Strategy commentary

Ninety One Global Environment

Quarter ending 31 March 2024

The following commentary gives the views of the investment manager at the time of publication.

Key points

- Global Environment delivered a positive absolute return and underperformed the MSCI ACWI
- Detractors included Infineon Technologies
- Contributors included Xinyi Solar
- There were no new additions or full exits during the quarter

Market background

Global equities had another strong quarter, with several markets reaching all-time highs and the MSCI All Countries World Index gaining more than 8% in USD. The upbeat mood in risk-asset markets was driven by broadly positive economic data as well as continued optimism around artificial intelligence (AI). From a regional perspective, the S&P 500 Index recorded another double-digit gain, with the large US technology stocks again leading the market. Chinese equities declined over the quarter overall, but momentum turned sharply positive in February, when the Chinese authorities intervened to stabilise sentiment. By sector, IT and communications services led the way, with energy and financials not far behind. Sectors hampered by the prospects of rates being higher for longer – namely real estate and utilities – were notable laggards.

Performance review

The Global Environment Strategy delivered a positive absolute return and underperformed the MSCI AC World Index (in USD, gross and net of fees[1]). The primary detractor from relative returns was the strategy's stock selection within information technology, primarily not owning NVIDIA (see below). Stock selection within industrials also dragged on relative returns due to idiosyncratic effects, as did overweight positioning in utilities which lagged the broader market, though positive stock selection provided some offset to this. The majority of underperformance came in January, when Chinese stocks again experienced negative sentiment. This reversed in February and March, with a number of Chinese names bouncing back due to positive regulatory updates and strong earnings. The strategy outperformed over February and March.

At the stock level, the main detractors from relative returns included the following:

- A zero weight in NVIDIA detracted as continued excitement about the company's potential to benefit from increasing adoption of artificial intelligence propelled the stock higher.
- Infineon Technologies is a market-leading power semiconductor company. Within renewable energy, Infineon supplies the top 10 wind-turbine and solar-inverter companies with power semiconductors. It also serves the electric vehicle (EV) market. Infineon's underperformance was driven by broad-based weakness in power semiconductors, resulting in a cut to the company's FY2024 guidance. Despite very weak sentiment towards EVs, particularly in the US, the company's automotive business has remained resilient as Infineon is exposed to the global EV value chain. China is by far the biggest EV market, with two-thirds of all sales, and it remains strong.
- Vestas Wind Systems is the world leader in wind-turbine manufacturing. Vestas experienced a significant share-price recovery during Q4 2023, due to strong US demand. Over Q1 the shares

[1] Where performance is gross of fees, returns will reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

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 in the Performance review section.

Past performance is not a reliable indicator of future results, losses may be made.

gave up some of these gains, largely due to profit taking, interest-rate sensitivity and short-term betting on weaker Q1 orders.

- Sanhua is a leading global supplier of automotive heat-management systems and heating, ventilation and air conditioning (HVAC) components. After a strong share-price performance in 2023, in contrast to the broader Chinese equity market, in February the stock fell due to unconfirmed media reports of upcoming US restrictions on smart cars and related components made in China. The US makes up a relatively small proportion of Sanhua's revenues, at c.14%.
- Aptiv is a global technology company that serves the mobility industry. We believe it is a leader enabling the transition to an electrified, software-defined vehicle of the future. The company was impacted by weakness in the auto sector, particularly in the US, and to a lesser extent Europe. However, similarly to Infineon, Apitv is exposed to the global EV market, of which China is the biggest contributor.

The following companies were the main contributors to relative returns:

- Xinyi Solar is the world's largest producer of solar glass. It is well placed to benefit from the move away from fossil fuels to generate electricity towards renewable energy. The stock's outperformance was driven by a strong 2023 earnings release and positive regulatory developments for the Chinese renewables value chain. Xinyi reported 50% volume growth over 2023, suggesting that the company has maintained its market share even in a very competitive environment. This, along with the positive regulatory developments, resulted in a significant share price jump, which catalysed a broader jump in Chinese clean-tech stocks.
- Apple delivered a negative return over the quarter. A zero weight in the stock benefited relative returns given the sizeable weight of the company in the benchmark.
- Waste Management is the largest waste-collection and processing company in the US. Through its landfill network, the company sequesters carbon and other greenhouse gases. In addition, Waste Management is a significant player in the recycling industry. The company reported a good set of results which highlighted strong growth over 2023, with similar expectations for 2024, and strong performance on cost efficiencies resulting in margin expansion. We expect margins could expand further as green capital expenditure continues to increase.
- Carlisle Companies is a market leader in US commercial roofing systems that improve energy efficiency. It continued its strong run during Q1, with the share price appreciating due to continued beats on margins and regulatory replacement demand.
- Sungrow Power Supply is the world's largest manufacturer of solar inverters, a crucial part of a solar power plant. The company is also a leader in energy-storage systems, solar-power project development and wind converters, with additional product capabilities in electric-vehicle (EV) charging and hydrogen electrolysers. Sungrow's outperformance was driven by a strong preliminary release of its FY2023 results, which highlighted year-on-year revenue and profit growth of more than 76% and 159%, respectively.

Portfolio activity

Significant buys

No new additions were made to the portfolio over the quarter.

Significant sells

No full sales were implemented over the quarter.

In January we added to Chinese names that sold off, and which went on to perform well in February and March. Following Xinyi's outperformance, we recycled capital into Orsted, which was down over March. We also reduced positions in Sungrow and Waste Management and added to our holdings in Croda, Iberdrola, NextEra Energy and Rockwell Automation.

Engagement: TE Connectivity

TE Connectivity is the world leader in connectivity and sensor solutions. It is positively exposed to structural growth as its solutions enable sustainable decarbonisation across various industries and end-uses. As an electronic components manufacturer, the company helps its customers produce smaller, lighter and more energy-efficient products. In transport, for example, the electrification of vehicles creates a need for more robust terminal and connector products, doubling the content opportunity for TE Connectivity relative to internal combustion engine vehicles. The company offers the broadest range of technologies in this space. Furthermore, its custom-engineered connectivity solutions are used to drive industrial automation, as well as cooler and greener datacentres.

As part of our annual review, we set engagement goals for all companies in the Global Environment portfolio. Our goals for TE Connectivity were as follows:

- Reporting company-wide carbon avoided.
- Adopting science-based targets.
- Disclosing detailed labour-management and supply-chain practices.
- Improving board gender diversity.
- Board refreshment.

In Q1 2024, we completed a collaborative engagement (via letter) with another impact investor, to seek enhancement in the quality of Scope 3 disclosures (by including downstream Scope 3 emissions), and clarity on work towards a definitive commitment to an SBTi-approved 'net-zero by 2050' target. We recognise TE Connectivity's efforts in setting near-term carbon-reduction targets but believe enhanced Scope 3 disclosure, coupled with a clear articulation of the steps that will enable the company to adopt an SBTi-approved longer-term 'net zero by 2050' target, will be critical in managing climate risk.

Following our engagement, we received a comprehensive letter from TE Connectivity detailing the challenges it faces in setting a net-zero emissions target. 95% of its emissions come from Scope 3, partly via a supply chain that extends to 10,000 suppliers. This makes it difficult to compile accurate and complete carbon data from which to develop an actionable emissions-reduction plan.

Despite the challenges, we were pleased to learn that TE Connectivity is looking to implement training programmes with its suppliers to improve carbon data. In particular, it has established a team to partner with its metals providers to calculate their respective carbon footprints, and is educating suppliers on how to reduce emissions through operating standards and investments in infrastructure. TE Connectivity is also working to roll out: an annual survey for suppliers to complete; renewable electricity and emissions accounting advice; and resin waste reduction in its own operations to reduce the amount of materials it procures. We will continue to engage with the company on these issues.

Outlook and strategy

With the US election approaching and uncertainty persisting over China's macro outlook, many of our investors have been asking about the prospects for decarbonisation in the world's two largest economies. Unsurprisingly, this has been on our minds too, hence why our research programme has included visits to Washington, DC and multiple Chinese manufacturing hubs in recent months.

First, China. After a poor start to the year, the recent performance of Chinese equities has been encouraging. It is too early to say whether we are at the beginning of a sustained rally. But what we can say is that, even through a difficult spell for China, demand for clean technologies has grown strongly: in 2023, China recorded 216GW of solar installation, more than double the volume of the next three biggest markets combined. One key reason for this is that Chinese officials continue to regard clean-tech sectors as essential enablers of the economic transition away from reliance on real estate, infrastructure investment and low-end exports. As such, we expect them to continue to receive government support.

For investors, care and selectivity remain crucial, because the current period of hyper-competition still has some way left to run. From a longer-term perspective, we think leading companies with strong competitive advantages in the decarbonisation sector will emerge stronger from the present difficulties, as weaker players with more generic offerings face a potentially existential struggle.

Meanwhile, the US Presidential election is being contested by candidates with starkly different stances on climate. There are three policy areas that could go in very different directions depending on the election result in November: fiscal, trade and tariffs, and climate. All of them may have consequences for the universe of companies driving the shift towards a lower-carbon global economy. Our trip highlighted the need to focus on what happens on the ground rather than the noise, and that potential tariffs will be far more consequential to climate investments than an IRA repeal, which we believe is less likely than The Street thinks.

For the first time in the portfolio's history, it is trading cheaper than global equities (MSCI ACWI) on a price-to-earnings basis. Meanwhile, the companies in the portfolio are generating stronger revenue growth than the broader index, and are steadily growing returns on equity due to their competitive advantages and good margins. Given these fundamentals, we are excited about the prospects for the current portfolio. As always, we will continue to challenge and test our ideas as we execute our highly selective investment approach within the universe of companies that are positively exposed to the shift to a clean-energy world, with a focus on leading businesses across sectors that are making a positive contribution to decarbonisation.

Specific risks

Commodity-related investment: Commodity prices can be extremely volatile and losses may be made. Concentrated portfolio: The portfolio invests in a relatively small number of individual holdings. This may mean wider fluctuations in value than more broadly invested portfolios. Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Derivatives: The use of derivatives is not intended to increase the overall level of risk. However, the use of derivatives may still lead to large changes in value and includes the potential for large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. Emerging market (inc. China): These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. Geographic / Sector: Investments may be primarily concentrated in specific countries, geographical regions and/or industry sectors. This may mean that the resulting value may decrease whilst portfolios more broadly invested might grow. Sustainable Strategies: Sustainable, impact or other sustainability-focused portfolios consider specific factors related to their strategies in assessing and selecting investments. As a result, they will exclude certain industries and companies that do not meet their criteria. This may result in their portfolios being substantially different from broader benchmarks or investment universes, which could in turn result in relative investment performance deviating significantly from the performance of the broader market. The full list of Fund risks is contained in the appendices of the Ninety One GSF prospectus.

Important information