MARCH 2022 - N.7

THE MESSAGE

ARMS RACE(S)!

ESG vs Non-ESG

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Man can assume different personalities, which we often simplify in two opposites: the Good and the Bad, like in the case of Dr Jekyll. When he's inspired, Man can create timeless masterpieces such as the Gioconda, the Coliseum or the Divine Comedy; when he's angry, he sows destruction, atrocities and terror.

As never before, these two extremes now emerge within Europe.

The war against Ukraine, while humanely terrible, has brought to the forefront in Europe two opposite needs: the Bad has called for an arms race, the Good for an alternative energies race. The latter seen as the only chance to get energy independence in the future.

Sustainable finance according to AISM LUXEMBOURG

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In the last month we often heard talking of the NATO pact and, in particular, of the 2% of GDP guideline for defence spending by each NATO member. Today only few are at target, but after the start of the war against Ukraine many promised to reach or even exceed that threshold. Germany, among the first, three days since the start of war announced EUR 100 bn defence spending, almost twice as much as 2020. Italy approved an increase of the defence budget up to 2% of GDP and Macron included a similar increase among his re-election program: EUR 50 bn within 2025. If the single countries rush for a new arms race, EU itself approved the creation of a 5000 men army and a specific defence budget to be able to intervene in full autonomy if need be. Even before the war, on Feb 15th, EU has proposed a tax reduction on weapons produced on the continent.

One should wonder whether sustainable investments, that typically exclude arms-producing companies from their investable universe, are going in the right direction. It's true that according to SFDR only exposure to controversial weapons is subject to disclosure, but the unripe world of ESG investments tends to neglect such subtle distinctions.

It's the other arms race, the one of investments in renewable energies, that is going in the same direction of that ESG world and sustainability closer to the common feel.

The current war has highlighted once more Europe's energy vulnerability due to its dependence from foreign countries, namely Russia. Additionally it showed the need to be fast and achieve energy independence as soon as possible, without further delays.

Once again, the first to move in the race was Germany, budgeting EUR 200 bn to accelerate the transition according to its Minister of Finance Christian Lindner. This, however, was after the coalition partner Greens staged protests fearing that the 100 bn defence spending would go to the detriment of the environmental budget. A thought that crossed the mind of a few investors, too.

The Bloomberg news about a second Eurobond to finance defence and energy, although later denied, prompted a rally for the companies of the two sectors. From Feb 23rd to the beginning of March renewable energy companies such as Orsted, Vestas or Nel bagged returns around 40-50% while the S&P Clean Energy index jumped by about 20%. After all, if the first Eurobond of March 2020 linked to the Next Generation EU program was followed by the best nine months for the renewable energy companies whose price grew by multiples, why there couldn't be a second wave of repricing?

The strong rally of the first week of war, as opposed to the decline in the rest of the markets, suggest that investors wandered away from these investments despite no changes in the EU's or world's governments plans on the subject. Of course a few critical points emerged: the increase of commodity prices, the supply chain issues, the delay of projects and the interest rates rise that penalise growth and utility companies. However their prices may have discounted bad news too much, as if the expected growth were in jeopardy. Speaking of growth, one of the reasons why investors shied away from renewable investments last year is the increased competition in sectors such as wind and solar, but it's easy to guess, given the need of energy from these sources, how much the demand would outstrip the supply.

If now investors don't explicitly bet on alternative energies companies, at least they don't ignore them anymore even though the critical points mentioned above have not disappeared. Actually the current war may only exacerbate them. The renewable investments may even overheat, and their volatility increase, if EU will actually go for a new Eurobond given the heightened sensibility of investors to this theme.

As we have always maintained, the energy transformation is often based on new technologies, sold by companies that will produce earnings only in a few years' time because today is the moment for heavy investments. The journey will last 30 years and we're only at the beginning: let's keep calm and carry on.