

# Decarbonisation 2050: Investment opportunities on the path to net zero

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Reaching the goal of achieving net-zero carbon emissions by 2050 as stated in the Paris Agreement international treaty on climate change will require significant capital investment, and governments worldwide are backing ambitious climate targets with policies and regulations. John William explains how he and his large team at M&G are capitalising on this long-term trend by investing in companies that benefit the most from this transition to ultimately deliver steady outperformance for investors, while simultaneously contributing to a greener global future.

In the wake of the rising number of extreme weather events seen around in the world in recent years, more and more governments and companies have signed onto the commitments of the 2015 Paris Agreement on climate change, dedicating funding and attention at the highest levels of organisations to gradually de-carbonise their operations and value chains to reach ambitious interim targets and net-zero by the year 2050. And importantly, governments have been enacting concrete policies and regulations to ensure the highest possible levels of adherence to these greener goals. It therefore makes sense that those companies that can help others achieve their net-zero targets more efficiently or at a lower cost – be that through providing advanced technology, technical skills and experience or other specialised services – are likely to encounter sustained high demand going forward, until those targets are met. And this demand is less likely to be impacted by shorter-term economic cycles given its long-term nature.

## What is a “Paris Aligned” fund?

At M&G we are taking advantage of this long-term structural trend via the [M&G \(Lux\) Global Sustain Paris Aligned Fund](#). “Paris Aligned” funds are those that invest in companies that have incorporated the goal of achieving net zero carbon emissions from their own operations (and possibly including their value chains) by 2050, and have shown commitment to reaching this goal through the use of credible measurements, timelines and dedication of resources. As long-term shareholders, we take this a step further by working closely over time with investee businesses to facilitate their decarbonisation journey however possible.

In constructing our Paris Aligned fund, we use our deep primary research to identify high-quality companies making tangible contributions towards achieving the Paris Agreement, with strong business models that can generate compound returns over a long period. The companies must also be trading at an attractive price relative to our assessment of their value, with a margin of safety. Over the 10 years since the fund’s inception in 2014, we have conducted in-depth research across a wide spectrum of companies, in the process building up a library of detailed information which has given us an excellent understanding of the investment cases. This knowledge, in turn, allows us to make relatively quick buying decisions in response to market moves, when these companies reach a compelling valuation. We are highly selective in our purchases, however, given that there are only 30 or so stocks in the portfolio.

## Our investment edge: A long-term approach

In our process, we believe our investment edge is our long-term view and holding period. In making our stock picks, we want to hold onto the stock for a decade. In fact, since launch the average holding period has been eight years, and the management team has changed an average of two stocks per year. So, in contrast to the broader market, which often looks at events like sudden sell-offs with a one- or two-year view that can be consequential for many stocks, our longer-term view means that the sell-off may not be consequential at all. This allows us to add an attractively valued stock at the

margin and wait patiently until it recovers, as well as accumulate attractively valued, high-quality companies over time, both of which can add significant outperformance to the portfolio.

This is why we choose those companies with the right business model that we believe can generate high returns on invested capital and compound these over time. And rather than weighting each stock based on the degree of our conviction, we are careful to choose a combination of diversified businesses, with exposure balanced approximately 50%-50% across two types of companies: larger high-quality companies with stable returns, and high-quality companies with less predictable returns. Those more predictable companies have weights of between 3%-5%, and the less predictable businesses are given smaller weights of between 1%-3%. Although the latter can be considered risky investments, we don't mind taking on more risk in the fund if we are adequately compensated for it. And we don't have to add volatility risk – outperformance is generated primarily through stock picking.

### Delivering outperformance for clients while going green

This strategy has proved to be highly successful in managing both risk and return in the portfolio. As Graph 1 shows, the M&G Global Sustain Paris Aligned Fund has ranked in the top quartile of its fund category over the past three-, five-, and 10-year periods to 31 March 2024, delivering steady outperformance of its benchmark, the MSCI World Net Return Index. This includes 2022 which was a difficult year for quality-oriented funds. Its volatility has also been largely in line with that of the benchmark, as illustrated in Graph 2.

### Graph 1

#### Performance

#### M&G (Lux) Global Sustain Paris Aligned Fund

*Fast performance is not a guide to future performance*

Rolling period performance (%)	Year to end of MRO <sup>3</sup>	YTD	1 Year	3 Years % pa	5 Years % pa	10 years % pa	FMT <sup>4</sup> % pa
Gross – USD C Acc	5.6	6.7	18.7	7.4	14.0	9.8	10.0
Net – USD C Acc	5.3	6.3	17.6	6.4	12.9	8.8	8.9
Benchmark <sup>1</sup>	8.9	9.5	24.9	6.7	12.8	9.2	9.0
Sector <sup>2</sup>	7.1	7.3	19.9	3.0	9.7	6.5	6.2
Quartile Ranking	4	3	3	1	1	1	2

Calendar year performance (%)	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Gross – USD C Acc	23.4	-14.3	25.1	14.4	34.3	-11.1	23.8	7.0	1.3	0.9
Net – USD C Acc	22.3	-15.1	23.9	13.2	33.0	-11.9	23.6	5.9	0.3	-0.4
Benchmark <sup>1</sup>	23.8	-18.1	21.8	15.9	27.7	-8.3	23.1	8.2	-1.8	4.7

<sup>1</sup> Performance comparison: The benchmark is the MSCI World Net Return Index. The benchmark is a comparator against which the fund's performance can be measured. It is a net return index which includes dividends after the deduction of withholding taxes. The index has been chosen as the fund's benchmark as it best reflects the scope of the fund's investment policy. The benchmark is used solely to measure the fund's performance and does not constrain the fund's portfolio construction. The fund is actively managed. The investment manager has complete freedom in choosing which investments to buy, hold and sell in the fund. The fund's holdings may deviate significantly from the benchmark's constituents. The benchmark is not an ESG benchmark and is not consistent with the ESG Criteria and Sustainability Criteria. The benchmark is shown in the share class currency. Between 30 September 2008 and 31 December 2011, it is the FTSE World Index. From 1 January 2012 to 31 December 2015, it is the MSCI ACWI Index. From 1 January 2016 to 8 November 2018, it is the MSCI World Index. Benchmark is Gross Return prior to 9 November 2018 and Net Return after this date. Fund performance prior to November 2018 is that of the Euro A share class of the M&G Global Select Fund (a UK-authorized OEIC), which merged into this fund on 9 November 2018. Tax rates and charges may differ.

<sup>2</sup> Sector: Morningstar Global Large-Cap Blend Equity Sector

<sup>3</sup> Year to end of Most Recent Quarter: 31 March 2024

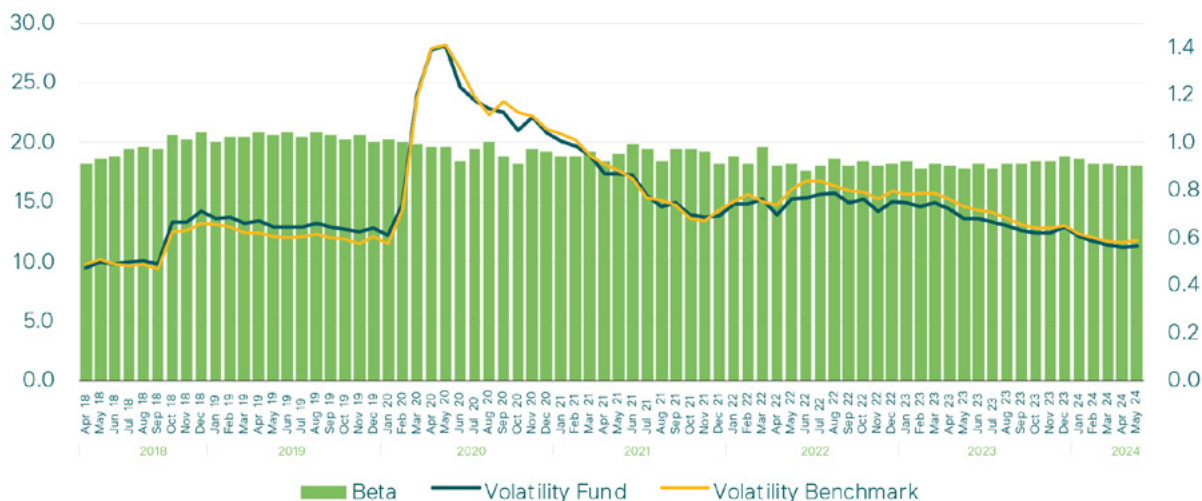
<sup>4</sup> Fund Manager Tenure: 30 June 2014

Source: Morningstar Inc. 31 May 2024, USD C Acc share class, income reinvested, price to price, net of all fees. Gross returns are product returns (priced at midday) from Morningstar, with the actual Ongoing Charge Figure reinvested back into the price, including income reinvested.

Graph 2

### Diversification is working

M&G Global Sustain Paris Aligned Fund



Source: Aladdin, 14 May 2024

### Counting on stock-picking expertise

So, what are some examples of the companies we are holding? In the first category of high-quality, predictable returns the fund has exposure to such well-known companies as Alphabet, Ansys, Microsoft, Adobe, United Healthcare and Novo Nordisk.

In the second category of high-quality, unpredictable returns it includes Schneider Electric, Weir, Johnson Controls, Solar Edge, Ball Corporation, and Linde. Some of these are less known but are equally highly regarded as leaders in their markets. For example:

**Schneider Electric** is a leader in its field of electricity grid management. Listed in Europe, it uses advanced AI to connect new, greener power sources to existing grids and manage power distribution. It digitises and automates the data in networks to reduce costs and optimise distribution.

**Weir Group** is a UK-listed mining equipment company with a market capitalisation of approximately US\$7.0 billion, commanding leading positions across its value chain. It is a high-quality company with a highly defensible revenue stream due the high percentage of revenue (77%) it receives from the services part of its business. Using its strong after-market service network, it sells very high-margin spare parts that are frequently replaced, creating a stable income stream, even in a weak market cycle. Among its clients are copper miners, a key component in the decarbonisation journey in which there is strong demand for copper wiring, new connectivity, electric vehicles and greener manufacturing processes. Through its advanced technology, Weir can help mining companies improve their energy efficiency by reducing energy usage and waste across all stages of the mining process, and consequently lower the miners' total costs. This can also be passed on to the automotive industry, among others.

Weir itself has a science-based target to lower its greenhouse gas (GHG) emission intensity from operations by some 30% by 2024 and to decrease its absolute level of GHG emissions from operations by 50% by 2030. Through our lengthy and extensive engagements with management, we know their plans are credible and aligned with the mining industry.

**Ball Corporation** is the world's largest aluminium can manufacturer, with clients including the world's largest beverage companies. Its size gives it pricing power in its sector and it has excellent governance. Meanwhile, its clients like Coca-Cola each have their own targets to reduce GHG emissions in their value chains that are immediate and high-profile challenges for them, particularly packaging and transport -- packaging accounts for a significant 25% of their total emissions. Ball's key advantage as a supplier is that aluminium is the most sustainable packaging available because it can be recycled an infinite number of times, whereas PET plastic can only be recycled twice before it becomes cloudy

and unusable. The company is therefore working towards attaining its own decarbonisation targets so that it will be even more competitive as beverage companies switch from plastic to aluminium packaging over time, particularly for water, which is where its greatest opportunity lies.

Ball has its own science-based targets to lower its GHG emissions from its operations by 55%, as well as 16% of its GHG emissions across its value chain, by 2030. It is also aiming for 85% of the aluminium content in each of its cans to be recycled by 2030.

### **Engagement as an investor**

As a long-term investor, M&G is committed to engaging and working closely with investee companies to help them improve across the different steps involved in the transition to net-zero, as well as achieve their targets. We can be involved in areas such as helping measure and report emissions levels aligned with industry standards; target setting; implementing science-based targets; helping form a strategy including determining milestones and pathways to reducing emissions; governance issues such as remuneration-linked achievements and capital spending alignment; and finally, monitoring that includes clear and regular reporting over time.

### **Fund credentials for the net zero transition**

At M&G we measure the M&G Global Sustain Paris Aligned Fund's sustainability credentials using key factors such as the number of companies it holds using science-based targets, numbers with committed or concrete reduction plans, and the portfolio's combined total carbon intensity, among others.

As of 31 May, the Fund has a combined weighted average carbon intensity (tons of CO<sub>2</sub> emitted per US\$ million total sales) of 41.8 compared to 98.6 for the MSCI World Index – or 58% lower.

Approximately 74% of the Fund's net asset value (NAV) is covered by science-based emissions targets (committed or concrete), as is 96% of the portfolio's carbon intensity. At the same time, 99% of the underlying businesses have their emissions covered by science-based targets.

Clearly, an investor wanting to contribute to a successful global green energy transition while having their investment outperform the MSCI World Index would want to consider the M&G Global Sustain Paris Aligned Fund, with its proven process and successful 10-year track record. Backed by a team of 10 experts in fund management, research and sustainability, M&G dedicates considerable resources to this important, specialised area of investing, and the results show these efforts have been beneficial for both our clients and the global climate to date.

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