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Investing for a
world of change

A structural investment theme poised for lift-off



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Are investors becoming more aware of the structural investment opportunity?

Yes; the transition finance penny is starting to drop. That's unsurprising given the high-profile climate crises we saw in 2023. We're starting to see greater recognition among sophisticated investors that to target the transition investment opportunity and make a meaningful contribution towards net-zero goals, they need to 'follow the carbon' – and that means investing in EM.

Asset allocators we talk to across the globe are increasingly aware that there is no global net zero without net zero in emerging markets (EMs) and that the sums of capital needed for this – either for companies and projects that are delivering new clean infrastructure and technology or for those that are investing to significantly decarbonise their existing processes – are vast.



Tom Peberdy
Investment Director

Today, more than 90% of global emissions come from five critical sectors: power, industry, transportation, agriculture and buildings. Among these, the importance of the industrial space in EM really stands out – over 80% of the world's industrial emissions come from EMs. This is because many of these critical, but hard-to-abate, industries like cement, steel, chemicals, and plastics – things that we use in developed markets every day and are going to use for the next 30 years – have been outsourced to EMs. So, it's encouraging to see something of a shifting tide in perceptions around net zero, with more people grasping the fact that a just transition to global net zero means working with these heavy emitting, but critical, industries within EMs.

How much is the higher-rates environment impacting this market?

Given the vast sums of money needed for the EM transition to net zero, companies that are making this happen need to tap into public debt markets and/or source private loans. Unsurprisingly, net issuance in the entire EM public debt market was anaemic in 2023. The cost of finance for many just hasn't made sense. However, as many EM corporates entered this higher rate environment in a healthy position – as noted by my colleague Victoria Harling in the [EM corporate debt outlook](#) – they can afford to be patient.

That said, many of the CFOs we meet feel that we are reaching a point in the cycle where it makes sense to just get on with business, even if that means potentially locking in slightly higher financing rates so they can move forward with the capital expenditure plans that are essential to fulfil their transition commitments.

The market environment seen in 2023 has also underscored to us the benefit of accessing the transition finance opportunity through both public and private debt markets. When rates markets are volatile, issuers may be willing to pay a bit of an illiquidity premium to see that their debt financing can be executed confidently and not be at the mercy of public bond market dynamics.

What excites you most about the year ahead?

It does feel like we're near a tipping point for EM transition finance, especially on the private credit side. Over the past decade, developed market companies have dominated the exponential growth of the private credit market that stemmed from a retreat by traditional lenders like banks following the Global Financial Crisis. Today in EMs, regional lenders are retreating and we are seeing a similar vacuum of credit to what we saw 10 years ago in developed markets. We could be experiencing that lift-off in EMs today.

Is the higher cost of capital deterring companies' transition investment activities?

Despite the higher cost of capital, healthy levels transition-related activity are continuing in emerging markets, which translates into a growing opportunity set for investors. There are several reasons for this. First, the leading companies in this space have made very public commitments of hitting their pathway goals (such as being certified by the [Science Based Targets Initiative](#)), which are hard to renege on. Secondly, the large bond owners in this space – such as Ninety One – won't let these companies off the hook; a high level of engagement continues, regardless. Finally, these investments increasingly make sense for the bottom line and companies are recognising there are significant financial benefits to, e.g., switching their energy source from the grid to renewables.

It's more on the non-core investments side – such as starting a transition-related subsidiary in a separate business from a company's core operations – that we've seen some scaling back of activity, but there's certainly no loss of momentum in transition-related activity within core businesses.

Where are you seeing the most interesting opportunities?

Although we noted earlier that public debt market issuance rates declined somewhat in 2023, there have been some notable exceptions. For instance, on the infrastructure side, we saw a new issuance from one of the larger producers of clean energy in Indonesia – a sector where the need to decarbonise is critical. We also saw one of the top five electric-vehicle battery manufacturers in South Korea issue a new bond.

But the transition finance opportunity set will continue to span a much wider area than this, and it is important to grasp the scale of this structural investment theme. Considering the amount of capital required to facilitate the transition in EM – the International Energy Agency predicts US\$1 trillion per year to 2050 – we expect to see a growing total addressable market of credible transition bonds and loans in the short, medium, and long term. Decarbonisation is creating a secular growth tailwind for the companies and projects that are contributing to net zero, and that translates to compelling opportunities for investors seeking attractive yields and competitive returns.

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