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Biodiversity Strategy

Aquifer depletion in France highlights perils of undervaluing natural capital

- Global stocks rose in August led by dovish Central Bank policy views and China's economic outlook
- Resilient infrastructure led performance this month; Sustainable Food & Agriculture saw weakness
- We increased positions in Advanced Drainage Systems and Microsoft

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Portfolio Managers, Listed Equity Impact

What's happening?

Global markets performed strongly in August, led by Japan and China. Both markets were bolstered by news of the extension of the US-China tariff truce mid-way through the month. The health of the Chinese economy being important to Japan as the second biggest importer of their goods. The US market also rose, aided by a generally healthy earnings season and dovish interest rate commentary from Jerome Powell at Jackson Hole. US earnings were strongest amongst the technology and financial sectors, with companies in the latter sector benefitting from falling short term rates and a steepening yield curve. Powell's dovish commentary reflected the Fed's dual mandate of managing both inflation and employment, with the latter warranting incremental caution following slowing job growth. The UK market kept pace in August despite weak underlying macroeconomic trends. The Bank of England cut interest rates to 4%, addressing weak economic growth and employment trends, and despite persistent inflation.

Companies' dependence on natural resources was in the news in August. France's mineral water companies, in particular Perrier, gained unwelcome attention as it is unclear whether they can continue to market certain products as "natural mineral water". This relates to alleged use of illicit filtration systems due to worries about water contamination relating to over-exploitation of groundwater resources. Natural mineral water sells at a considerable premium to tap water and should be unaltered between source and bottling. Perrier currently abstracts water from 130m deep aquifer in southern France, which is increasingly pressured by climate change and intensive agriculture. Previously thought to be insulated from anthropogenic pressures, aquifers are becoming contaminated as pollution concentrates in their depleting volumes of water. This arguably unsustainable use of natural capital (groundwater filtered through limestone over years to form aquifers) highlights the importance of regulation and appropriate pricing, as well as understanding the multiple stakeholders interested in its long-term, sustainable management.

Portfolio positioning and performance

The Biodiversity strategy underperformed the broader equity market in August.

Source: All data sourced from Bloomberg, local currencies, as at 31/08/2025

Resilient Infrastructure led returns in August with Advanced Drainage Systems contributing the most. ADS reported strong results earlier in the month characterised by impressive margin protection in the face of weak volumes. Some investors had worried that ADS's pricing might soften given the continued end market weakness, but this appears not to be manifesting. We decided to increase our position in ADS given what we perceive to be an upside-skewed risk-reward setup. Dutch environmental consultant Arcadis was the biggest detractor to returns. The stock remains un-loved, having reported several quarters of weak organic growth. There was little new news in August, apart from the announcement of a new, external CFO. We added to our position in Arcadis earlier in the year, expecting the stock to revert to organic growth and recover.

Ecolab led returns in Responsible Production & Consumption. The US business services company performed well following solid results reported late in July. Ecolab reported the acquisition of Ovivo Electronics for \$1.8bn; an ultra-pure water company supplying semiconductor manufacturers. This complements Ecolab's High-Tech business, which already supplies circular water solutions to a similar customer set. Ecolab will hold its analyst day on 4th September giving a strategy update and likely fielding questions on this deal. US building materials company James Hardie was the biggest detractor to returns as the company reported weak fiscal Q1 results and materially cut guidance for the fiscal year. As legacy shareholders of Azek we obtained a small position in James Hardie following their acquisition, but worried analyst estimates remained too high. This came to fruition, led by the company's weak North America Fibre Cement business. Ultimately, we consider this reset healthy and believe the company retains attractive competitive advantages and growth attributes.

NXP Semiconductors led returns in Technology Enablers with the stock continuing momentum after reporting strong results towards the end of July. NXP could be well-positioned to benefit from a cyclical recovery as auto inventories normalise and industrial inventories recover. Such a recovery should also benefit margins as plant utilisation rises and operating leverage manifests. Software companies SAP and Bentley Systems were the equal biggest detractors to returns. Investors in Bentley took profits following recent share price strength. SAP was weak as investors worried about the implications for Generative AI on SaaS (Software as a Service) business models. We believe leading enterprise software providers, like SAP, to be lower risk given higher barriers to entry. Longer term, SAP should in fact be a net beneficiary of AI as it presents additional monetisation opportunities, drives operational efficiencies and addresses critical data ownership issues. Relatedly, we decided to increase our position in Microsoft, which we believe will also be a long-term AI beneficiary.

Sustainable Food & Agriculture had a weak month, with Deere leading the detractor of returns. Deere reported mixed results mid-way through the month with tariffs a larger than expected headwind to the business. Analysts have made modest downgrades to fiscal 2026 earnings estimates to reflect a likely softer North America new equipment market. This is offset somewhat by South America and Europe where farmer profitability is healthy and interest rates have stabilised. Ingredients company DSM-Firmenich and food equipment producer GEA Group both contributed positively. DSM has been weak year to date, but the company may be nearing a positive catalyst with private equity firm CVC reportedly the only remaining bidder for their remaining animal nutrition and health assets. GEA reported strong results, led by its Separation & Flow Technologies business, which beat consensus margin expectations by ~250 basis points.

Outlook

We think the portfolio is well-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 biodiversity strategy 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. However, we do not 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. Moreover, companies are increasingly realising their dependencies on scarce natural resources, such as water, and making considerable investments to manage this risk.

Source: All data sourced from Bloomberg, local currencies, as at 31/08/2025

Our outlook on financial markets remains unchanged. We believe markets have largely adjusted for a “higher for longer” interest rate 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 or can outperform a more buoyant market with stronger growth.

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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