can also play a role in capturing carbon, for example via enzymatic recycling.

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Opinions based on current market conditions; subject to change without notice and without any obligation to update.

In addition, we are seeing more policy support worldwide for businesses that are enabling energy efficiency, for example via insulation and other construction solutions. Governments are increasingly recognising that the cleanest energy is the energy we do not use. Finally, looking further ahead, there is a potentially exciting opportunity in green hydrogen. This is a nascent industry and some of it is still loss-making. At this point in its evolution, we think it is essential to focus on the select group of companies that are generating decent returns on capital. Nevertheless, it looks increasingly likely that green hydrogen will have an important role to play in transitioning the global economy to a lower-carbon model.

Current topics

While we maintain a strongly positive view on the future of decarbonisation-linked parts of the economy, we are as ever mindful of further risks to the investment thesis. Below, we detail our responses to the topics most frequently discussed with our investors in the past year.

Is the energy transition still affordable at current interest rates?

The sell-off in clean energy companies in 2023 suggests that some investors believe these companies cannot deliver the renewable-energy infrastructure needed to transition at current interest rates. Our analysis shows that the energy transition remains eminently affordable at today's borrowing costs, across all three transition pathways:

Renewable energy

The cost of switching to renewables rose by c.11% in 2023. However, only about one-fifth of this increase resulted from interest rate rises. The larger drivers were higher equipment and transportation costs, which are now starting to reduce. Renewables remain the cheapest source of electricity in countries accounting for 85% of global GDP.

Electrification

For the transport sector, which produces c.15% of net greenhouse gas emissions, improvements in batteries and lower material costs have far outweighed the effect of rate rises. This resulted in decarbonisation costs for the sector falling c.30% in 2023.

Resource efficiency

Rising energy costs are incentivising the adoption of resource-efficiency products and services, offsetting any drop in demand that might be expected as capital costs have risen. For example, Trane Technologies has seen an 8% year-on-year increase in demand for its HVAC (heating, ventilation, and air conditioning) products, which reduce the energy consumption of buildings.

Notwithstanding the above, we recognise that if interest rates rise significantly from current levels, the energy transition becomes increasingly less affordable. At the time of writing, the market is pricing in the peak of interest rates in the US and Europe, with rate cuts expected later in 2024.

Will China continue to disappoint?

Chinese equities had a year to forget in 2023, and sentiment remains rock bottom. However, we retain high conviction in our Chinese exposure:

- The cost of capital is falling in China as the authorities implement stimulus, with more declines expected in 2024. That has unleashed strong growth in the decarbonisation sector. For example, in H1 2023 alone, China installed new solar-power capacity equivalent to the entire UK electricity grid.
- From a policy perspective, Chinese authorities are increasingly seeing investment in clean-tech industries as a way to reduce reliance on the property sector. Renewable energy, batteries and EVs are focus areas for government support to spur growth and employment.
- The domestic market for the companies we own is vast and far outweighs their US export market. Consequently, revenue and growth for these companies is reasonably well insulated from US/China geopolitical tensions.

That said, selectivity remains vital. Not all Chinese companies in the decarbonisation sector have strong competitive advantages, and there are areas where policy impetus has led to oversupply. As a result, we believe an active investment approach, with in-depth fundamental analysis, is essential from a risk and return perspective.

Since inception of the Global Environment Fund, Chinese exposure has remained within the three biggest country-level contributors. These holdings also bring diversification to the portfolio, given their low correlations to the rest of the portfolio.

How will the potential for a growth slowdown in 2024 and elections in the US and elsewhere affect the decarbonisation investment opportunity?

If growth slows, there will be less upside potential nearer term in more cyclically-exposed companies relative to the more ‘pure-play’ decarbonisation companies – i.e., those that are more directly levered to the structural growth driven by the energy transition, such as the renewables value chain, utilities and EVs. The latter is where we think investors should focus.

Regarding US politics, we think it will be extremely difficult to get a wide-scale roll-back of the Inflation Reduction Act (IRA) through Congress, not least because a lot of the IRA’s benefits in terms of jobs and growth will occur in Republican states. The IRA is a game-changing piece of legislation, and we continue to see it supporting climate-solutions sectors in the US. However, depending on the US election outcome, investors should be mindful of the potential for alarmist headlines that may negatively impact some clean-tech stocks. There could be buying opportunities.

Key portfolio metrics

We regard valuations in our portfolio as attractive, based on our conservative assessments of intrinsic value, even taking into account a recessionary scenario in the next 12 months. As of early January 2024, the portfolio weighted upside was c.60%, compared to c.40% at the beginning of July 2023. This base case utilises what we believe to be conservative forecasts, leaving a margin of safety regarding intrinsic value. Other portfolio datapoints of note are summarised as below.

Key portfolio estimates and metrics

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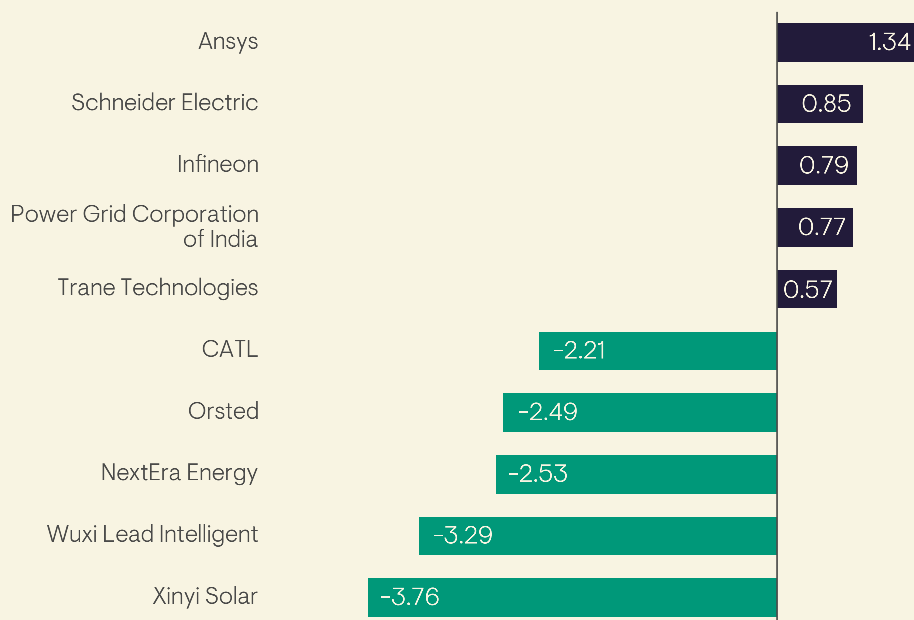
Source: Ninety One, January 2024. The portfolio may change significantly over a short space of time. For further information on specific portfolio names, please see the Important information section. Potential revenue growth and potential upside to our price targets based on Ninety One proprietary company models. For further information on targeted returns, please see the Important information section.

5 Individual company attribution

The top five individual contributors and detractors to relative performance over 2023 are shown below



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Top detractors

Xinyi Solar

Xinyi Solar is the world's largest producer of solar glass, controlling one-third of the effective production of global solar glass output, which can support up to 120GW of solar modules. It has industry-leading profitability thanks to its production know-how, yield control and equipment efficiency.

Xinyi Solar's shares were impacted in 2023 by negative sentiment relating to the continued deterioration of solar-glass industry profitability (despite a strong demand outlook for Xinyi Solar's products), a weak Hong Kong/China equity market, and concerns over the potential impact on Chinese solar companies of the Biden administration's new restrictions on investment flows into China. Xinyi Solar also missed its H1 2023 earnings guidance due to one-off issues, including natural-gas cost increases.

Following the company's H1 2023 results, we conducted a comprehensive review of Xinyi Solar and concluded that the issues reported were indeed one-off in nature, with evidence that the company's profitability was returning to an upward trend. In December 2023, we met with Xinyi Solar management in person in Hong Kong, which confirmed our positive view on the earnings trajectory.

We continue to see near-term evidence of strong structural growth in solar demand, with the latest data from China highlighting >100% year-on-year growth to more than 200GW in 2023, and worldwide growth at >50% year-on-year to c.400GW. This is consistent with Xinyi Solar's volume growth reported in its H1 2023 results and guidance for 2023, suggesting that the company has maintained its market share even in a very competitive environment. For full-year 2024, we expect to see[7]:

- <20% global solar installation growth year-on-year. This is lower than the >50% in 2023, driven by a higher base effect, an interest-rate impact and geopolitical issues affecting the solar supply chain.
- Volume growth of >20% at Xinyi Solar and profit growth of 10-20% as margin recovery is partially offset by pricing considerations due to price wars at solar module makers who are Xinyi's direct customers.
- Growth in total industry solar-glass capacity to be lower than demand growth, due to a stricter regulatory approval process in China.
- A stable return on equity (ROE) vs. the current 14%.

Our estimated upside potential for this company is c.100% and we view the stock as attractively valued, trading at a c.8.6x price-earnings (P/E) multiple in January 2024.

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Wuxi Lead Intelligent Equipment

Wuxi Lead Intelligent Equipment predominantly designs, manufactures and sells battery and solar production equipment and services to leading EV battery manufacturers, EV manufacturers and solar manufacturers. It underperformed in 2023 due to market concerns over lithium-ion battery overcapacity in China, slower EV growth expectations, the impact of the Inflation Reduction Act on Chinese EV supply-chain businesses, and weak sentiment towards Chinese equities in general.

We continue to see strong structural growth in EVs globally, with the latest estimate 33% growth to 14 million units of xEVs[8] in 2023; and within China, where EV sales made up 35% of total auto sales in 2023. Some people have questioned the sustainability of this growth, but we believe we are approaching a steepening point of the technological 'S curve'[9].

Order intake activity at Wuxi Lead has somewhat declined slightly (10% decrease year-on-year to CNY23 billion), as mainland China EV battery orders have slowed. But this is partially offset by: (a) order growth from Chinese energy storage systems (ESS); (b) ex-China battery orders; and (c) solar-equipment orders. Growth from European customers has been significant: in 2023, Wuxi Lead won c.20GWh of battery orders in Europe from Volkswagen and ACC (a joint venture between Stellantis, TotalEnergies and Mercedes Benz Group). We think the latter demonstrates the company's strong competitive advantages globally.

In 2023, we carried out a comprehensive review of the growth opportunities at Wuxi Lead, concluding that it is benefiting significantly from the trend of European EV supply-chain localisation. We further concluded that the company should be able to maintain its profit margins during the downturn in the Chinese battery-equipment market. During the year we met with Wuxi Lead's chairman, who is also the founder and controlling shareholder of the company. The meeting confirmed our view that the company's international expansion is well underway. In light of the market weakness (as at January 2024, Wuxi Lead was trading at <10x 2024 price-earnings), the chairman has proposed a share-repurchase programme of CNY350-500 million, the first such programme in the company's history.

Going forward, we expect Wuxi Lead to continue benefiting from its customers' capacity expansions, particularly as most of its competitors lack the scale required to support these ambitious expansion plans. We expect to see annual revenue growth for 2024 of c.20% and an ROE of c.27% (in line with historical averages). Our upside potential estimate for this company is c.100%.

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8. xEV refers to all types of electric vehicle, including hybrid, plug-in hybrid and battery EVs.
9. Many innovations have historically followed 's-curves', a growth trajectory characterised by slow initial adoption, a phase of accelerated adoption as the technology matures, and then a stabilisation of the rate of adoption over time.

NextEra Energy

NextEra Energy is the world's largest generator of electricity from wind and solar, a market leader in battery storage, and the market leader in North American renewable energy. The company also operates and invests in electric transmission in the US.

In addition to the difficult backdrop for utilities given rising rates, NextEra Energy shares faced downward pressure last year due to a reduction in dividend-growth expectations from subsidiary NextEra Energy Partners (NEP), as higher financing costs made it more difficult for NextEra to sell assets at prices that would be accretive to the dividend yield at NEP. This led investors to question the growth of NextEra, partly on the view that higher financing costs would also limit renewable development and that NextEra would no longer receive the c.US$1-2 billion of capital from asset sales to NEP. However, these asset sales represent c.7% of NextEra's capital expenditure and can be easily replaced with tax credits, which are easier to monetise following the introduction of the US Inflation Reduction Act (IRA). Furthermore, we see a strong renewable development pipeline which, even at current financing costs, is extremely competitive versus the fossil-fuel alternative. As a result, we see good value in the stock.

A further company-specific headwind in 2023 stemmed from allegations of political involvement and lobbying in the Florida local elections. Our conclusion regarding these allegations, following analysis, is that there were errors of judgement by the management of Florida Power and Light (FPL) – in particular by former CEO Eric Silagy – but that no damage was done to the company's key stakeholders. NextEra has since conducted a comprehensive review and enacted governance improvements and personnel changes that we see as positive.

We believe NextEra remains one of the world's leading renewable-energy developers, with scale and first-mover advantages, while also enjoying regulated monopoly status through FPL. It also has a competitive advantage from having both businesses (NextEra Energy Resources and FPL) in the same company, creating credit-rating and tax-capacity advantages. The company's plans for net zero provide additional structural-growth drivers, including via building more solar, battery storage and green hydrogen, which is expected to come at zero incremental cost for its customers.

The business expects consistent, visible, partially regulated, structural earnings growth year-on-year. There was no change to guidance through the recent period of stock-price volatility. In fact, the company saw record additions to its backlog and increased the guidance for the returns it expects to see on the backlog to the low '20s' in percentage terms for wind and storage, and 'mid-teens' for solar, as lower equipment prices more than offset higher funding costs. We are confident the company will achieve the top end of its earnings-per-share guidance range of 6-8% growth over the next few years. We expect to see moderate growth in its return on capital over time. Our upside potential estimate is c.50%.

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Past performance does not predict future returns; losses may be made.

Orsted

Orsted is the global leader in developing, constructing and operating offshore wind farms, with more than three decades of experience in a broad range of green-energy solutions.

The share price saw a significant decline in the second half of 2023, driven by factors including rising interest rates, concerns over cost inflation, negative headlines relating to other offshore players abandoning projects, and in particular impairments and project cancellations specific to Orsted. These issues were compounded by poor shareholder communication before and after Orsted's Q3 earnings release, leading to the market losing confidence in the quality of the management team.

While prior to those events we had some concerns over gaps in management's experience, reflected in a smaller position in the portfolio relative to our upside estimates, we accept that our assessment of management's ability to deliver large-scale infrastructure projects and to effectively deploy capital was too optimistic. However, our deep analysis supported a view that the stock-market reaction implied a no-growth, value-destructive scenario, with valuations below the operational value of current projects. We estimate existing assets alone are worth between c.DKK400 per share, even including cancellation fees for projects that are no longer going ahead, with a conservative valuation of the pipeline suggesting close to 80% upside. Put another way, the company would be valued significantly more highly by private infrastructure investors. Based on these estimates, we concluded that there is significant upside potential given Orsted's valuation, and we believed it is our fiduciary duty to work with the company as engaged shareholders to unlock this value for our clients and help steer Orsted in the right direction, owing to its importance in the energy transition.

In early November, we met with the CEO and outgoing CFO, and followed up with two meetings with the Chairman of the board and another in-person meeting with the CEO and interim CFO in Denmark. During these engagements, we made clear our views that decisive action was needed on the following issues:

> Strengthen the management team: management had not demonstrated it had the appropriate expertise and project-governance oversight in place to reassure investors that there would not be further write-downs of a similar scale to those already incurred, particularly as the company embarks on a project at Hornsea-3 that is more than twice as big as any previously undertaken.

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Past performance does not predict future returns; losses may be made.

> Release a clear funding plan: the delay in releasing a clear funding plan following project cancellations has risked further undermining of market confidence. Orsted's future investment plans depend on debt, private infrastructure and public equity markets remaining open to it, and on confidence in the company's ability to deliver. It is also important for management that, given the company is trading at a discount to asset value, dividends will be sacrificed before new equity is raised.

> Show discipline on project governance and capital allocation: we believe that management, the board of directors and in particular the audit and risk committee, need to be crystal clear that future projects will only happen if they meet the previously stated return criteria of 150-300 basis points above the company's cost of capital, including an appropriate margin for error in the assumptions, and that they should provide the market with detail on the project internal rates of return (IRRs) that are being underwritten.

We supported this engagement by writing a letter to the chairman. We also deepened our understanding of the issues by further research on the company's stakeholders and competitors, meeting with independent industry experts and discussing the market landscape with select energy companies. Since our engagements, Orsted has made management changes aligned with our proposals, which received a positive market reaction. We added back to our position following this, viewing it as a positive signal that the company is listening to shareholders and willing to take the necessary action to restore confidence and rebuild value. Our engagement is ongoing, and we will look to build further confidence in the management team and the funding roadmap.

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Contemporary Amperex Technology

Contemporary Amperex Technology (CATL) is the largest electric-vehicle (EV) battery and energy storage system (ESS) battery manufacturer globally. The company has industry-leading profitability and directly contributes to the global transition to EVs and renewable energy. In 2022, CATL shipped 192GWh of EV batteries, equivalent to 3.7 million EVs and plug-in hybrids. In the same year, CATL also shipped 47GWh of ESS batteries, equating to 38% of the global market.

Weakness in the company's share price was largely driven by the same dynamics that impacted Wuxi Lead Intelligent Equipment (described above). In fact, during 2023 CATL reported consistently strong results. For the first nine months of the year, the company grew revenues by 40% and net profits by 70%. Nevertheless, market sentiment towards CATL saw little improvement during the year as almost every other company in the EV battery value chain reported significantly worse earnings year-on-year. Media reports on the US political backlash against a CATL-Ford partnership, as well as European investigations into Chinese EV supply chains, also weighed on the stock.

In November 2023, we visited CATL's two major production facilities in Ningde and Yibin, both in China. The trip confirmed our view that CATL not only has by far the largest scale and therefore lowest unit production cost, but that it is also a leader in lowering the carbon footprint of its battery production. Phase 1 of the CATL Yibin production facility is the first ever zero-carbon battery factory in the world, and CATL aims to achieve Scope 1 and 2 carbon neutrality by 2025. We believe this, alongside CATL's technology and cost advantages, will be a core competitive advantage to help the company navigate through the geopolitical uncertainties and continue to grow.

For 2024, we expect CATL to continue increasing revenues and profits, with revenue growth of c.10% and net profit growth of >10% (implying a 'low-teens' 2024 price-earnings ratio) and an ROE of c.26% in 2024, in line with historical averages. Our upside potential estimate for this company is c.80%.

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Past performance does not predict future returns; losses may be made.

Top contributors

Ansys

Ansys develops simulation software for computer-aided engineering, which is used to predict how products will behave in the real world. Its software allows customers to reduce material inputs, increase energy efficiency and stimulate innovation within low-carbon technologies across renewable technologies, electrification solutions, and building and industrial processes. Its strong performance was mostly attributable to solid earnings results during Q1, reflecting broad-based growth across regions and industries, and rumours that Ansys will be acquired by Synopsys during Q4.

Schneider Electric

Schneider Electric provides energy-management and industrial-automation solutions. The company serves the major transitions towards a more electric, decentralised, decarbonised and digitised world. The company enjoyed a rally in cyclically-sensitive names early in the year and continued to perform strongly during Q2 after reporting strong results and raising its guidance. In November, Schneider had its first capital markets day since the appointment of a new CEO. It announced upgraded targets for sales growth and margin expansion, which were well received by investors.

Power Grid Corporation of India

Power Grid Corporation of India is a leading transmission business in India, focused on building and operating the country's power grid. Since we initiated the position in Q1 2023, its shares have been supported by competitively bid new project wins, a strong capital expenditure outlook for the integration of renewables and an attractive free-cash-flow yield, as well as positive views on its structural-growth opportunities.

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Infineon Technologies

Infineon Technologies is a market-leading power semiconductor company whose products have wide application across clean-energy technologies. During Q1, Infineon outperformed along with the technology sector and more cyclically-sensitive equities generally. The company then delivered better-than-expected results in November, with revenues driven higher by continued strong demand for semiconductors, especially for renewable energy and electrified transport. Infineon also provided a resilient outlook for FY2024, further contributing to its outperformance.

Trane Technologies

Trane Technologies is a leader in heating, ventilation and air conditioning (HVAC) solutions. Its share-price performance reflected strong results on the back of a resilient commercial market[10].

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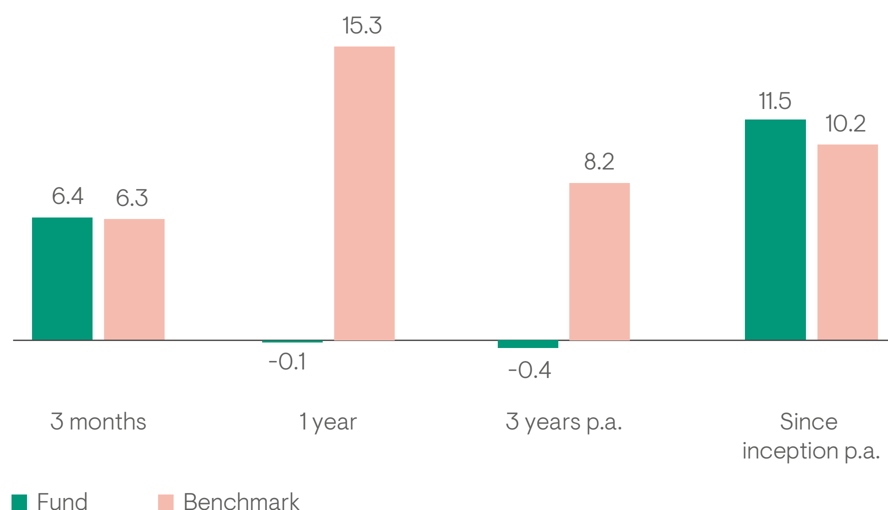
10. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided.
 Not all securities held have been discussed, for further information on how the overall strategy performed during the period covered, please reference the relative performance noted elsewhere in the Performance and attribution section.

6 Appendix

Fund composite performance (GBP)



Calendar (%)	2020	2021	2022	2023
Fund	47.8	12.9	-12.4	-0.1
Benchmark	12.7	19.6	-8.1	15.3
Active return	35.1	-6.8	-4.3	-15.4

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Source: Morningstar, 31 December 2023. Performance is net of fees (NAV based, including ongoing charges), with net income reinvested where applicable, in GBP. Performance start: 25 February 2019. Performance prior to 02/12/2019 is based on a longer existing share class, adjusted to match the fees of this share class. Fund: Global Environment (I Acc GBP). This fund is actively managed and is a sub-fund of the Ninety One Funds Series iii (OEIC). Performance shown prior to the fund's launch on 02 December 2019 is based on the Luxembourg-domiciled Global Environment Fund. Benchmark: MSCI AC World Net Return, is used for performance comparison.

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CS_561 02/2024 - MACS16848