Sustainable Quarterly review

Q2 2024 market review

Overview

- US equity markets continued to rally and hit record highs
- Central banks' rate cutting regimes began to pick up pace
- Market participants keep a close eye on global election results

Macroeconomic landscape Q2 2024

After a slight pullback in May, US equity markets continued to **rally** and hit record highs, lifted by Nvidia, Apple and Microsoft, with Nvidia briefly overtaking Microsoft in June to become the world's most valuable company. The narrowness of the markets was even more pronounced this quarter, as Nvidia rose 37% while the S&P 500 **Index** gained 4.3%. Nvidia is responsible for some 35% of the S&P 500's gains since the start of this year. In comparison, the equal weighted S&P 500 Index fell 2.6% in the quarter, clearly indicating a handful of companies continue to drive the indices.

Government **bonds** fell slightly throughout the quarter as market participants weighed up the outlook for inflation and economic growth. Investment Grade and High Yield bonds showed resilience, benefiting from the strong economic growth outlook and the tailwind provided by their high-income component.

Markets have fluctuated between anticipating one or two Federal Reserve (Fed) rate cuts this year. However, due to persistent price pressures and a robust job market, the Fed is unlikely to rush to cut rates. Meanwhile, the Bank of England (BoE) indicated in June it is more comfortable cutting rates and will likely start in August. While the European Central Bank (ECB) lowering interest rates by 0.25% (to 3.75%) in its June meeting was expected, it is noteworthy that interest rate cutting regimes are picking up pace with central banks in Sweden, Switzerland and Canada all cutting rates.

Following an unexpected rise in April, the US Consumer Price Index (CPI) showed signs of moderation, suggesting inflation is heading in the right direction. Bond yields followed suit, with 10-year Treasuries reaching 4.7% early in the quarter before falling to 4.4% by quarter-end.

On the political front, Rishi Sunak's decision to bring forward the UK general election to 4th July stunned market participants. Labour won the election by a landslide, but markets showed limited reaction to the news as polls had predicted the Labour victory for months. Given that fiscal headroom remains limited, policy changes are likely to be marginal despite the huge electoral swing.

In the US, the first presidential debate brought forth fresh concerns over President Joe Biden's health and former President Trump continues to lead key swing states. In early June, the European Parliamentary elections showed surging support for right-leaning parties, with President Emmanuel Macron calling a snap national election in France. The French CAC 40 fell over 6% following Macron's announcement and the difference in the amount of interest that French bonds pay over German Bunds reached levels not seen since 2017. However, following the second round of voting, France now faces gridlock as none of the three main parties secured a majority.

Can the energy transition survive the 2024 election cycle?

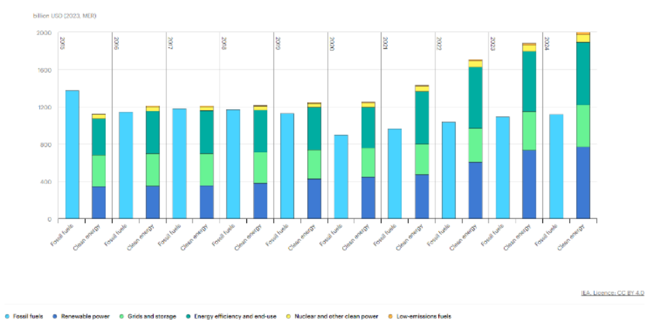
Written by Kevin Le, Trainee Portfolio Manager

In the global climate transition journey, we have seen a significant amount of investment from governments into boosting cleaner energy generation and support for broader solutions needed to mitigate the effects of climate change. However, at the halfway point in a year defined by the number of influential elections and geopolitical tensions rising, the question remains as to how these investments will be affected?

The story so far

Over the past ten years, we have seen a significant amount of investment into clean energy and infrastructure. A report by the International Energy Agency (IEA) found that the world now invests almost twice as much in clean energy as it does in fossil fuels.

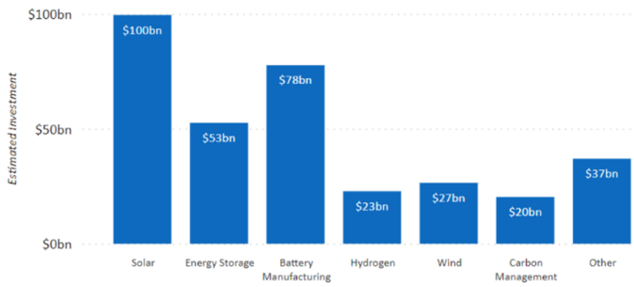
Global investment in clean energy and fossil fuels, 2015 – 2024



Source: International Energy Agency (2024)

While on the face of it, the majority of investment decisions have been primarily driven by the private sector, governments continue to play a crucial role in directly and indirectly shaping capital flows into the climate transition. For instance, in the US, the Biden administration passed the Inflation Reduction Act (IRA) focusing on cutting emissions by 40% by 2030. It pledged $369 billion of stimulus in the form of tax incentives, lending, and grants. Since its release, US companies have announced more than $336 billion investment into a range of technologies surrounding the clean energy economy. In the Electronic Vehicle (EV) space where individuals can get up to $7,500 of tax credits, six out of the top ten US automakers saw EV sales grow by over 50% in Q1 2024. The IEA estimates that EV sales are expected to double in 2025. While EVs still account for approximately 1% of all vehicles on US roads, its growth is something that cannot be ignored.

Announced IRA investments by technology: over $336 billion is being invested in a range of technologies



Source: Rhodium Group / Clean Investment Monitor (CIM)

In Europe, the EU has also been providing significant support to the green economy with its Green Deal Investment Plan, a collective of sustainable programmes, which aims to allow access to €1 trillion in sustainability investments within the next decade to reach net zero by 2050.

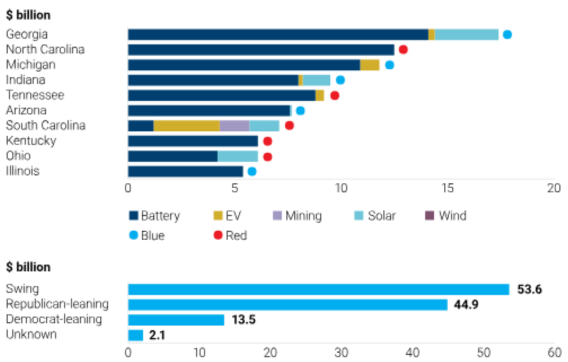
Political uncertainty ahead

The policies we have seen implemented in the US and EU have given remarkable support to the climate transition, but with elections looming, the question remains as to whether these initiatives will endure?

With the US election on the horizon, there have been reports stating that Trump would axe the IRA if elected and repeal restrictions on the fossil fuel industry, a stark contrast to the climate and energy policy implemented by his opponent. While reports seem to suggest that the fate of the IRA solely rests on which party will be winning the election, we find that much of the benefits from the IRA are concentrated in non-Democratic states. For example, since the introduction of the IRA, the majority of investment announcements have been in Republican and swing states which leads to more job creation and economic growth. In this case, it seems unlikely that a full repeal of the IRA would garner sufficient support from within the Republican party, let alone the potential backlash from other stakeholders. This is not to say that a Trump presidency would not look to make some adjustments to the Act, but the overall impact may be limited.

The EU's political environment is also unstable with increasingly polarised views across the spectrum. In Germany, the Green Party's vote share appears to have almost halved since the last election in 2019 and since the snap election in France called by President Emmanuel Macron, we have seen support for the Green Party fall by a similar amount. Despite these losses, the centre ground in politics is still holding and the progressive policies we have seen emanate from the EU over recent years remain in place. Like the US, we do not believe that politics is binary in terms of the influence on climate policy and whilst leadership and global policy co-ordination is important, we should not forget the other drivers of change and progress, not least the economic argument.

Domestic manufacturing types and state locations (top) and billions invested (bottom)



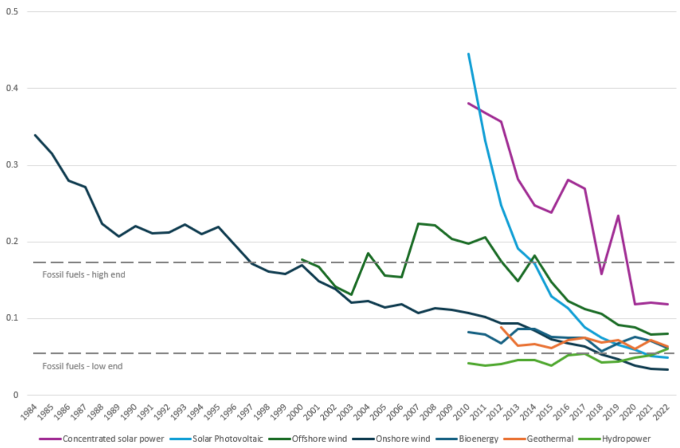
Source: BloombergNEF, March 2024

The trends we have seen in the wind and solar markets signal that government policy was beneficial in kickstarting the growth in those industries. However, as production has risen there has been a significant reduction in costs, thus making it more economically attractive. Renewable energy is now the cheapest form of electricity generation in most instances, so it stands on its own two feet as the rational way of meeting our energy demands regardless of other influences. With this dynamic now in place, it provides significant opportunities for those leading companies scaling renewable generation and therefore opportunities for their investors.

Levelised cost of energy by technology, World

The average cost per unit of energy generated across the lifetime of a new power plant. This data is expressed in US dollar per kilowatt-hour, adjusted for inflation.

Source: International Renewable Energy Agency

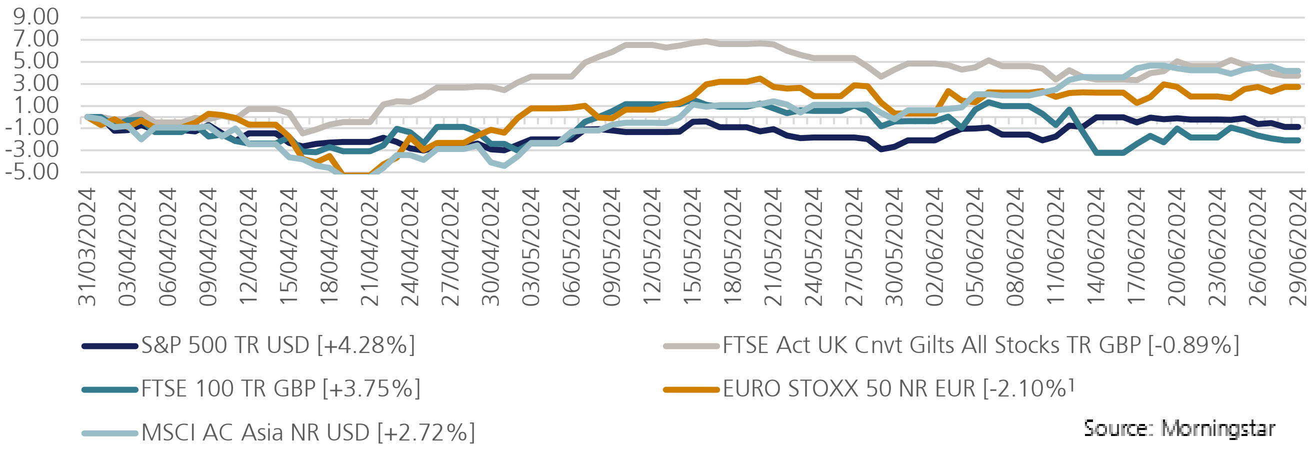


Data is expressed in constant 2022 USD.

Politics not the only game in town

Political leadership on the energy transition is very important, and we have a better chance of meeting global climate goals if we have supportive politicians in positions of power strengthening policy. It is also true that we are in an election cycle where there are more polarised views. However, when you dig beneath the surface of the politics and economics in the energy transition, we believe there are strong structural reasons as to why progress will continue regardless of election outcomes which will benefit our goal of addressing the impacts of climate change, and the investment opportunities associated with it.

Q2 2024 index performance (%)



Model portfolio performance as at 30 June 2024

Portfolio	3 months	6 months	1 year	3 years	Since inception (01.11.2018)
Defensive	0.71	2.20	7.02	-0.34	18.11
Cautious	0.75	3.22	8.11	1.24	25.88
Balanced	0.91	4.14	8.86	2.86	36.75
Growth	0.91	4.98	9.58	2.87	46.47
Adventurous	0.98	5.64	9.54	2.67	50.83

12-month rolling performance

Portfolio	01/07/2019 - 30/06/2020	01/07/2020 - 30/06/2021	01/07/2021 - 30/06/2022	01/07/2022 - 30/06/2023	01/07/2023 - 30/06/2024
Defensive	3.22	7.93	-8.23	1.47	7.02
Cautious	3.31	12.21	-9.42	3.38	8.11
Balanced	3.58	18.32	-10.43	5.49	8.86
Growth	5.66	22.44	-12.31	7.05	9.58
Adventurous	6.12	25.09	-13.61	8.50	9.54

Sources: Morningstar

Performance is gross of 0.30% AMC and net of underlying charges

Past performance is not a reliable indicator of future performance; and the value of investments, as well as the income from them can go down as well as up, and investors may get back less than the original amount invested.

Performance of sustainable funds in Q2 2024

Stewart Asia Pacific Sustainable Leaders	+5.93%
Polar Capital EM Stars	+5.05%
Janus Henderson Global Sustainable Equity	+4.14%
Foresight Global Real Infrastructure	+3.95%
Impax Asia Environmental Markets	+2.60%
HC Cadira Sustainable Japan Equity	-6.29%

Source: Morningstar

The second quarter of the year saw positive market performance within Asia, particularly in Asia Emerging markets. Stewart Asia Pacific Sustainable Leaders, Polar Capital EM Stars rose by 5.93% and 5.05% respectively. Within the region, positive macroeconomic data, signs of government stimulus, and attractive valuations have turned investor sentiment more favourable, leading to strong performance and promising prospects for continued growth.

Janus Henderson Global Sustainable Equity (+4.14%) also saw considerable gains with the US leading the charge with momentum and **mega-cap** tech stocks propelling markets. Investor attention remained focused on the '**Magnificent 7**' with Nvidia seeing significant stock price appreciation and accounting for c. 33% of the S&P 500 performance in the first half of the year. Nvidia accounts for approximately 7.5% of Janus Henderson Global Sustainable Equity.

Foresight Global Real Infrastructure (+3.95%) saw positive gains this quarter, showcasing a small bounce back from its poorer performance in Q1. As the market begins to price in lower fund rates across the long term, we saw the negative drag of the fund which has a significant exposure to long duration assets ease slightly for the quarter. Additionally, we saw stock specific gains from Foresight Global Real Infrastructure with Brookfield Renewable Partners (BEP) announcing a 10.5 GW framework agreement with Microsoft to develop renewable energy projects within the next 4 years. On the day of announcement, the stock saw a c. 30% increase in price.

HC Cadira Sustainable Japan Equity (-6.29%) saw a decline over the quarter as the yen continued to depreciate and we saw conservative earnings forecast for Japanese companies. We added HC Cadira Sustainable Japan Equity to the higher risk models in May, bypassing the majority of the quarterly decline and with the Bank of Japan showing signs of proactive interest rate hikes indicating a commitment to stabilising the economy, this could pave the way for future recovery and growth.

For fixed income, we witnessed central bank divergence as some had begun their easing cycle, most notably the ECB while the Fed and BoE remain on hold. Even though evidence shows that inflation is returning to the 2% target there was continued uncertainty around the timing of the Fed's first rate cut. In this environment, it was short duration and high yield bond funds that benefitted given their lower sensitivity to interest rates. The Vontobel TwentyFour Sustainable Short Term Bond fund returned +1.1% in Q2.

Portfolio changes and rationale

Adding into Japan from EM

- Given at the start of the quarter where we saw recent market strength in Asia Emerging markets, we took this opportunity to trim some of our exposure by reducing our position in Impax Asia Environmental Markets across our Growth and Adventurous models by 1.5% and 2% respectively. While we still hold a relative overweight to the region, trimming our position has allowed us to take advantage of recent market uplift while balancing our geographical exposures.
- We added HC Cadira Japan Sustainable Equity to our approved list, a fundamentally driven fund with strong ESG and sustainable credentials focusing on investing in high quality Japanese companies.
- Structural reform in Japanese markets have provided attractive opportunity for investors as corporate governance reforms prompt increased shareholder-friendly initiatives and government support for markets resilience. As opposed to our other Asia funds which provide minority Japan exposure, having Cadira as a dedicated Japanese fund within our range strengthens our ability to capitalise on Japanese market tailwinds.

Reducing cash in Defensive, Cautious and Balanced Models

- Whilst cash has been an attractive asset over the last one to two years, as interest rates start to come down this will diminish. The macro landscape has not shifted significantly of late however the general economic picture is relatively robust and corporate forward-looking expectations in aggregate are also supportive.
- We have been considering opportunities to reduce our cash allocation in our more defensive portfolios (where we have retained larger exposures) for the past few months and believe that increasing our core global equity bucket and US holding is a prudent approach at this time, providing broader market exposure.
- We also propose increasing the Trojan Ethical weighting to 10% in Defensive and Cautious, this further increases a degree of market exposure (c.20% equity allocation), whilst providing some exposure to government bonds where **yields** look attractive and gold as a further diversifier.

Further material

Take a deeper dive into the Q2 2024 investment landscape with key members of the LGT Intermediary Investment Services team.

Click here

Watch Ben Palmer, Lead Sustainable Portfolio Manager, discuss the second quarter of 2024 in a five-minute quarterly roundup.

Click here

Glossary of terms

Bonds	Bonds are debt securities issued by governments and corporations to raise money. Similar to an IOU, the investor lends money with the agreement that it will be paid back by a specific date, and they will receive periodic interest payments along the way. Bonds come under the umbrella of '**fixed income**' investments.
Defensive	Defensive positioning means prioritising asset protection during market turbulence by favouring stable sectors like utilities, consumer staples, and healthcare.
Earnings season	The period during which publicly traded companies release their quarterly financial results to the public.
Growth vs Value	Most stocks are classified as either value stocks or growth stocks. Generally speaking, a value stock trades for a cheaper price than its financial performance and fundamentals suggest it's worth. A growth stock is a company which comes at a higher price however, its profits are expected to grow significantly in the coming years as the company develops – this is typical for technology firms.
High conviction	An investment portfolio with a small number of carefully chosen securities, reflecting the manager's strong confidence in their selections.
Index / indices	A benchmark that tracks the performance of a specific group of assets, such as stocks or bonds
Index linked bond	A type of bond whose interest payments and principal value are tied to a specific index, such as inflation or a stock market index.
Magnificent Seven	A group of high-performing technology companies considered industry leaders, including Apple, Amazon, Alphabet, Microsoft, Meta, Tesla, and Nvidia.
Quality	A quality stock is one from a financially sound company with stable earnings, consistent growth, and strong management.
Rally	A market rally is a sustained increase in stock prices driven by positive investor sentiment and economic conditions.
Sentiment	Market sentiment is the overarching attitude or outlook of investors towards a particular security, sector of the market or economy as a whole.
Soft vs hard landing	A soft landing refers to a gradual economic slowdown or adjustment, usually avoiding a recession, while a hard landing is a sudden and severe economic downturn often leading to a recession.
Market capitalisation / mega-caps	Market 'cap' is the market value of a company based on its current share price and total number of shares. Ultra-large cap companies have the largest market capitalisation. The largest companies by market cap are currently Apple, Microsoft, Alphabet (Google), Amazon, Nvidia and Meta (Facebook).
Yield	The income you receive on an investment, such as dividends from shares or interest from bonds.
Yield curve	The yield curve is like a snapshot of how interest rates are right now for different types of loans or bonds. It shows how much you'd earn if you invested your money for a short time, like a few months, versus if you invested it for a longer time, like several years.
Volatility	Volatility refers to the degree of fluctuation in a security's price or a market's performance over time. A highly volatile share experiences larger price changes compared to more stable investments, indicating higher risk.

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