Biodiversity Strategy

Outlook on reducing plastic pollution remains mixed as UN talks fail to establish production limits

- US equity markets rose following the re-election of President Trump while European and Chinese equities fell on concerns over US trade policy, and weak economic data.
- Alliance to End Plastic Waste failed to meet its target to divert 15mt of plastic from the environment due to prioritising investments in new capacity over recycling facilities.
- We opened a new position in US sustainable building materials company Azek.

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What's happening?

Global equity markets rose in November in US dollar terms led by strong performance in the US following the re-election of President Trump. The potential extension of the 2017 Tax Cuts and Jobs Act, deregulation in areas such as energy and financial services, and trade policies that favour domestic companies provided a strong tailwind for US equities. Furthermore, 3Q earnings fared slightly better than expected and macro data continued to be robust. Elsewhere, European equities fell on concerns over US trade policy and weakness in areas such as autos and consumer goods while China was unsurprisingly weak given the threat of higher US tariffs. Sector returns were broadly positive led by consumer discretionary, financials and energy. Conversely, materials and healthcare were the only sectors to decline. Growth outperformed value but both were up in absolute terms.

November was another busy month of biodiversity-related news flow led by stories on plastic and packaging. Fossil fuel producing companies see plastics as an ongoing growth opportunity, perhaps beyond energy, which must moderate if we are to reduce emissions (fast) enough. Plastic producers unsurprisingly see recycling as the solution, rather than producing less virgin plastic. However, recycling capacity, relative to plastic production capacity, is a mere fraction. This undermines initiatives like the Alliance to End Plastic Waste (AEPW), set up by incumbent producers in 2019 including Dow, ExxonMobil, Shell and TotalEnergies. The AEPW planned to divert 15m tonnes of plastic from the environment over five years but fell woefully short of this target achieving just 119,000 tonnes. This compared to production of 132m tonnes of virgin plastic over the same period, demonstrating why most consider this initiative merely a greenwashing exercise. One of the key reasons for its failure was a prioritisation of investment in new production capacity over recycling capacity. At the end of November, the fifth round of UN-led talks on plastic pollution resumed in South Korea, seeking to establish a global treaty on plastic production. This initiative seeks to halt all plastic pollution by 2040 and the consensus view is that this will only be possible with production cuts. We will revisit the outcome of these talks in our December update.

Source: All data sourced from Bloomberg, local currencies, as at 30/11/2024

Portfolio positioning and performance

The Biodiversity strategy underperformed the broader market in November.

Responsible Production and Consumption was the strongest contributing sub theme over November. Diversified industrial Kadant was the strongest performing name as US small and mid-cap stocks performed well following Trump's election victory. Kadant should benefit from general improvement in economic conditions, given its diversified business model, and some of its end markets will benefit from de-regulation. Swedish software company Hexagon was the biggest detractor to returns as the company announced the somewhat unexpected departure of CEO Paolo Guglielmini as the company looks to outline its next phase of growth. Hexagon is also in the process of selling its Asset Lifecycle Intelligence business, which should streamline the business.

Cadence Design Systems – the leading semiconductor software company – was the strongest positive contributor to returns in Technology Enablers, just ahead of construction software company Procore Technologies. The stock performed well following strong quarterly results announced at the end of October. Cadence continues to see strong demand for next-gen AI/accelerated compute chip design programmes and investors remain confident of ongoing organic growth delivery. Further down the semiconductor value chain, NXP Semiconductors was a weaker performer as ongoing industrial and auto end market weakness weighed on the stock price. NXP also held an analyst day shortly after announcing quarterly results where long term growth and margin targets were presented.

Engineering and Construction consultancy Aecom led returns in Resilient Infrastructure as the share price benefitted from the post Trump election win bounce in mid-caps. Aecom also posted solid quarterly results later in the month. Aecom outperformed some of its peers given its lower exposure to US federal funding and thus lower perceived risk to Department Of Government Efficiency initiatives. Recycled plastic water products business Advanced Drainage Systems was the biggest detractor in November as the company reported weak results. These were primarily driven by weak trends in the non-residential end market and some negative effects from storms in the US. Long-term we remain confident in the ability of ADS to take share from concrete pipe incumbents and grow faster than the market.

Sustainable Food and Agriculture returns were led by Deere as the company reported solid quarterly results, precipitating a strong share price reaction. This was driven by continued progress in rationalising dealer inventories and an increasingly aged fleet. These metrics may be evidence that the company has reached a cyclical trough which led us to top up our position in October. We believe that Deere still has a long way to go to emerge from the current agricultural malaise. German ingredients company Symrise had another poor month, continuing trends observed in October. Symrise held an analyst day later in November where the company stressed its commitment to improving margins and continued mid-single digit organic growth. This modestly positive news helped arrest share price weakness earlier in the month.

During November we started a new position in US sustainable building materials company Azek. We are optimistic regarding the company's ability to gain share from incumbents (using non-sustainable materials) and thus grow ahead of the market. There is also potentially a cyclical tailwind if mortgage rates fall from currently elevated levels. We also topped up our position in Novonesis following weak performance and we trimmed our position in Kadant following strong performance.

Source: All data sourced from Bloomberg, local currencies, as at 30/11/2024

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.

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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