AS AT 31.05.2024

Market Review

Expectations about US Federal Reserve (Fed) monetary policy governed market movements in May. Economic indicators provided little help in deciding whether activity and inflation are slowing or the inflation risk is being kept high by very strong growth. The pushback of expected policy rate cuts led to upward pressure on bond yields, which in turn weighed on equities. Despite little consensus, investors gradually locked in on the unusual situation where 'bad news' on growth is 'good news' for risky assets as monetary policy loosening should come soon.

In the US, April inflation was in line with expectations after remaining surprisingly hot for three months. Core personal consumption expenditures (PCE) inflation, the Fed's preferred measure, rose by 0.25% between March and April, slowing from 2.81% year-on-year to 2.75%, the lowest since March 2021. Year-on-year core inflation was 3.6%, the lowest since April 2021. Gross Domestic Product (GDP) growth for the first quarter was revised down slightly to 1.3% annualised. After four consecutive declines, the services sector Purchasing Managers' Index (PMI) rose to 54.8, its highest in a year. The Fed's quarterly Senior Loan Officer Opinion Survey (SLOOS) on credit distribution showed less tightening of lending conditions and less decline in demand, suggesting the US economy should not move into recession as a result of tighter monetary policy, but that activity is likely to slow. Chair Jerome Powell said on 1st May 2024 during his press conference that the Fed was ready to keep the federal funds target rate unchanged 'for as long as necessary' but also clarified that he did not believe the 'next rate move will be a hike'.

In the eurozone, data on consumption and production improved. The composite PMI for the eurozone stood at 52.3 in May, the highest in a year and a sixth consecutive rise. Orders and employment recovered. The 12-month business outlook strengthened in May. The European Central Bank (ECB)'s commitment to start its easing cycle in June remained credible to investors, but expectations of subsequent moves weakened: While futures markets in March were foreseeing four 25bp cuts in 2024, this fell to barely above two by the end of May.

In China, indicators showed a slight slowdown in growth in April. Industrial production continued to recover but nominal retail sales growth slowed to 2.3% and the contraction in real estate investment continued. Credit growth remains lacklustre. Issuance of very long-dated Chinese government bonds, designed to boost the economy, started in May and are expected to total RMB 1 000 billion, with maturities of 20, 30 and 50 years (Source: Chinese Ministry of Finance website, 13 May 2024).

In other emerging markets, the resilience of consumption and the recovery in investment in the first quarter pointed to solid growth for the year as a whole. Goods prices have normalised and services inflation persists. This, and the postponement of the start of the policy rate cut cycle in the US, should lead to central banks in emerging economies slowing the pace of their monetary easing.

After quickly recovering the ground they lost in April and setting new records, global equities ended May on two consecutive weeks of declines. By 20 May, global and emerging equities had gained more than 5.0%

Source: BNP Paribas Asset Management as at 31 May 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%

compared to the end of April, but they then slipped to end the month up by 3.8% (MSCI AC World index in US dollars) and by 0.3% (MSCI Emerging Markets index in US dollars).

Emerging market equities underperformed, mainly due to the fall in Chinese equities at the end of the month: After rising by 11% by 21 May, finished by gaining only 3.6% (MSCI China index). The MSCI AC Asia ex Japan index rose by 1.9% in May.

US equity markets significantly outperformed in May. The S&P 500 gained 4.8% over the month, while the Nasdaq composite gained 6.9%.

In the eurozone, previous highs were surpassed in mid-May by several indices. The EuroSTOXX 50 finished the month up by 1.3% - a year-to-date rise of 10.2% - while the MSCI EMU index (in euros) rose by 1.7% (up 9% YTD) on improved economic news.

The fall in US long-term bond yields in the first half of the month helped the Growth style (+5.0% for the MSCI AC World Growth index) outperform the Value style (+2.6% for the MSCI AC World Value index). Globally, the tech sector continued to lead the way, particularly semiconductors.

Fund Performance & Portfolio Activity

Fund Performance

In May, the BNP Paribas Energy Transition fund returned +12.68% (Classic, Capitalisation share class, net of fees, NAV-to-NAV with dividends reinvested, in EUR), outperforming its long-term reference benchmark (MSCI ACWI) which returned +2.49%.

Largest contributors

During the month, we saw interest in artificial Intelligence (AI) and data centres broaden out to the clean energy sector as investors look for derivatives to play the theme. Renewable energy is essential to power data centres, particularly as many tech companies have net zero commitment. This resulted in good performance from a number of our holdings, including FLUENCE ENERGY INC, FIRST SOLAR INC, and BLOOM ENERGY contributing positively to performance of the fund relative to the MSCI ACWI as well as relative to the thematic reference indicator.

In addition, there were a number of policy announcements that benefitted First Solar. This includes targeted tariffs on a number of clean energy equipment imported from China to the US including solar cells, the removal of bifacial module exclusion under Section 201, Department of Commence accepted the new AD/CVD (Anti-dumping and countervailing duties) petition that focuses on solar cell production in four Southeast Asia countries, and additional guidance on domestic content bonus as part of the Inflation Reduction Act that uniquely benefited First Solar as the only large scale vertically integrated solar cell and module manufacturers.

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Siemens Energy reported strong earnings during the month exceeding expectation and upgraded its FY24 guidance. The grid technology business particularly stood out, with the order book increasing by 27% yoy to €3.7bn, according to company Q2 presentation result1. The turnaround on the wind business continues to be on track with no change to provisions, sales activity of the onshore wind (4x platform) to restart in Europe by end of 2024, and they will remain focus on core markets in Europe and the US. The company now guided to higher revenue growth, higher profit margin and higher free cash flow generation for the full year.

Sunnova also contributed positively during the month. Sunnova reported a solid Q1 earnings with higher than expected cash flow generation which is what investors have been focused on. Although the company reduced its full year guidance on customer addition, it reiterated the guidance on adjusted Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA), implying higher profitability. The company also priced its second-Department Of Energy backed Hestia Loan Asset Backed Securities (ABS) during the month, with the AAA-tranche spread coming in 25bps tighter than a similar transaction from November 2023, reflecting that the solar ABS securitisation market remains healthy.

Largest detractors

During the month, our China and Electric Vehicle (EV) exposures detracted from performance relative to the MSCI ACWI (as well as relative to the thematic reference indicator). For **Li Auto,** the market was disappointed that it is delaying the launch of its Battery Electric Vehicle (BEV) model from 2H24 to 1H25 as management believes it needs to increase the number of charging piles and upgrade its average store capacity to ensure successful BEV launch. The company maintains full year volume guidance despite delaying its BEV launch as it is seeing solid order momentum following the launch of its latest model L6 which, according to the company, has received 41,000 orders within three weeks.

Key Portfolio Activity

Earlier in the year we positioned the portfolio more defensively given the challenging market context for the theme, introducing positions in European utilities where risk-reward had become more attractive. More recently we have rotated out of some of these positions in favour of higher conviction solar and storage names given more attractive risk/reward.

We have also recently introduced some exposure to Artificial Intelligence (AI) on a select basis (and only in stocks where there is clear, and sufficiently significant link, with products and services that are directly attributable to energy efficiency) – examples are ARM HOLDINGS PLC and Nvidia. Given the high level of carbon emitted by data centres, we view the provision of energy efficiency solutions for this area is an important part of the energy transition. We thus have exposure to companies such as Nvidia whose GPUs enable large tech companies to run their data centres in a significantly more power efficient way for the same amount of compute.

We continue to have very limited exposure to areas we believe could be negatively impacted by a Trump win (for example Electric Vehicles (EVs), biofuels).

Over the month, we introduced to our portfolio: Electrical Components & Equipment firm NEXTRACKER LLC, Semiconductors company ARM HOLDINGS PLC and NVENT ELECTRIC PLC, three American corporations.

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Arm Holdings: Arm is the leading technology provider of processor IP, offering the widest range of cores to address the performance, power, and cost requirements of every device. Currently, two processing architectures dominate the computing market x86 vs. ARM. ARM has better performance than x86 at the same power envelope by up to 40%.

NVent Electric: Nvent provides enclosures, thermal management and electrical connection and protection solutions. The company is well positioned to benefit from a number of structural themes including electrification, onshoring and growth of data centres. As cooling accounts for 40% of energy consumption in a data centre and as AI training and inferencing workloads requires more cooling due to their power intensity, increasing efficiency is key to reduce emission. Nvent offers liquid cooling products that is more efficient than traditional air cooling due to liquid having higher thermal transfer capacity.

NEXTracker: NEXTracker is the largest solar tracker company globally with impressive execution track record and industry leading technology. We continue to see strong underlying demand for utility scale solar. Order intake has been consistently at $1bn per quarter, with backlog now standing at $4bn, providing visibility on earnings.

We sold: American-based Electrical Components & Equipment firm SHOALS TECHNOLOGIES GROUP LLC, Chinese-based Automobile Manufacturers company BYD CO LTD and British-based Electric Utilities corporation SSE PLC.

Fund Outlook

We continue to believe that the clean energy space is significantly mispriced with the market trying to balance a 'higher-for-longer' scenario and elevated thematic volatility with valuations in the clean energy theme having hit all-time lows only seen since the Global Financial Crisis (GFC) and European Debt Crises.

Whilst the theme has been under pressure because of (1) rising interest rates hurting capital intensive clean energy investments and (2) long duration growth innovation through higher discount rates, we are seeing this turning as interest rates are forecast to fall in both Europe and the US.

The short to medium-term catalysts for the theme are:

Valuations at all-time lows: the theme WilderHill Global Clean Energy Composite (EUR) standing at 0.9x P/S (Price/Sales) and relative to the broader market (MSCI ACWI) at 2x P/S and growth (MSCI Information Technology) at 5.3x P/S.

Interest rates: ongoing weakness in US macro data is likely – in our opinion – to force the Fed to cut interest rates quicker than the market expects, with the ECB likely to cut this month.

Merger & Acquisition (M&A): We have seen a significant pick up of M&A transactions in the space in 2024, where private equity firms are buying public equity clean energy companies at 20-60% premiums leaving room for additional upside. We have seen three more deals in May highlighting the growing interest among infrastructure funds and private equity in renewable energy assets given the structural tailwind and attractive valuation.

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Longer-term, the secular nature of the theme also remains rock-solid in our view with plenty of structural drivers such as population growth and rising incomes, energy and power scarcity from electrification and IoT, fossil fuel volatility discouraging use of gas and coal, continued cost deflation increasing adoption and total addressable markets, exponentially growing need for power to feed artificial intelligence and data centre growth and not least, climate change and the urgent need to speed up the energy transition.

As with all investing – including thematic investing – there are always risks. Apart from the broader equity market and associated risks, the risk we see are:

Higher interest rates: Whilst we see this as entirely unlikely, if inflation prints start turning higher and the Fed does not embark on interest cuts or indeed raise interest rates in the US, we believe this would create some pressure to the clean energy theme as we have seen it since 2021. However, with the most recent soft US economic data and a risk of a harder landing than expected, Fed is likely "behind the curve" and more likely to cut more aggressively in our view, than raise rates.

US election risk: This remains a potential headwind but we believe is very unlikely to lead to a full repeal of the Inflation Reduction Act (IRA) and likely to only impact specific areas within the theme. the energy transition theme never rallied more than under Trump, and never fell more than under Biden. It is unsurprising in a way – electrification is going in one direction and clean energy is no longer just driven by a desire to decarbonise, it is driven by significantly lower costs of producing power and the only way to meet power demand forecast to increase by 100% in the next 30 years. Whilst a Trump win and full Republican sweep it might create volatility and movement in sentiment short term, we believe any downside will be an opportunity to add to positions. Trump is likely to propose tax cuts and push for lower interest rates by influencing the Fed, all of which will only spur demand for clean energy investments. Finally, and more importantly, 80% of the investments earmarked for the Inflation Reduction Act (IRA) will benefit Red / Republican states and most of the IRA is built around so-called domestic content, US production of clean energy equipment.

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