The energy transition to an ultra-low carbon economy

Climate change may be the single biggest issue facing mankind yet progress in tackling it globally remains frustratingly slow.

The science is telling us that we need to accelerate the pace of decarbonisation. Current progress and ambition both fall considerably short of meeting internationally agreed goals to limit average global temperature rises to less than two degrees centigrade – and ideally 1.5, in line with the Paris Accord.

Last week saw World Environmental Day while COP28 (Conference of the Parties to the UN Framework Convention on Climate Change) will be taking place in little over four months. But while both draw attention to devastating issues, with the latter welcome as a forum in which world leaders can achieve agreement on important issues, the implementation of key regulations is often frustrated by bureaucracy.

Despite the demoralising headlines and slow progress, we should remind ourselves that significant sums of money are being allocated towards carbon reduction schemes, by both governments and financial institutions. Through the effective deployment of capital in companies and technologies that make our world *cleaner, healthier and safer*, we remain optimistic that much can be done to mitigate and adapt to the climate crisis facing society.

Last year the US made headlines with the introduction of the US Inflation Reduction Act, which earmarked $370 billion to fight climate change by reducing carbon emissions. The EU '*Fit for 55'* target of reducing net greenhouse gas emissions by at least 55% by 2030 will double the share of renewables. Even China has stated its target of being carbon neutral before 2060 and to phase down coal post-2025.

Looking at the private sector, large amounts of capital are being committed to financing the renewable energy growth. In 2022 we saw extremely strong progress in this area, with key banks committing £3 trillion of finance to clean energy projects. To put this into perspective, if 1MW of renewables is roughly £1 million, then this amount could fund 3000GW, which is equivalent to the entire capacity of US electric generation. This gives an idea of the quantum of capital that is being targeted towards renewables, and the critical importance of banks being prepared to finance these projects.

Focusing on renewables

When we as societies look to resolve the energy trilemma of being affordable, secure and clean, there is little that can compete with renewables. The cost of generating electricity from solar and onshore/offshore wind has continued to fall over the past 10 years. In addition, the competitive position of renewables versus fossil fuels has improved dramatically following volatile price spikes in fossil fuels.

Broader implications across the economy

The displacement of carbon-intensive electricity generated from burning fossil fuels by ultra-low carbon renewables is a vital ingredient, but it is by no means the whole picture. We believe there will be profound impacts across the whole economy and look for companies whose products and services can accelerate decarbonisation. The areas we have identified as playing an important role are:

- **Infrastructure needed to decarbonise** – this includes upgrading our antiquated electricity grid systems, as well as providing infrastructure needed in many areas of the economy that will be decarbonised by using electricity.
- **Energy efficiency** is a great way to reduce the amount of energy wasted and has the benefit of cutting users' energy bills and emissions. This is applicable to the whole economy and includes buildings, transport, industry as well as fast growing areas such as computing power used in digitisation.
- **Business strategy** to ensure businesses are set up to thrive in the ultra-low carbon economy. We discuss this and challenge businesses we are invested in to innovate and use this as a differentiator to gain a competitive advantage over their less proactive peers.

Investing in companies that help to reduce emissions – an underlying investment driver for our range of sustainable funds – will, we believe, also benefit investors as these are the businesses likely to see significant growth. Of our 20 sustainable themes, those six areassociated with increasing resource efficiency which will benefit from, and contribute to, the shift to an ultra-low carbon economy. As well as using more renewables to generate electricity, equally important is reducing the amount of energy we waste, increasing recycling, improving how we manage water, making industrial processes more efficient, ongoing transport shifts and substantial changes to the way we heat and cool buildings. As at 31-Dec-2023 the SF Equity funds had an average of 25% invested in these *cleaner* resource efficiency themes.[1]

Since we launched our Sustainable Future (SF) funds in 2001, our proposition to clients has been to deliver superior returns by investing in sustainable companies – those companies that are making our world *cleaner, healthier and safer*.

We believe these businesses have better growth and greater resilience than the market anticipates. In addition, by allocating capital to these businesses and engaging with management, we can accelerate environmental and societal improvements.

The drivers of the energy transition continue to strengthen and support long-term growth. In a world where future economic growth is expected to be sluggish, these pockets of growth provide great nuggets of the economy in which to invest. We look forward to an accelerated energy transition and an appreciation in value of the companies we have selected that are driving this positive change.

Mike Appleby, Investment Manager, Sustainable Investment team

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For more insights and views from Liontrust visit: https://www.liontrust.co.uk/insights/ourinsights

[1] SF Review 2022. Exposure to themes is disclosed for all individual SF funds, along with a wealth of sustainability data in our fund sustainability reports . These are available on our website here: https://www.liontrust.co.uk/fund-managers/sustainable-investment/sustainable-documents#sustainability

For a comprehensive list of common financial words and terms, see our glossary at: https://www.liontrust.co.uk/glossary

Key Risks

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

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