THE MESSAGE

HESITATIONS

ESG bear market

Massimiliano Comità, Portfolio Manager

Hesitations have begun to surface. After only four months from the start of the Russian invasion of Ukraine, the roar for renewables' revival appears to be fading, if not dead already. Articles suggesting that ESG investments are now out of fashion are starting to appear. Surveys report that investors consider the Taxonomy as an hindrance to finding investment opportunities. And redemptions from ESG funds seem a real risk in the second half of the year: the darker the green, the higher the potential redemptions. Investments such as hydrogen are seen as too long-term until they become profitable, given the high costs and the lack of earnings for the next two years or more. Rising rates all but strengthen this perception.

Sustainable finance according to AISM LUXEMBOURG

Alpha Investor Services Management

Luxembourg

CONTACTS
info@aism.lu
+352 27 85 47 1
21 Rue Aldringen
L-1118 Luxembourg

To support this thesis, we have as well news coming from Germany, Austria, Italy, Belgium and other European countries that, to face the energy emergency, not only postpone the closure of nuclear plants but re-open the infamous coal-powered power stations.

Is this the end, then? The oil companies generous dividends are enticing for many. With sky-high oil prices and record cashflows, who wouldn't want to invest in oil companies? Even defence stocks, since the start of the war, have prompted ESG funds to tweak their screenings, separating manufactures of generic weapons from those of prohibited non-conventional weapons.

The world of finance seems to focus more on a short-term horizon than on long-term investment returns. Driven by the need for positive performances in three, six months or one year, funds look for loopholes not to miss opportunities that could make their clients happy.

The European energy transformation will last thirty years. Maybe more, but the direction hasn't changed. On the contrary, the targets are revised up every time there's an external shock: from the *Green Deal* to *Next Generation EU* when the Covid-19 pandemic started, to Fit for 55 and finally *Repower EU* after the invasion of Ukraine. Incidental circumstances are like market trends: a bear market can last one or two years, but if one were to bet systematically on a down trending market, in the long run they would probably only lose money. Europe is firmly convinced of this structural change: as Ursula von der Leyen underlined, Europe should take the current crisis as an opportunity to push ahead, rather than going back to the dirty fossil fuels. Oil companies know that, too, and will use the huge cashflows generated by the current oil price to accelerate on a transformation that is unavoidable.

The same holds for governments that now fall back to coal-powered stations: in Germany the announcement came from Habeck, the minister for Economic Affairs and Climate Action, a member of the Green Party. A supporter of clean energy forced to such a decision by the sudden 40% reduction in Russian gas supplies, that made untenable an already difficult situation. Untenable today, that is: but what will happen when the emergency will end?

The point is that if private investments don't go along with public incentives, certainly the energy transformation will slow down. Finance must give its own contribution during this difficult period, and the returns will come, even for those energies that are now unprofitable.

Going back to the case of hydrogen, for example, we could say that ten years ago even residential solar panels was unprofitable. In Italy it would have costed 30 thousand Euros and the energy savings alone were not enough to offset it. With public incentives, however, one would have gained almost 90 thousand

Euros in 20 years.

Green hydrogen is similarly unprofitable today, given its costs, but thanks to ever more ambitious targets set by EU in terms of green electrolytes (from less than 1GW today to 6GW in the *Green Deal*, to 17.5GW in the *RepowerEU* by 2025), one can hope in considerable public incentives.

Today, residential solar panels in Italy cost around 10 thousand Euros and with current electricity prices one could save up to 1500 Euros per year. Even without considering the incentives for building renovations, it's an investment that returns 3x in 20 years: a respectable 7.2% per year. The same will happen with hydrogen, that EU will support until it will be strong enough to become profitable per se.

Those who invest in the energy transformation, announced as the biggest revolution after the industrial one two centuries ago, cannot simply look one or two years ahead but should have more foresight and conviction that a more sustainable future is possible. Otherwise, we know already how it will end.