AS AT 28.03.2024

Market Review

Most developed market central banks appeared to confirm that 2024 would see policy rate cuts begin. While higher-than-expected inflation data raised question-marks over the timing, investors were reassured by central bankers' rhetoric. First to cut was the Swiss National Bank in March. The US Federal Reserve and the European Central Bank could potentially be ready to act in June.

The outlook on global economic growth improved, especially in the US. In the eurozone, some tentative green shoots of growth appeared. In China, the authorities set their 2024 Gross Domestic Product (GDP) growth target at 5% and hinted that they would use their fiscal and monetary policy margins to support the economy.

In the US, Inflation forecasts for beyond 2024 were left unchanged, implying the Fed is not too concerned about the unexpectedly high figures posted in January and February. That said, consumer and producer price indices showed how tough the 'last mile' of the anti- inflation marathon will likely be. The inflation slowdown is continuing, although very laboriously – from 4.2% to 3.8% over the last six months. Labour market normalisation, too, appears to be underway, but still only gradually.

In the eurozone, most European Central Bank (ECB) governors reinforced the notion of a first rate cut in June. At the end of March, the market-based probability of a cut on 6 June was almost 100%. More than three cuts are expected in 2024. Flash purchasing managers' indices (PMIs) in March showed improving services activity but a still worsening situation in the manufacturing sector. Even so, the German economy started to show encouraging signs. Initial inflation estimates for March in the major eurozone economies suggested the slowdown in price increases would continue, but not rapidly. The ECB forecast a modest normalisation of the labour market.

In China, the first available data since the Lunar New Year (for January-February) was encouraging, with industrial production up by 7% YoY and retail sales by 5.5%. The real estate sector remains depressed. The National People's Congress in early March set the 2024 GDP growth target at 5%, which we think reinforces the likelihood of proactive policies on employment and incomes. The People's Bank of China reminded markets that it has significant room to manoeuvre on monetary policy when needed.

After their February surge, global equities continued on up, many indices reaching new record highs. The MSCI AC World index in US dollar terms gained 2.9% over the month and 7.8% over the first quarter.

European stock markets rose by 4.2% (EuroSTOXX 50) and 4.3% (MSCI EMU index in euros) on the back of some improvement in several business surveys, especially in Germany, raising hopes that the cyclical trough has passed in the eurozone.

Globally, the growth style rose by 1.8% compared to the end of February (MSCI AC World Growth index), while the value style saw a more pronounced rise (+4.4% for the MSCI AC World Value index), fuelled by the good performance of banks, especially in Europe. Over the quarter, growth (+10.0%) outperformed value (+6.9%).

Fund Performance & Portfolio Activity

Source: BNP Paribas Asset Management as at 28 March 2024. **Past performance is not indicative of current or future performance.** The above views represent our judgement as at the date of this report and may be subject to change without notice. Any economic and market trends/forecasts are not a guide to future performance of the fund. The funds/securities mentioned above are for illustration only and shall not constitute any investment advice. Calendar year performance: 2023: -25.77%, 2022: -35.22%, 2021: -16.85%, 2020: 188.38%, 2019: 2.55%

Fund Performance

In March, the BNP Paribas Energy Transition fund increased by +3.30% (Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in EUR) in March, modestly outperforming its long-term reference benchmark (MSCI ACWI) which returned +3.29%. From a sub-industrial perspective, our stock selection detracted from performance while sub-industry allocation made a positive contribution.

Largest contributors

SIEMENS ENERGY AG (+19.7%; +83bp): Siemens Energy has a unique portfolio of products and services that contributes to energy transition, covering the full energy value chain from gas services, grid transmission, decarbonisation technologies including hydrogen electrolyser, onshore and offshore wind. Positive performance this month was helped by news article suggesting the company is preparing to resume sale of its onshore wind turbines after the quality issue they encountered last year. In addition, one of its closest peer, GE Vernova, is spinning off from its parent, General Electric, in April at a higher multiples than Siemens Energy, supporting the re-rating story for Siemens Energy.

BLOOM ENERGY CORPORATION (+28.5%; +78bp): Bloom Energy is a provider of solid oxide fuel cell that is fuel flexible and can produce electricity from hydrogen, natural gas, or biogas. During the month, performance was helped by positive sentiment on AI-related stocks as data centers is one of the key end markets for Bloom Energy's fuel cell, particularly as grid access remains a key bottleneck to the build out of data centres.

LI CYCLE CORP (+147.1%; +65bp): Li Cycle is a company that focuses on lithium battery recycling technology. The company has announced $75m strategic investments from Glencore and continue to progress with the Department of Energy on getting financing to restart construction of the Rochester Plant.

FLUENCE ENERGY INC (+13.8%; 78bp): Fluence is a leading global provider of large-scale battery storage system, services and software that optimise renewable and energy storage assets. Its share price rebounded in March after being negatively affected by a short-seller report that was published in February. We have since spoken to the management team of Fluence to clarify the points that were raised in the short seller report and believe there were a number of inaccurate facts. For example, the short report mistakenly stated that the ongoing lawsuits with Siemens Energy at $2mn (which is immaterial given the size of Fluence and ordinary course of business) is the reason that Siemens AG is selling down its stake in Fluence, but in fact, Siemens Energy and Siemens AG are two different parties. In addition, although it is true that AES is becoming a smaller part of Fluence revenue mix, it is because Fluence is growing its business with other customers, and on an absolute basis, AES increased their business with Fluence by 52% in 2023.

Largest detractors

ARCADIUM LITHIUM PLC (-20.2%; 65bp): Arcadium was formed after the merger of Livent and Allkem on 4 January 2024 and is one of the leading player in lithium with presence in South America, Australia and Canada. Lithium spot price has decreased by a small amount towards the end of the month but has stablised after the larger increase saw in February.

RENEW ENERGY GLOBAL PLC (-7.5%; -63bp). Renew Power is one of India's largest renewable energy

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Independent Power Producers (IPPs) in terms of total energy generation capacity. India's clean energy transition is rapidly underway, and we expect Renew to be a big beneficiary, which continues to trade at a discount to its domestic peers. The stock is sensitive to interest rates (given US debt) and was under pressure as treasury yields climbed in March.

SHOALS TECHNOLOGIES GROUP LLC (-12.7%; -86bp) Shoals is a market leader in electrical balance of systems (EBOS) for utility-scaled solar projects. Stock performance this month has been affected by volatility in treasury yield that affected the broader clean energy space.

Key Portfolio Activity

Over the month, we introduced to our portfolio: ENPHASE ENERGY INC and SUNNOVA Inc.

Our overall stance remains relatively defensive versus year end given market context. In February we shifted out of residential solar in favour of defensive utilities selling both SunRun and then Sunnova. After significant selling pressure eased in March we have cautiously re-entered residential solar via a position in Sunnova (which we favour over SunRun where we hold only an extremely small position) and introduced a small position in solar equipment through Enphase, given the bottoming of the inventory cycle. In parallel, we sold our position in Schneider Electric, as we believe the security is overcrowded.

Our overall stance remains defensive which we believe is prudent given continued market volatility and uncertainty around the timing of rate cuts. Meanwhile, we acknowledge that the theme is trading at extreme valuation-lows relative to 20-year history and remain vigilant and ready to shift up the risk curve once warranted looking at short covering data, communication from Fed on timing of interest cuts and earnings that are all catalysts for a re- rating.

Fund Outlook

The volatility in the energy transition sector has made our pure play approach to managing BNP Paribas Energy Transition particularly challenging. Within current macroeconomic conditions, we believe companies are trading at multiples not seen in 20 years, and the space remains valued close to all- time lows at approximately 1.2x Electric Vehicle (EV) / Next Year Sales (having peaked at 3.5x EV / Next Year Sales in February 2021. We believe the market continues to misprice growth potential for companies within the energy transition theme due to the nascent, and in some cases complex, nature of these technologies and the business models underpinning them.

Interest rates are still close to 20-year highs and we believe the headwinds since 2021 are likely to turn into significant tailwinds for the energy transition theme given its cyclical exposure to growth and interest rates. We are now building conviction that we are close to the bottom of the cycle with numerous catalysts underpinning this view. From a macro perspective, looser monetary conditions should ease pressure on earnings. From a bottom-up standpoint, energy transition companies are trading at a significant discount both relative to the history of the sector and to the broad equity market.

Despite short term volatility, we firmly believe that the Year to date (YTD) sell-off in the theme that was primarily seen at the start of the year. was mainly profit-taking and not an indication of fundamentals.

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The downside risks to our outlook are that interest rates may stay higher for longer, keeping pressure on valuations and earnings in the short term and there could be further delays in US Treasury guidance on tax credits related to the Inflation Reduction Act. We will continue to monitor these risks and adapt our exposure to these cyclical risk factors.

It is also worth considering the energy transition implications of the 2024 US presidential election. A second Biden term could see additional efforts to ramp up climate action. In contrast, a Republican presidency would likely see some attempted pull-back on climate action, slowing, but not reversing, climate adaptation. Any negative impact on climate policies from a Republican win would in our view likely affect electric vehicles, biofuels and batteries only as climate policies favour Republican states, creates jobs and factories – and votes.

There is no doubt that climate policy is not high on the Trump agenda, however, there are a number of misperceptions about US climate policy, who benefits and what Trump really can do in regard to overturning or changing the Inflation reduction Act (IRA). We believe that the market underappreciates how difficult it is to undo legislation like this. For the Republicans to be able to change or repeal the IRA, they must not only control the White House but also both chambers of Congress. Absent this, it seems unrealistic that much will change from what the IRA look like today. Whilst a Republican president could repeal some Environmental Protection Agency (EPA) regulations targeting vehicle and power plant emissions, there will be no authority to change or repeal existing tax credits.

In the case where Republicans do win the White House And both chambers, we expect some legislated changes to the IRA which is very different from a full repeal.

Controversially, we do in fact see some positive outcomes on environmental policy from unified Republican government in accelerating permitting timelines. This would unfortunately bring meaningful benefits to fossil fuels, but equally to clean energy and electric transmission projects.
Lastly, from a longer-term perspective, we believe the structural tailwinds underpinning the strategy remain as strong as ever. These include:

- Government commitments and intergovernmental treaties
- Trillion of dollars of funding needed for the energy transition to reach net zero by 2050
- Governments' motivation to develop domestic, nationally secure and inflation-decoupled supply chains
- Continued cost decline in renewable energy technologies making them increasingly competitive with fossil-based solutions

It is worth noting that, regardless of any secular theme one considers, including AI and Internet, investors have always early on

1) Underestimated the speed and magnitude of adoption of emerging technologies.

The implication is that investors are typically late in getting into the theme and miss out on the most material performance from the emerging theme, think AI for example that has really only emerged as "mainstream" investable theme 6 months ago.

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2) Been too focused on the short term (on both earnings and macro-economic cyclicality) and not appreciated the long-term secular growth opportunity

Both Artificial Intelligence (AI) and Internet companies had very volatile revenue and earnings growth as theme emerged – as most emerging technologies have per definition – which saw most investors screening these companies out from their investment universe. In addition, cyclicality often shakes investors out at the bottom – only to get in when most of the returns have been made in the team (this is what happened in late 2020).

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