Biodiversity Strategy

COP16 highlights intensifying challenges facing nature and the environment

- Global stocks ended 5 months winning streak on US election concerns and rising bond yields
- Share price reaction to generally solid results were mixed reflecting elevated expectations
- Reduced exposure to semi equipment and increased position in Deere, a leading US provider of agriculture machinery

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What's happening?

Global equity markets declined in October in US dollar terms following several months of robust performance. Speculation around the upcoming US elections led to heightened volatility given its implication for inflation and interest rates. The US Federal Reserve is expected to continue to reduce interest rates over the coming months, but a strong labour market and resilient inflation have reduced the likelihood of another 50bp cut. Elsewhere the European Central Bank cut rates for the third time and the UK budget announcement put pressure on the gilt market. European and Asian markets declined the most while the US held up better. Sector returns were broadly negative led by materials, healthcare, and consumer staples. Conversely, information technology, communication services and financials were flat. Growth and value stocks declined in absolute terms.

Beyond financial markets Biodiversity was a prominent theme over the month as the sixteenth Biodiversity COP was held in Cali, Colombia. As is often the case with COPs, expectations were high entering the event, and unfortunately were not wholly met. The event did make tangible progress; delegates agreed on a global levy on products made using genetic data from nature, with the proceeds pooled to create a biodiversity conservation fund. In addition, indigenous communities were formally included in the decision-making process for the first time. However, the event was criticised for a lack of leadership and urgency from key participants such as the EU and China. This manifested in a lack of progress on reforming environmentally damaging subsidies and the event ended without an agreed-upon overarching finance strategy for nature conservation or plan for monitoring progress on biodiversity targets. While there was no "Paris moment" for Biodiversity at COP16, it continued to highlight the intensifying challenges facing nature and the environment. And, while these challenges persist, there will continue to be strong demand for the solutions provided by portfolio companies' products and services.

Source: All data sourced from Bloomberg, local currencies, as at 31/10/2024

Portfolio positioning and performance

The Biodiversity strategy underperformed its benchmark in October.

Technology Enablers led returns in October with software companies generally performing well. Design software company Autodesk led returns as the company held its annual Autodesk University event where construction and engineering customers noted their positive outlooks for 2025. Autodesk used the event to draw attention to its portfolio of AI-enabled products, which should improve functionality and strengthen the company's leading competitive position in AEC (Architectural, Engineering and Construction) software. Infrastructure software design company Bentley Systems was weaker as investors continue to debate levels of near-term growth. Bentley also held its Year in Infrastructure Conference in October, a similar event to Autodesk's. This highlighted Bentley's opportunities in AI and its attractive end markets.

Returns in Responsible Production and Consumption were led by US waste and recycling company Waste Management. WM reported strong third quarter results as the business continues to demonstrate pricing power. WM's shares also responded strongly as the company noted expectations of improving free cash flow growth in 2025 as sustainability capex moderates as recycling and renewable natural gas projects ramp up. Recycled packaging maker Ball Corp was a drag on returns as the company's quarterly results were taken negatively by the market. This was mainly due to volume weakness in North America and some South American markets. Ball effectively reduced production levels in the quarter to protected margins well. Going forward Ball should grow in-line with underlying markets and capture any recovery from currently depressed markets.

AGCO led returns in Sustainable Food and Agriculture despite near term cyclical headwinds persisting, characterised by ongoing production cuts to manage dealer inventory levels. While such measures pressure earnings in the short term, longer term they could reduce the duration of the downcycle with retail demand returning in 2025. European ingredients companies Symrise, Novonesis and DSM-Firmenich were the biggest detractors to returns in October as investors took profits following strong share price performance year to date. We believe these innovative companies should continue to benefit from structural drivers of growth including demand for more efficient food production systems.

Resilient Infrastructure was the weakest sub-theme in October with US environmental testing and healthcare tools company Thermo Fisher the biggest detractor to returns. Thermo reported solid third quarter results but shares subsequently sold off over the following days as the unchanged 2024 guidance was not enough to meet elevated investor expectations. US infrastructure and environmental consultancy Aecom was the strongest contributor to returns as the company continues to evolve its business model to focus more on higher margin, lower risk design and programme management services. The funding environment remains healthy for Aecom's end markets and should continue to drive strong growth.

During October we closed our position in Applied Materials due to continued weak demand in China and an uncertain outlook on leading foundry investment. We also sold our position in Trimble as the company's exposure to agriculture has fallen over time. Proceeds from these sales funded an increase in Deere, which we think is near a cyclical low.

Outlook

We think the portfolio is well-positioned to benefit from the structural tailwinds supporting investment in biodiversity. We think agriculture and food, closely followed by water, are the two biggest issues facing the natural world, and we think the fund's holdings in these sectors provide highly valued solutions to these challenges. While good progress has been made in recent years regarding regulation, in particular the Global Biodiversity Framework and the EU Nature Restoration Law, we find the more recent lack of consistency on environmental regulation frustrating. However, we don't think this is stifling innovation or progress in the private sector where companies are making sustainability-oriented investments independent of regulation. In fact, we are encouraged to see technology beginning to disrupt old-fashioned industries, like construction and agriculture, which have some of the largest negative biodiversity footprints.

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Our outlook on financial markets remains unchanged. We believe markets are adjusting to a "higher for longer" environment where there will be greater scarcity of finance and growth. This should favour higher quality companies – those with strong cash flow generation and organic growth opportunities – who should be relatively unaffected. We believe the portfolio has good balance and can weather a potentially weaker economy in 2024, feeling the impact of sustained high interest rates, or can outperform a more buoyant market in the event of a "soft" or "no-landing" outcome.

No assurance can be given that the Biodiversity strategy will be successful. Investors can lose some or all of their capital invested. The Biodiversity strategy is subject to risks including Equity; Emerging Markets; Global Investments; Investments in small and micro capitalisation universe; Investments in specific sectors or asset classes.

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