Biodiversity Strategy

Significant flooding disrupted one of Brazil's most productive agricultural regions.

- Global equity markets rose on reinforced expectations of interest cuts.
- Floods in Brazil starkly illustrate the interconnectedness of climate change and biodiversity loss and their impact on global food chains.
- Market leadership was very concentrated and many technology stocks that outperformed are not part of the biodiversity investment universe.

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What's happening?

Global equity markets rose in June in US dollar terms as softer macroeconomic data reinforced expectations of interest rates cuts later in the year despite more hawkish commentary from the US Federal Reserve. The European Central Bank cut rates as expected but stubborn services inflation meant they were keen to stress further normalisation will be dependent on the data. There was a high degree of dispersion in sector level returns with information technology once again the standout followed by communication services and consumer discretionary. Conversely, utilities, materials and industrials declined. Growth stocks outperformed value during the month.

Aside from the financial markets, biodiversity made headlines for the wrong reasons in Brazil as significant flooding significantly disrupted Rio Grande do Sul, one of the country's most productive agricultural regions. Floods have ruined food stores, damaged soils, and disrupted harvests. Peak flooding occurred in mid-May, but the extent of the damage has more recently become apparent. Scientists believe exceptional rainfall levels to have been driven by a combination of El Nino, a heatwave and seasonally high humidity. National food production estimates have since been revised down; the 2024 soybean production estimate has fallen ~2%, for example. This has also contributed upwards pressure to commodity prices and could offset more recent food deflation trends. Western Europe is a big importer of Brazilian soybean, using it primarily for animal feed. Floods in the south of Brazil starkly illustrate the interconnectedness of climate (change) and biodiversity (loss) and remind us of the global nature of food value chains.

Portfolio positioning and performance

The Biodiversity strategy underperformed the broader equity market in June.

Technology Enablers was the strongest performing sub theme, with Autodesk making a strong positive contribution to returns. Autodesk had been weak in prior months as the company delayed the publication of its 2023 Form 10-K to further investigate several accounting practises. However, at the start of the month, this headwind abated with the announcement

Source: All data sourced from Bloomberg, local currencies, as at 30/06/2024

that no accounts would be restated and there would be a change in CFO. On the other hand, semiconductor company Silicon Laboratories was weak as demand for the company's products remains muted while channel inventories are worked down. Long term, the company is well positioned as a leader in Internet of Things connectivity.

Defensive companies Republic Services, Clean Harbors and Ecolab led returns in Responsible Consumption and Production over the month. These companies continue to benefit from relatively non-discretionary demand for their products and services in a month when the market worried about a weakening consumer and economy. US can maker Ball was a detractor, catalysed by a disappointing analyst day where EPS growth guidance was downgraded. Prior to this, Ball shares had generated solid returns as the company finalised the spin-off of their aerospace business and demonstrated improving volume growth.

In Sustainable Food and Agriculture, Symrise led returns as brokers upgraded the stock, based on moderating input costs and improving volume growth. Symrise appears to be benefitting from its new CEO and we look forward to a more formal update when the company holds an investor day in the autumn. Conversely, UK specialty chemicals company Croda weighed on returns as the company struggles to return to volume growth and analysts debated whether the company might need to cut 2024 guidance. Croda's business model has the potential to drive operating leverage and a share price recovery but needs volume growth to re-emerge.

In Resilient Infrastructure, Halma was the strongest driver of returns as the company reported better than expected H2 FY2024 results. These were driven by solid organic growth, in turn supported by Halma's photonics business, which benefitted from very strong demand from data centre customers. Advanced Drainage Systems reversed recent months of strong performance and was a detractor to returns. Investors took profits as well as expressed some concerns regarding weakness in non-residential construction, to which the company is partly exposed. We expect ADS to digest potential cyclicality as its structural growth drivers continue to manifest.

During June we increased our positions in Novonesis and Thermo Fisher and reduced our position in Agilent.

Outlook

Following recent trades, we think the portfolio is incrementally better positioned to benefit from the structural tailwinds supporting investment in biodiversity. We think agriculture and food, closely followed by water, are the two biggest issues facing the natural world, and we think the fund's holdings in these sectors provide highly valued solutions to these challenges. While good progress has been made in recent years regarding regulation, in particular the Global Biodiversity Framework and the EU Nature Restoration Law, we find the more recent lack of consistency on environmental regulation frustrating (e.g. Scotland's decision to delay its deposit return scheme for recycling). However, we don't think this is stifling innovation or progress in the private sector where companies are making sustainability-oriented investments independent of regulation. In fact, we are encouraged to see technology beginning to disrupt old-fashioned industries, like construction and agriculture, which have some of the largest negative biodiversity footprints.

Our outlook on financial markets remains unchanged. We believe markets are adjusting to a "higher for longer" environment where there will be greater scarcity of finance and growth. This should favour higher quality companies – those with strong cash flow generation and organic growth opportunities – who should be relatively unaffected. We believe the portfolio has good balance and can weather a potentially weaker economy in 2024, feeling the impact of sustained high interest rates, or can outperform a more buoyant market in the event of a "soft" or "no-landing" outcome.

No assurance can be given that the Biodiversity strategy will be successful. Investors can lose some or all of their capital invested. The Biodiversity strategy is subject to risks including Equity; Emerging Markets; Global Investments; Investments in small and micro capitalisation universe; Investments in specific sectors or asset classes.

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