Ninety One

Global Sustainable Equity

Market context

Markets performed strongly in the third quarter, not without volatility. Increasingly weak US labour data and a hawkish move by the Bank of Japan (BoJ) which raised short-term rates to 0.25%, sparked a sharp global reaction and unwind of carry trades. Additionally, lacklustre earnings from big-tech companies contributed to a sizeable risk-off move. However, sentiment improved as the quarter progressed, helped by central banks' dovish pivot including the US Federal Reserve's (Fed) decision to cut rates by 50bps and the BoJ's indication that further tightening would depend on financial stability. US economic data also improved, while China unveiled its most substantial stimulus package since the pandemic.

Against this backdrop, global equities delivered a positive mid-single-digit return, with emerging markets outperforming developed markets. Chinese equities posted the best quarterly performance since Q2 2009, returning c.20% following the significant stimulus announced by the People's Bank of China (PBoC). Within developed markets, following a strong Q3, US equities recorded their strongest year-to-date performance of the 21st century. However, mid-quarter turmoil arose as disappointing earnings results cast doubt on big-tech company valuations and the 'Magnificent 7' moved into correction territory. While US equities recovered, there was a notable rotation away from tech stocks, with utilities the strongest performing sector. European and UK equities also advanced albeit by a smaller magnitude. Japanese equities were the exception as they fell back for a second quarter following the initial rate hike by the BoJ and the subsequent yen appreciation.

Performance

The Strategy delivered a positive return and outperformed the MSCI ACWI (in GBP, net of fees)[1].

Strong performance was delivered largely through stock specific exposure, with structural growth drivers across the different themes – climate adaptation and financial inclusion specifically – seeing a strong contribution for the quarter. Not holding the 'Magnificent 7' stocks, which led the market for the previous two quarters, contributed to relative returns. However, our exposure to companies that contribute towards decarbonising the growth opportunity embedded in the AI trend detracted slightly from returns as market sentiment swung away from tech and AI-related stocks. Exposure to financial services companies generated strong returns.

The main contributors to relative returns include the following:

- **AIA Group:** Asia's leading insurance company tackling financial inclusion in priority regions benefitted from the Chinese market rally and improving market conviction in the company's growth trajectory
- **Aon:** global insurance broker with growth opportunities around tackling the emerging need for climate adaptation gained on the back of strong quarterly earnings and organic growth developments

[1] Where performance is gross of fees, returns will reduce 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 does not predict future returns; losses may be made.

- **Yadea Group:** the producer of electric two-wheelers benefitted from news of the sooner than expected release of new national standards within China, reinforcing Yadea's safety positioning and brand strength
- **NextEra Energy:** the world's largest generator of electricity from wind and solar is a market leader in both battery storage and North American renewable energy saw strong performance. NextEra is forecast to see significant growth in renewables to meet the rising demand from AI data centres. We view this surge in data centre demand as a pivotal new growth opportunity
- **Intact Financial:** the Canadian insurer's differentiated business model integrating risk and data insights into policy positioning for customers tackling climate resiliency delivered strong quarterly earnings as one of the best operators in the insurance industry
- **Veralto:** the water business reported strong results with attractive growth and margin expansion seen in the strongest quarter for the company since its spin out from parent Danaher late in 2023.

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

- **Visa:** global payment network business saw news of growing regulatory scrutiny of its US based debit business, a drag on sentiment we see as misplaced relative to the value add of the business model within the financial and digital inclusion ecosystem
- **RELX**: the London-listed information and analytics group improving access globally to high-quality research and scientific progress saw some macro concerns hitting segments of the business
- **Wuxi Lead Intelligence:** the Chinese based producer of battery production equipment and services saw a challenging quarter with compromises in cash collection and order win rates. Following extensive debate, we have now exited the position given reduced conviction in the competitive advantage of the business model
- **Waste Management:** America's largest waste-collection and processing company with structural growth opportunities to decarbonise the US household and business waste collection industry saw market pressure following digestion of recently announced Stericycle acquisition and ongoing investor questions on return opportunities within renewable natural gas activities
- **TSMC:** the chip manufacturer lifted forecasts for FY2024 revenue expectations but saw some rotation away from AI-exposed names.

Portfolio activity

Significant purchases

- **Bank Rakyat Indonesia:** As Indonesia's leading microfinance, consumer, and corporate bank, Bank Rakyat offers significant opportunities for financial inclusion within a largely underbanked domestic population. Indonesia is among the world's most underbanked countries, with approximately 100 million adults—around 55% of the adult population—lacking access to financial services. Bank Rakyat, Indonesia's second-largest bank by assets, has recently pivoted its portfolio toward bottom-of-the-pyramid lending through strategic acquisitions. Microfinance and SME loans now make up over 50% of its loan book and represent its fastest-growing segments.

- **Steadfast:** as Australia's leading insurance broker, Steadfast plays a crucial role in helping SME clients build financial resilience against climate change. Over the past decade, the company has achieved a 15% CAGR in revenue and profits per share, driven by brokers—and Steadfast in particular—gaining market share as insurance carriers pull back coverage in many areas. Steadfast has also expanded its underwriting agent business, providing customers with better access to wholesale markets and hard-to-price policies, further enhancing its climate adaptation credentials. Customer retention is high in this high-margin, asset-light industry. Additionally, Steadfast's decentralised yet scalable network of brokers generates impressive financial returns, benefitting from strong negotiating power with insurers and the ability to offer additional services to network members.

Significant sales

- **Wuxi Lead Intelligence:** despite the company's potential to drive decarbonisation in the global EV sector, our conviction in its competitive advantage diminished over the quarter. Interactions with the company and team discussions highlighted a likely narrowing of its competitive moat. Signs of intensifying industry competition and key international customers shifting away from integrated production lines became increasingly apparent, reducing our confidence in Wuxi Lead's ability to maintain a durable competitive edge within a softening industry landscape.

Stock in focus: Nu Holdings

Nu Holdings is a digital bank operating in Brazil, Mexico, and Colombia, regions where roughly 139 million people are either unbanked or underserved - a significant portion of the 260 million underserved individuals across Latin America. The company focuses on providing financial services to those with limited or no access to traditional financial products.

We believe the firm has several competitive advantages, including a cost edge across three of the four primary banking expenses. Its cost to serve clients is 85% lower, with a workforce of 7700 compared to 100,000 at Brazil's leading bank, Itaú Unibanco. Customer acquisition costs are also lower, driven by organic referrals, which account for over 80% of its nearly 85 million customers. Additionally, Nu Holdings' cost of risk is about 10% below the Brazilian market average, supported by its 'slow and grow' credit approach, where clients can start with a credit limit as low as US$10. These advantages are likely to strengthen as Nu grows its customer base, benefits from operational leverage, and reaches profitability in its Mexican and Colombian operations.

In addition, we believe Nu Holdings' returns are sustainable due to its digital business model and prudent credit scoring/lending approach, which enable it to achieve structurally higher ROEs – above 50% in Brazil over the past two quarters - compared to the country's top banks, which average around 21%, despite maintaining higher capital adequacy ratios. Operating in countries with significant needs for financial inclusion, Nubank's mission is to 'fight complexity to empower people in their daily lives by reinventing financial services.' The company has successfully expanded financial access, particularly among lower-income segments. In Brazil alone, Nubank has brought 21.6 million previously unbanked or underbanked individuals into the formal financial system since inception. It also saved clients over US$ 11 billion in fees in 2023. The company also qualifies within the sustainable solutions framework, with clear intentionality in its mission and materiality, given that its primary growth driver is its credit portfolio, which includes credit cards, personal loans, and, most recently, payroll loans.

Outlook and strategy

As an investment team, we continue to see sustainability creating a wide and growing opportunity set for active, concentrated investors. The decade ahead will be critical for addressing a broad range of sustainability challenges, presenting investors with significant potential to both generate returns and invest in companies contributing to positive social and environmental outcomes.

Although inflation appears to have peaked, and central banks have initiated their rate cutting cycles, financial markets remain volatile as investors weigh the prospect of a more pronounced slowdown in the US and the Fed being 'behind the curve' against the prospect of a soft landing coupled with the stimulus of rate cuts and easing financial conditions. While keeping a close eye on how macro trends may affect our portfolio companies, we remain focused on identifying companies with sustainable structural growth, enduring competitive advantages and sustainable returns, at attractive valuations. We view these characteristics as particularly advantageous in the current environment, giving companies not only a greater ability to withstand a challenging economic backdrop, but also exposure to areas of structural growth as efforts to address critical environmental and social issues advance.

We continue to see opportunities in our focused investment themes of decarbonisation, financial inclusion, healthcare impact, climate adaptation & water and pollution management, digital inclusion and access to education.

From a wider perspective, we continue to see positive longer-term prospects for the diverse group of companies in the portfolio, and we maintain our belief that companies that put sustainability at the heart of their business models and operations – and that proactively manage their relationships with all of their stakeholders, including employees, business partners, customers, local communities, the environment and society – stand the best chance of achieving success over the long term.

For active managers, volatility continues to present opportunities. Looking ahead, we will remain patient and ready to respond to compelling opportunities to enter positions in businesses we have been monitoring, and to add to existing positions in which we have strong conviction.

Specific risks.

Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. 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. 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. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise. Liquidity: There may be insufficient buyers or sellers of particular investments giving rise to delays in trading and being able to make settlements, and/or large fluctuations in value. This may lead to larger financial losses than might be anticipated.