

Investment and market update

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21 October 2021



01

The long road back to normality

Global economic outlook: Less synchronized global growth, with upgrade to Europe, but downgrade to China and US



GDP Growth forecasts, Annual average %

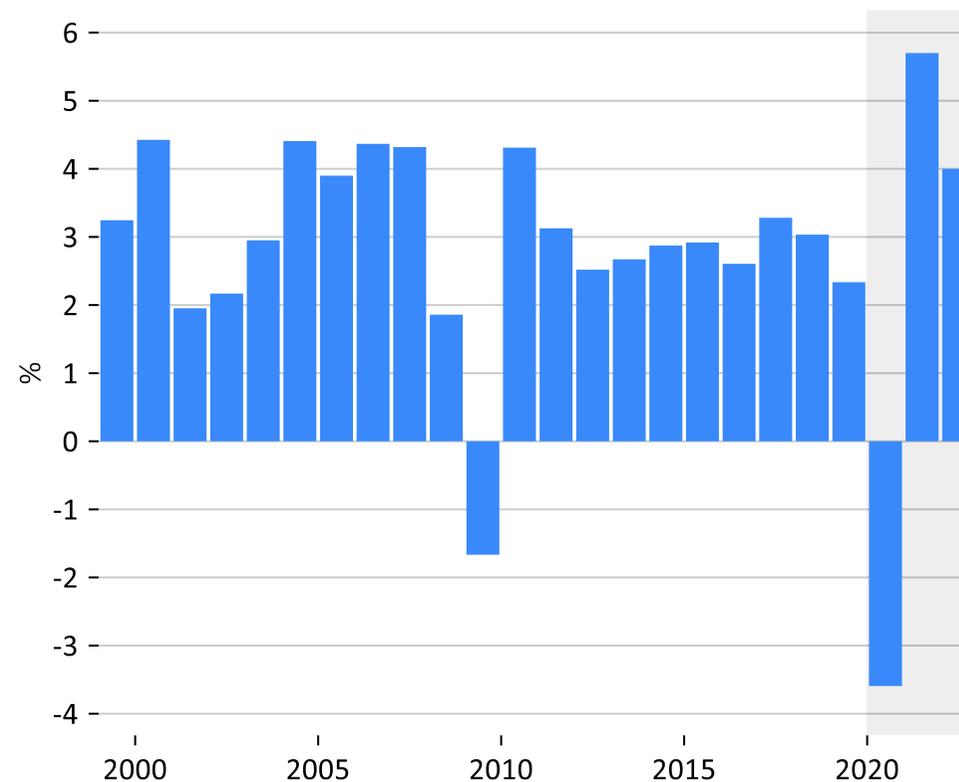
	2020	2021	2022
China	2.3	8.3	5.5
US	-3.5	5.5	3.1
Eurozone	-6.7	4.9	4.0
UK	-9.8	6.6 (6.8)	4.9 (5.2)
Japan	-4.8	2.4	2.5
World	-3.6	5.7 (6.1)	4.0 (4.4)

Note: Figures in parenthesis are forecasts at time of IPC June 2021.



Global Real GDP Growth (USD terms)

Global GDP, USD, real



Source: Macrobond, 12.10.21

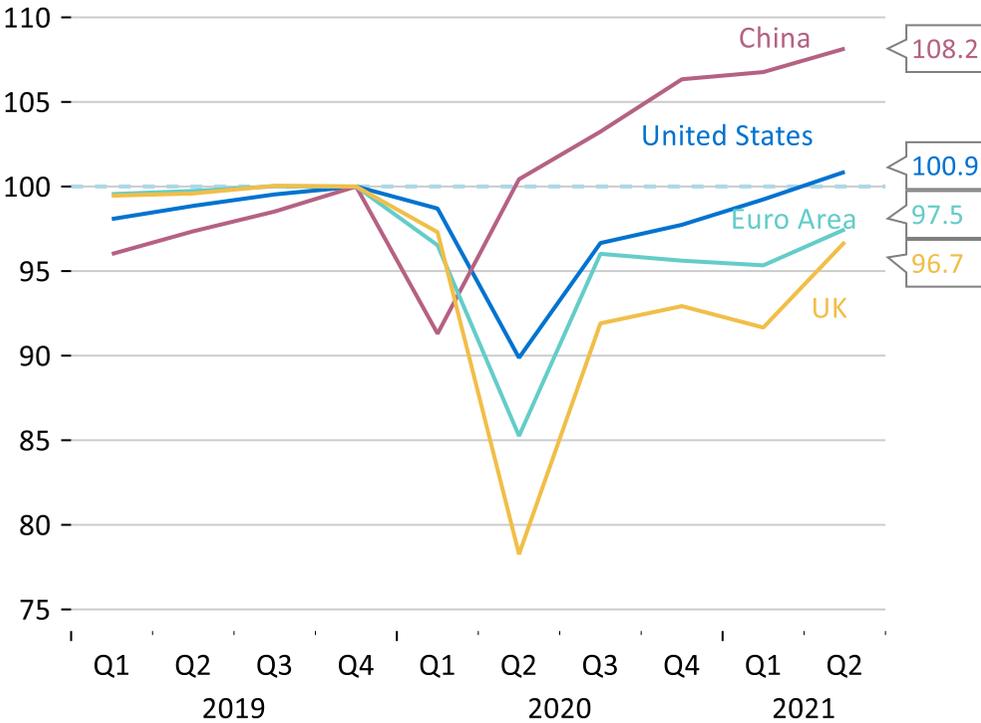
Source: Sarasin & Partners and Macrobond Sept 2021

Global GDP expected to be above pre-COVID levels by end of 2021 - economic surprises now moderating

 The US & Chinese economies already larger than pre-COVID

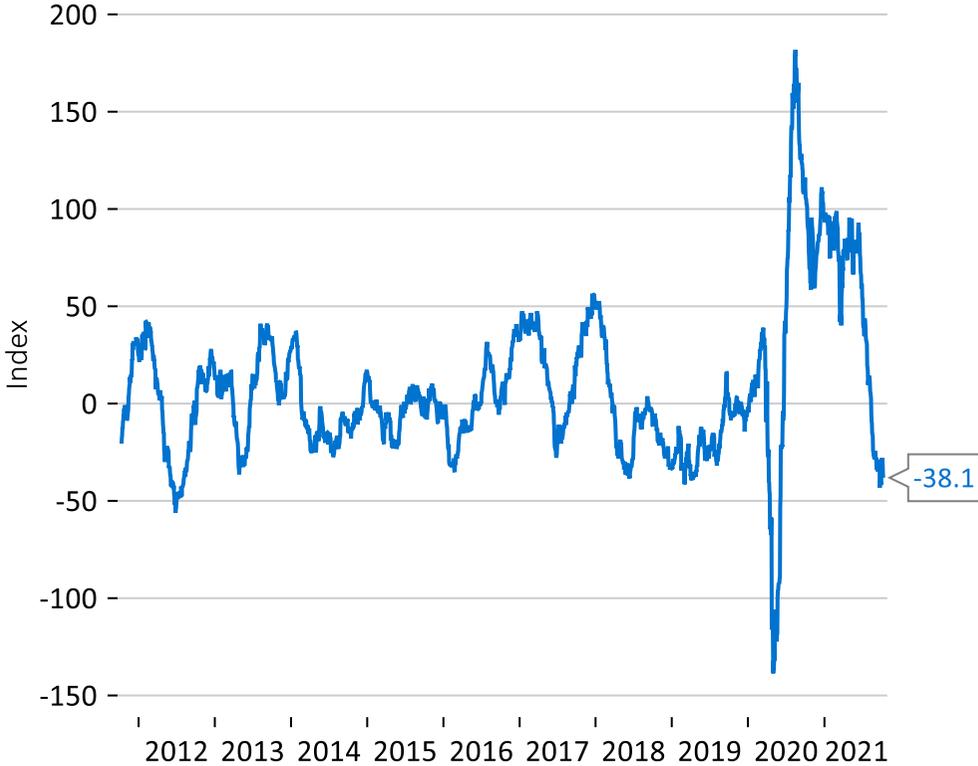
 Economic momentum now modestly below expectations

GDP in selected countries
Indices: 2019 Q4=100 (the start of COVID)



Source: Macrobond, 12.10.21

G10 Economic Surprise index (Citi)



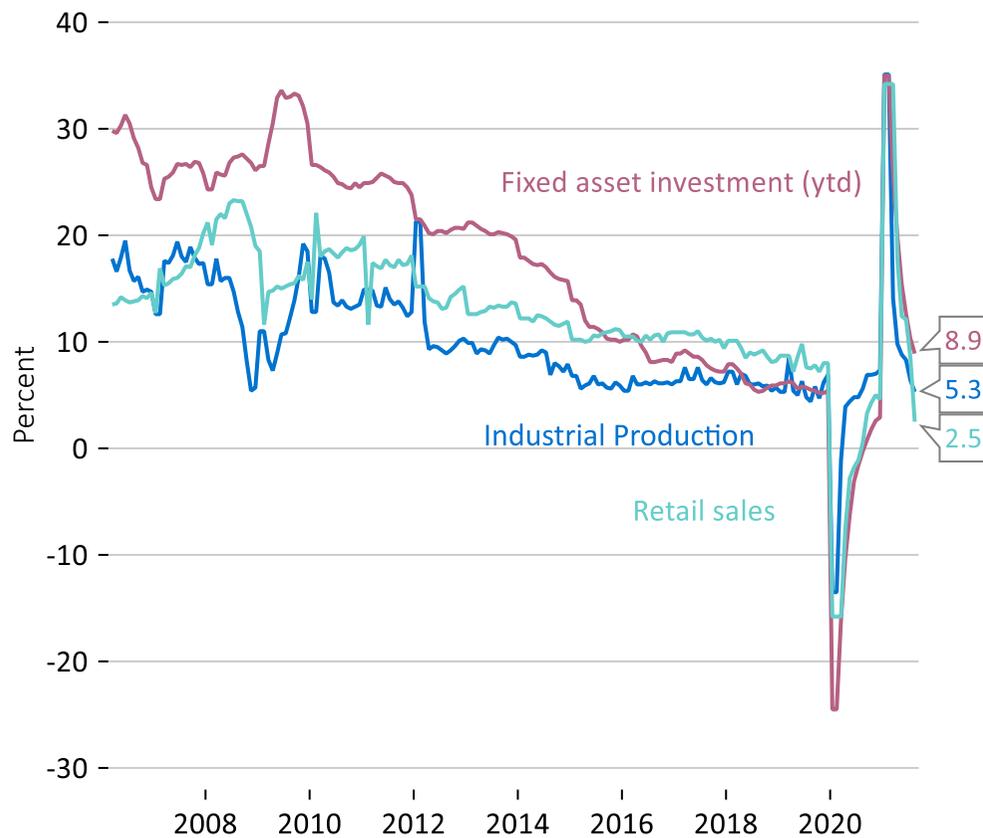
Source: Macrobond, 12.10.21

Key risks: 1. China slowdown

Domestic activity weaker-than-expected, driven by COVID restrictions, floods & regulation



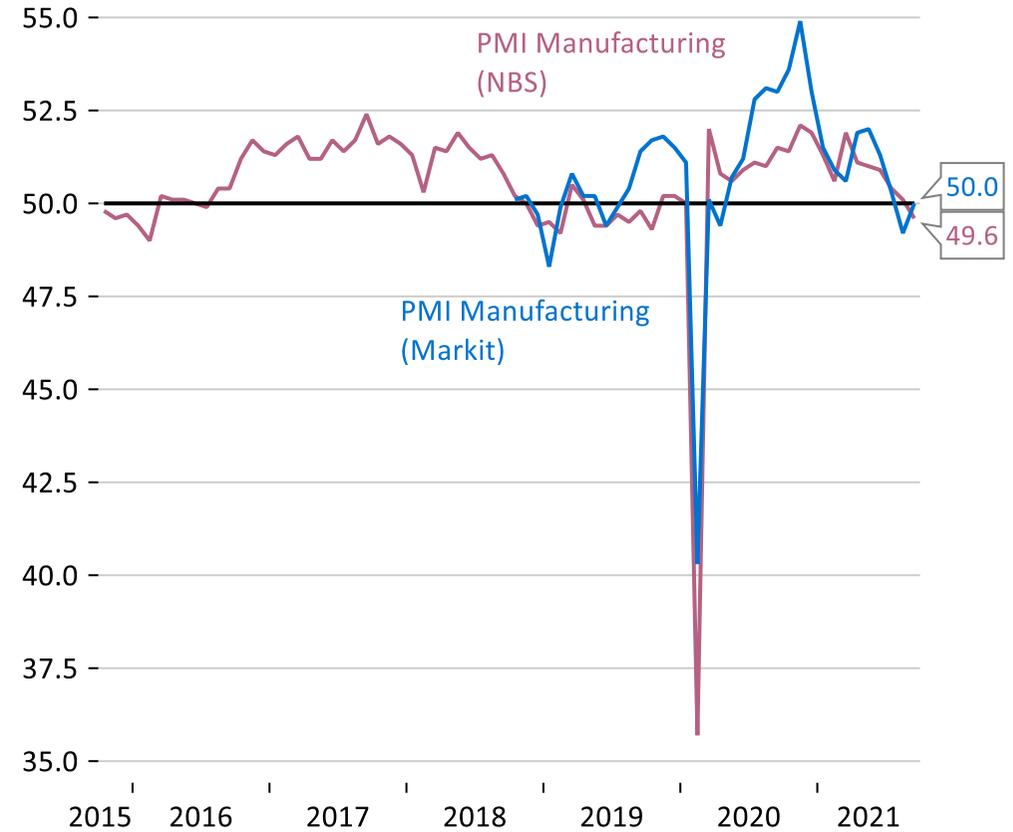
Chinese data continues to weaken



Source: Macrobond, 12.10.21



Purchasing Manager Surveys weaken



Source: Macrobond, 12.10.21

Rising Chinese property strains & high yield spreads could limit flexibility of the PBOC



Surging Chinese input costs meet slowing property prices



Chinese high yields spike as default concerns rise

Chinese Property and Producer Prices



Source: Macrobond, 13.10.21

US vs China high-yield spread

Yields



Source: Macrobond, 13.10.21

The China regulatory shock

The beginning of the end of the China regulatory shock?

- Our view is that we now have an overarching regulatory framework (i.e. we have a much clearer idea what the government now wants)
- To build an internet company will need 3 ingredients - *now we have regulations covering all of them*
 - Capital – raise money (e.g. PE, VE, IPO) to capture a market as quickly as possible
 - User data – know your users as much as you can to provide the most relevant products and services
 - Algorithm – create and improve engagement (then time spent, mindshare and ad \$ will follow!)

Capital	User data	Algorithm
CAC*'s cybersecurity review on overseas listing	Data Security Law (effective 1 Sep)	CAC's draft regulations on algorithm on 27 Aug
Anti-trust regulations on predatory pricing	Personal Information Protection Law (effective 1 Nov)	

- In the future, we should hopefully see
 - more of the same: regulations/investigations: e.g. like gaming, China has now further tightened how many hours the underage can play, but relevant regulations already exist
 - specific social issues that China wants to address: e.g. after-school tutoring, and fan-based culture

2. Supply chain disruptions to weigh on growth for some time

GM has paused production at most of its US assembly plants following Toyota, Ford and others

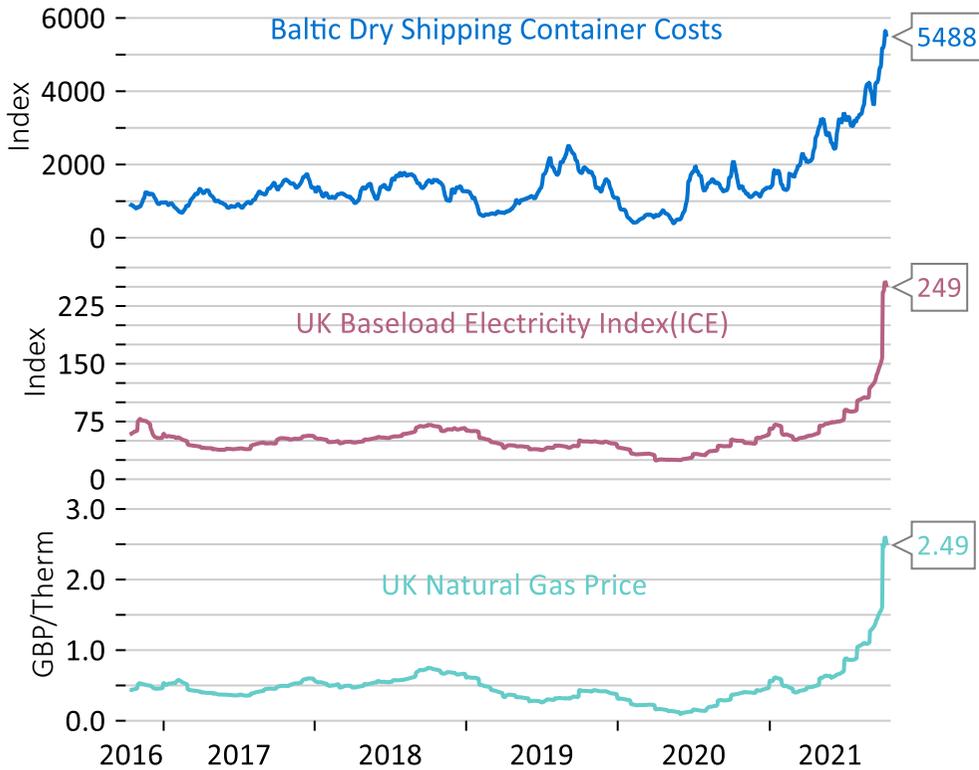


Transport and energy costs surge



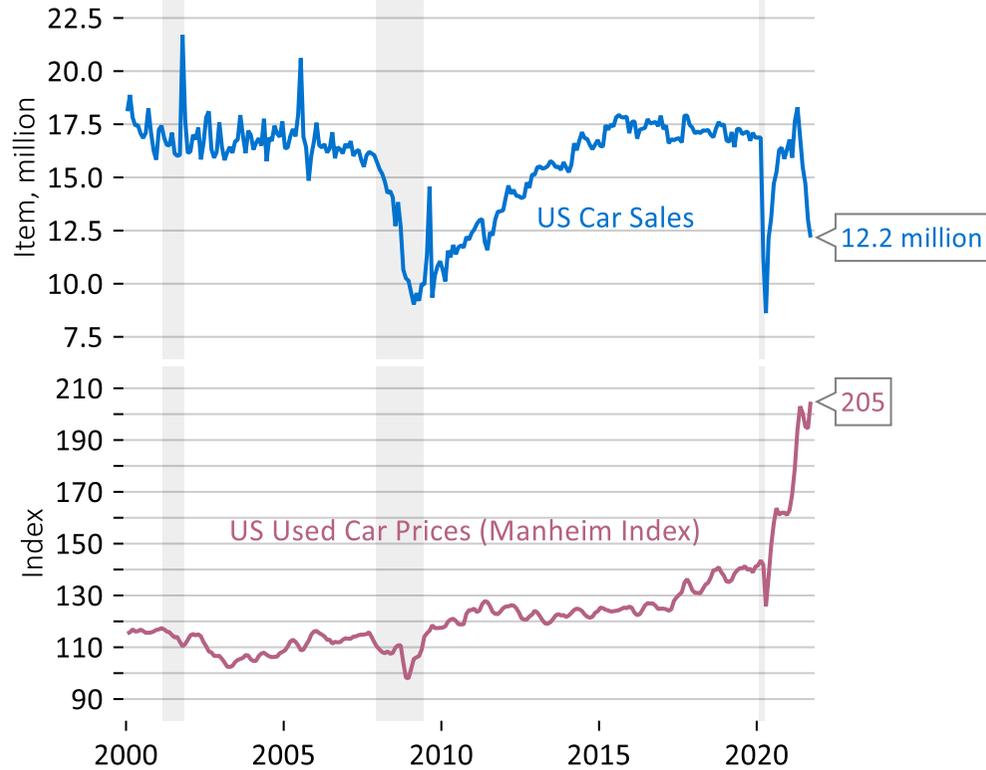
Global auto production shortfall estimated at 6-7m units

Squeeze on transport and energy costs



Source: Macrobond, 12.10.21

US Auto Sales and Prices



Source: Macrobond, 12.10.21

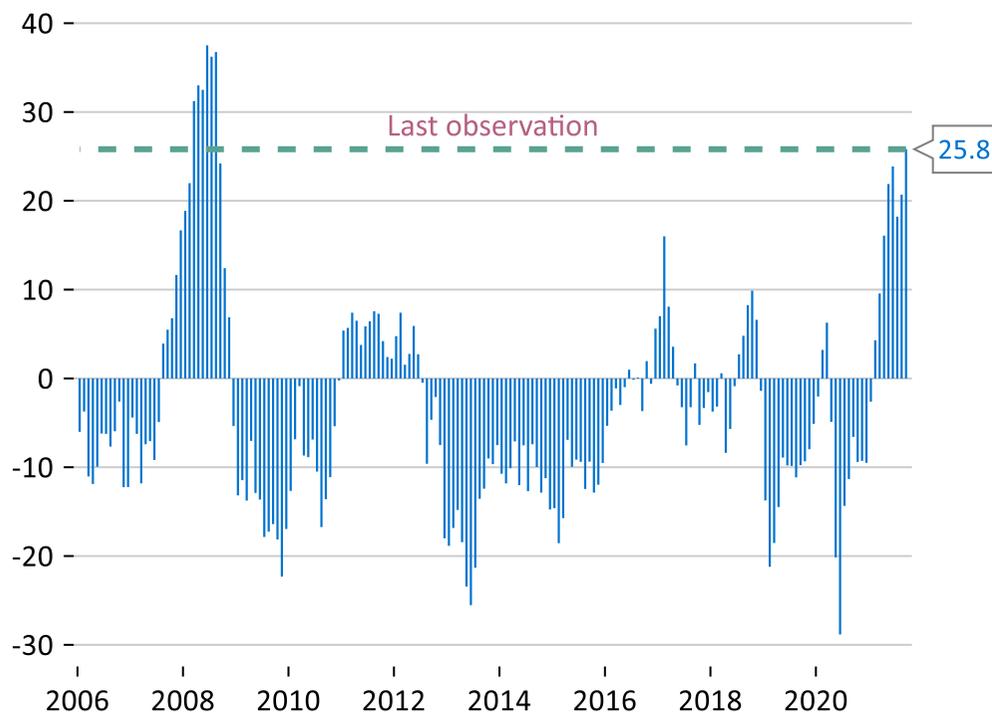
3. Rising global inflation risks are already prompting central banks to lift rates...



Global inflation risks are rising

Inflation surprise hits highest level since 2008

Source: Citigroup

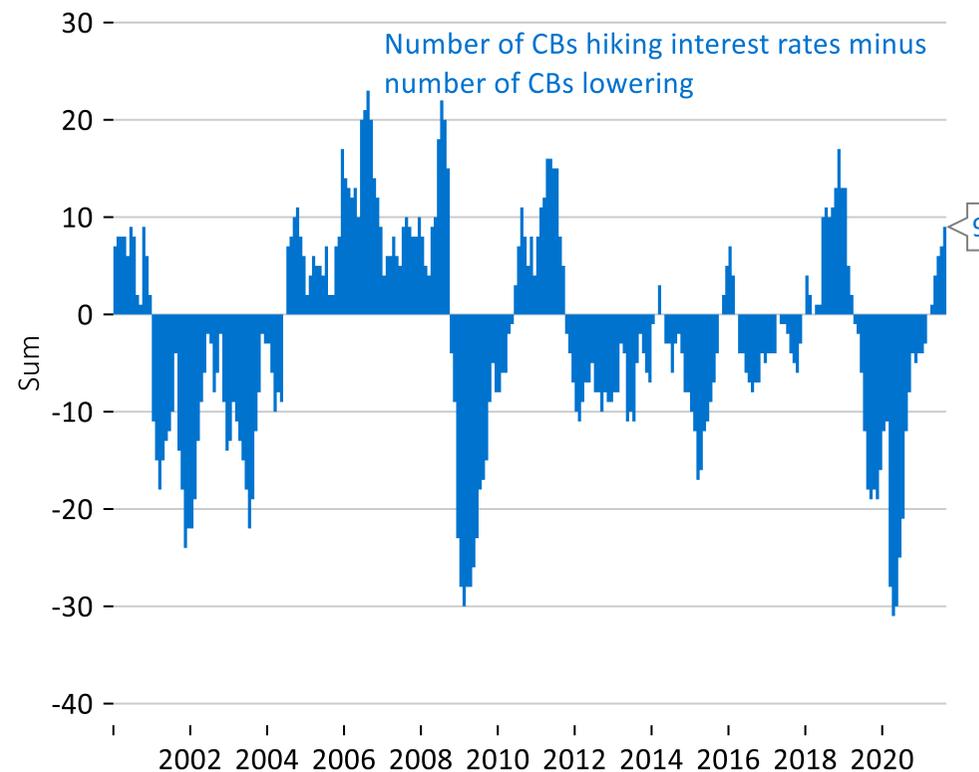


Source: Macrobond, 13.10.21



Global monetary policy now starting to tighten

Global monetary policy cycles



Source: Macrobond, 13.10.21

Rate rises already seen in 2021 include Norway, Brazil, Mexico, S Korea and New Zealand

02

Inflation risks rising

Inflation outlook: Base effects, supply bottlenecks and capacity constraints in some sectors drive inflation higher in 2021



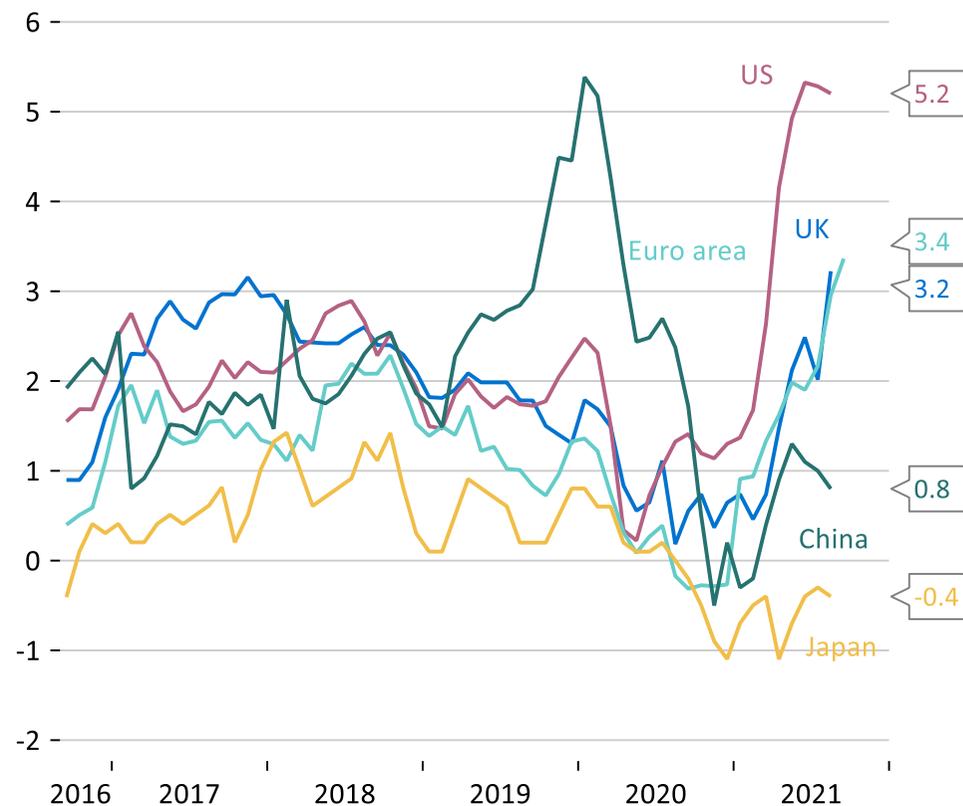
Inflation forecasts, annual average %

	2020	2021	2022
China	2.5	0.9	1.6
US	1.2	4.4	3.6
Eurozone	0.3	2.2	1.7
UK	0.9	2.1 (2.1*)	2.9 (2.5*)
Japan	0.0	0.0	0.4

Note: Figures in parenthesis are consensus forecasts



Consumer price inflation (yoy)



Source: Macrobond, 12.10.21

Source: Sarasin & Partners and Macrobond Sept 2021

US inflation: Is it all transitory - Probably not?

Headline CPI expected at 4.4% in 2021 and 3.6% in 2022, Core at 3.4% in 2021 and 3.1% in 2022

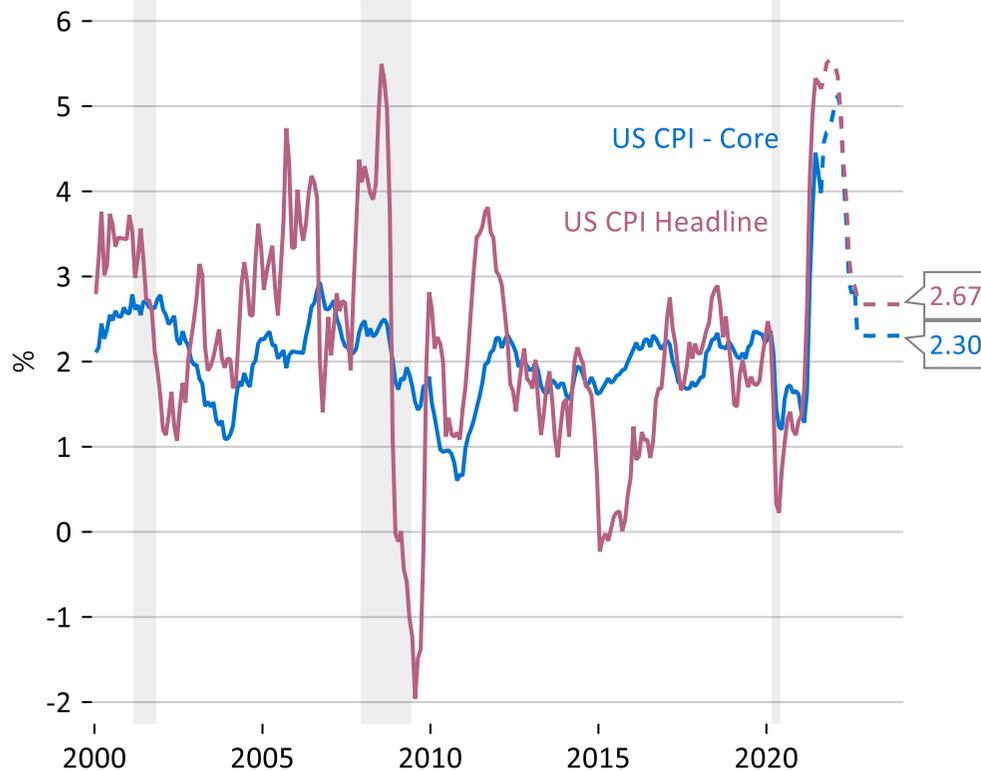


US inflation to settle *modestly above 2%*



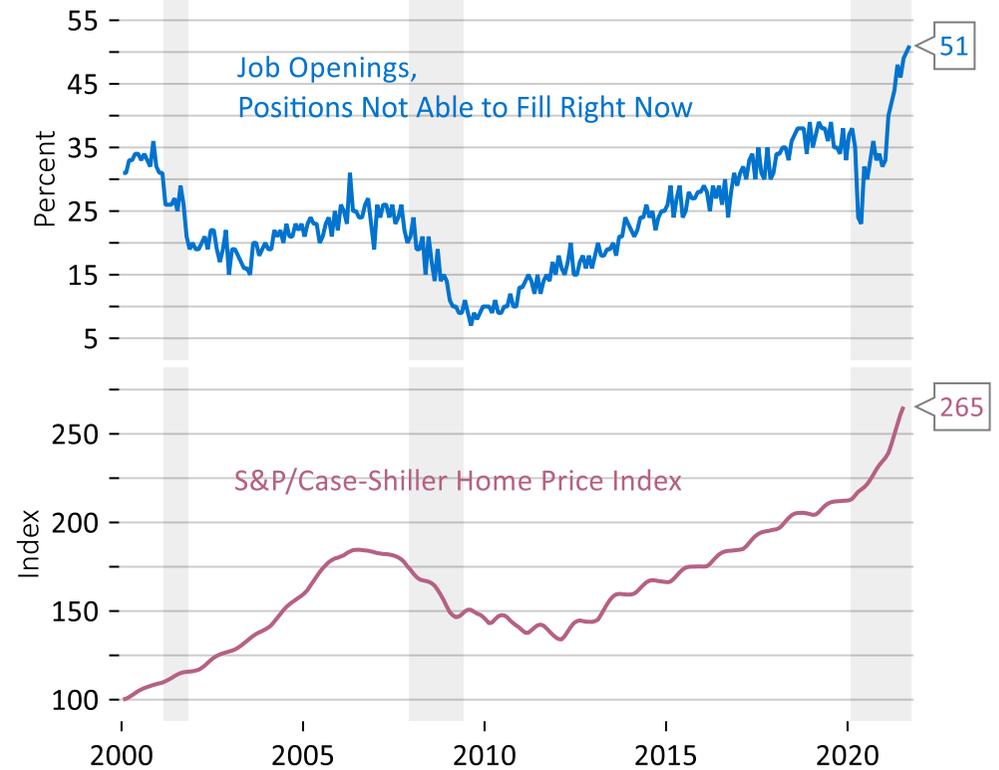
Upside risks from tight labour market & rising housing costs

US CPI



Source: Macrobond, 12.10.21

US Labour and Housing markets



Source: Macrobond, 12.10.21

Note: Shaded areas are US recessions

Could the UK be the first G7 Central Bank to lift rates?

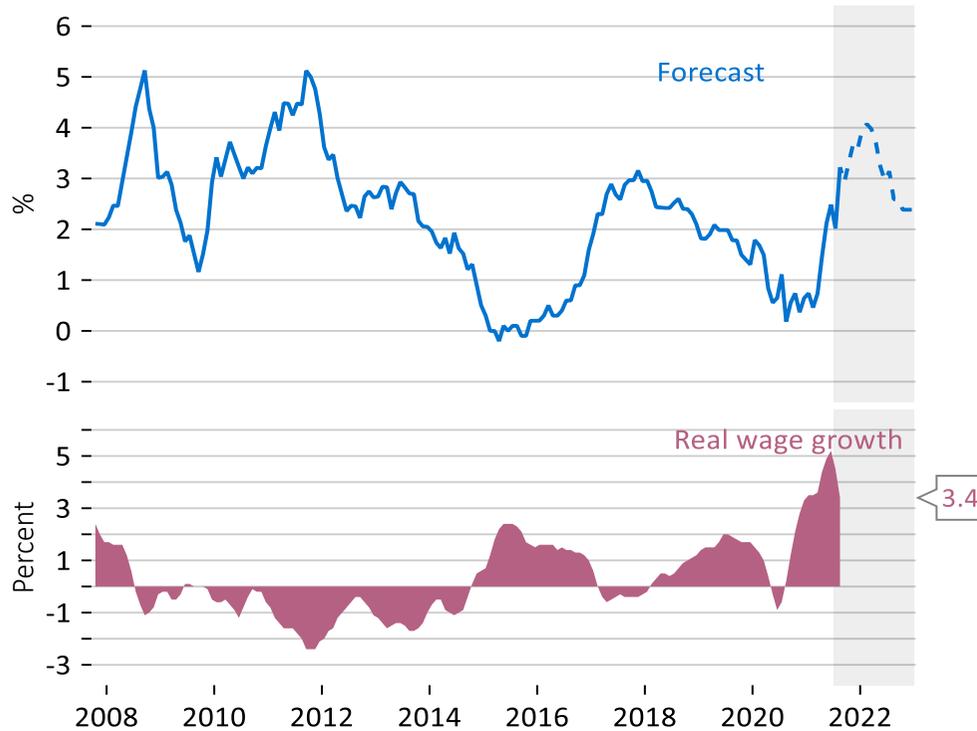


Expect inflation to reach 4% by end 2021



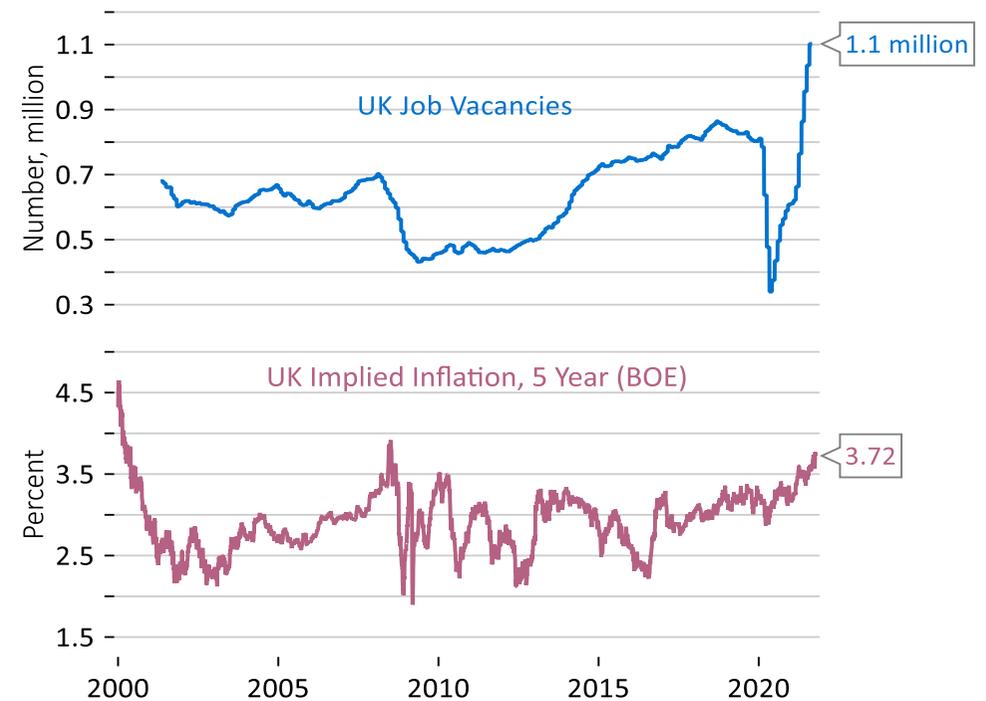
Tight UK labour market - Market measures of inflation climb

UK CPI growth



Source: Macrobond, 13.10.21

UK Job Vacancies and Implied Inflation



Source: Macrobond, 13.10.21

“We have got some very big and unwanted prices changes”

Andrew Bailey Governor BoE 9/10/21

“Increases in the bank rate... do not need to wait for the end of the current asset purchase programme” (end 2021)

Andrew Bailey 27.9.2021

03

Policy implications

Equities: Market performance 2021-to-date

Equities lead global asset returns – growth style catches up – volatility rises

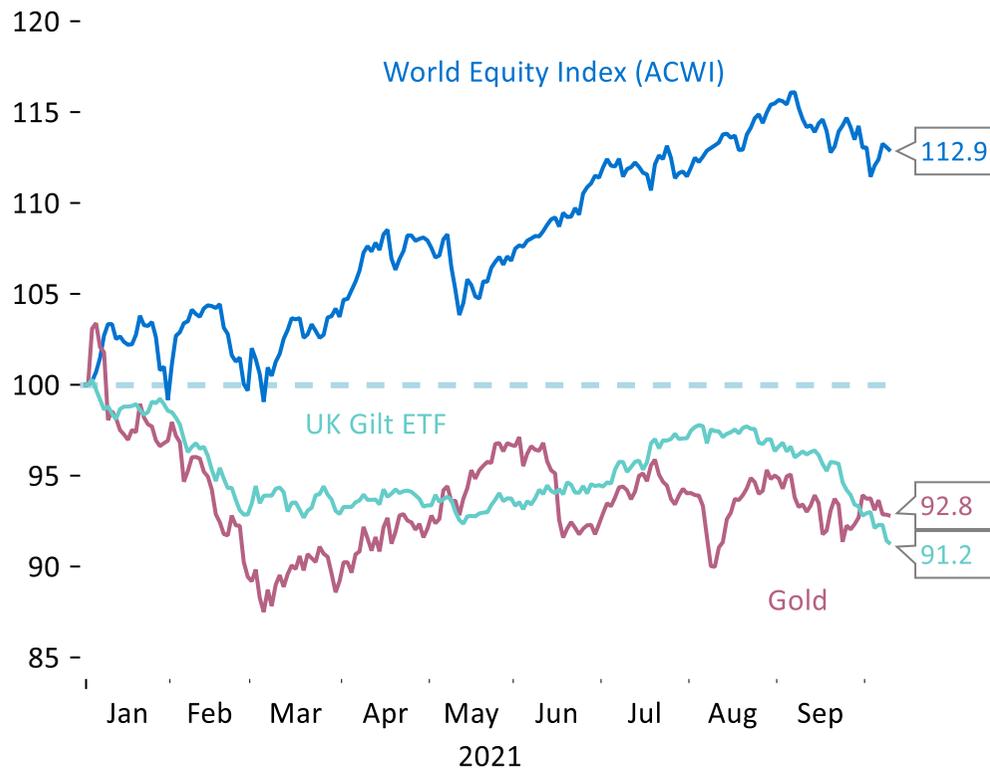


Equities rally, bonds & gold decline



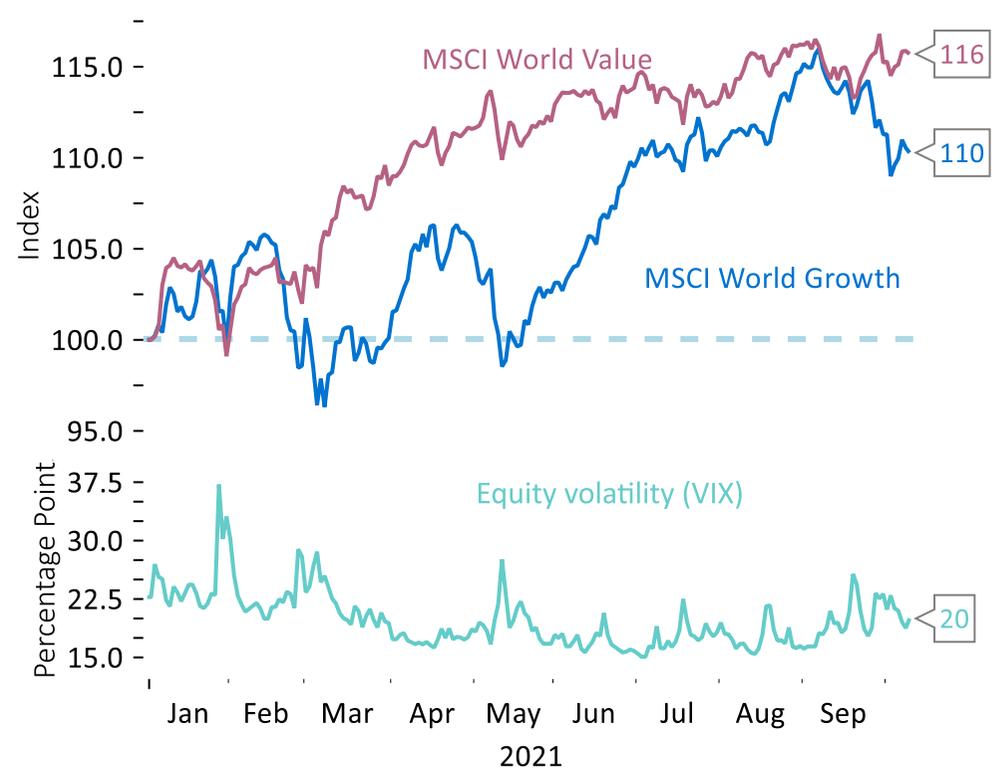
Growth catches up to value as volatility falls

Global Asset Class Returns 2021 (GBP) to date



Source: Macrobond, 12.10.21

World Equity Style 2021



Source: Macrobond, 12.10.21

Why are we overweight risk assets? 1. Record fiscal and monetary support will only be withdrawn slowly

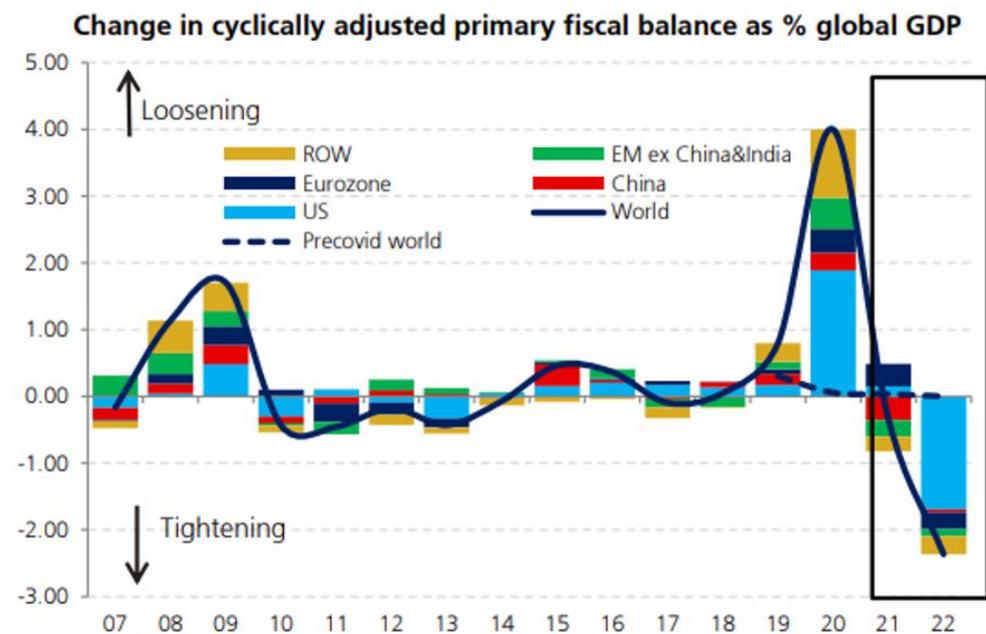


Fiscal stimulus turns to modest tightening in 2021



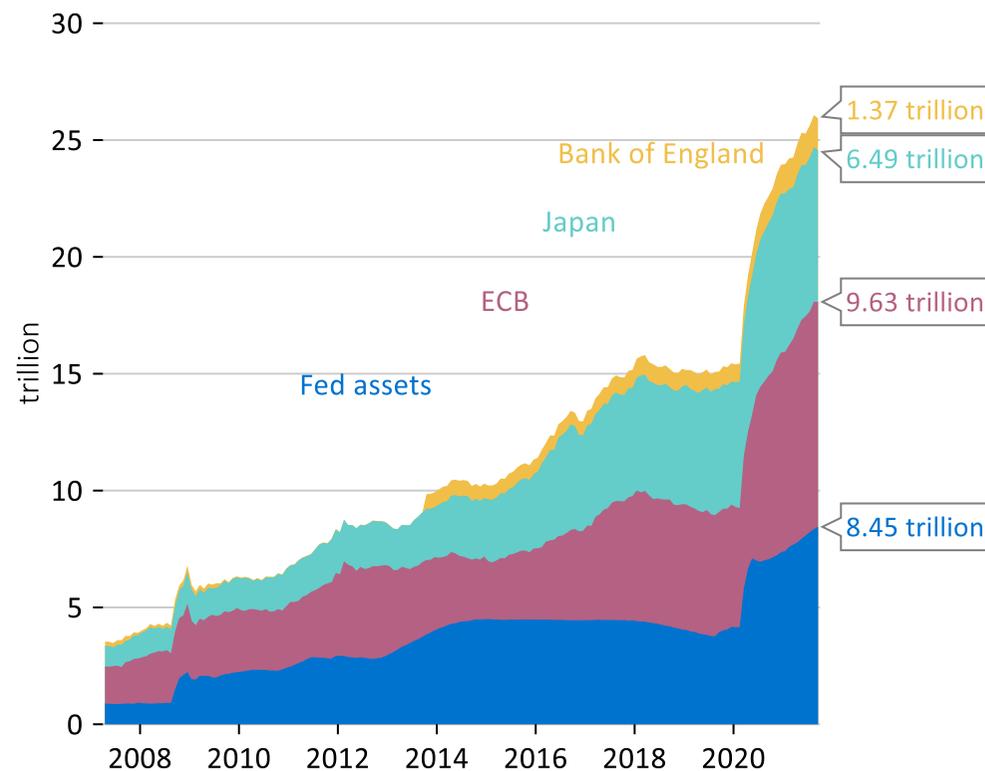
Fed & ECB will still purchase \$2 Tr of assets even with taper

Figure 3: Historically large fiscal retrenchment ahead



Source : UBS, Haver, European Commission, CBO

Central bank balance sheet (USD, monthly)



Source: Macrobond, 12.10.21

2. Negative real bond yields continue to support equity valuations

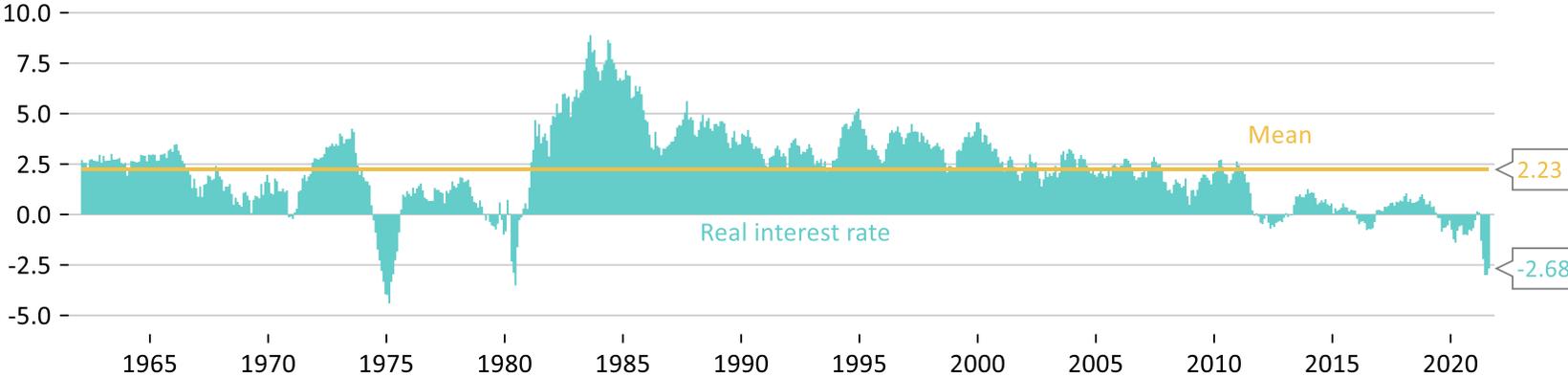


Today's real bond yields are almost 5% below their 60 year average (note past energy crises)

US: Core CPI and 10-year yield



Real interest rate with long-run average

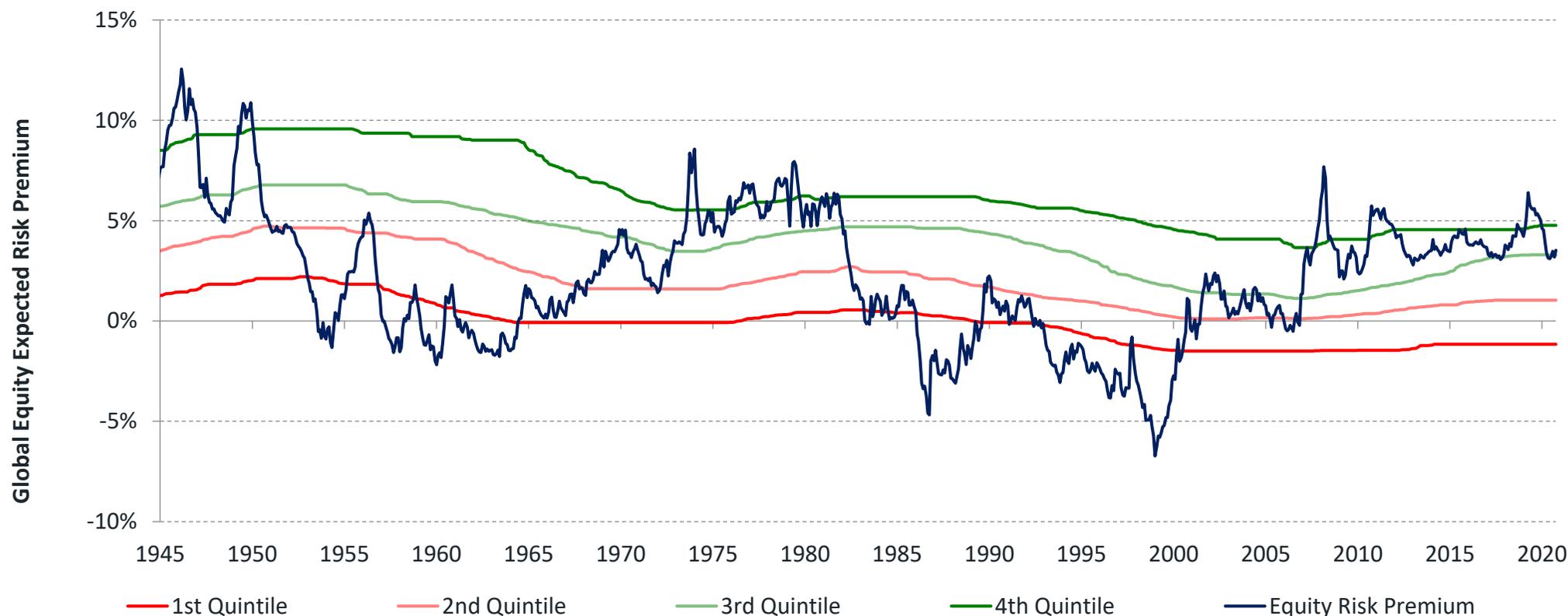


Source: Macrobond, 13.10.21

The Equity Risk Premium still looks broadly supportive despite the recent rise in 10 year yields



The US 10yr yield has rebounded to 1.6%

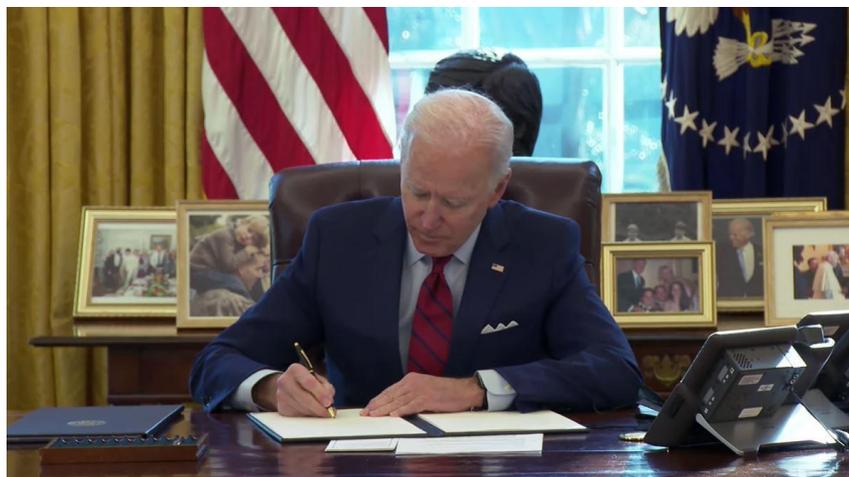


Source: Sarasin & Partners LLP, 30/09/21. Calculations use real trend-adjusted earnings, trend real growth, and US CPI and 10 year Treasury bond yield. Adjustment for trend based growth, inflation, earnings and payout ratios based on Sarasin calculations. Additional data from Robert Shiller at Yale University (S&P prior to 1969), MSCI (MSCI World and MSCI All Country World Indices (from 1970 and 1988 respectively), Bloomberg, and Bureau of Labor Statistics. 1939 – 2016. Quintile levels refer to rolling 50-year ranges. **Past performance is not a guide to future returns. Chart does not reflect Sarasin's expectations of future returns of equities or bonds.**

3. Climate spend will support industrial earnings

Massive capital spending in a short timeframe needed to mitigate global emissions

Government commitments on emissions



Key new commitments made on emissions:

- **UK** 78% reductions by 2035 below 1990 levels
- **EU** 55% reductions by 2035 below 1990 levels
- **US** 50% reductions below 2005 levels by 2030
- **China** Reduce coal use 2026-30 & carbon neutrality 2060
- **Japan** 46% emissions reductions by 2030

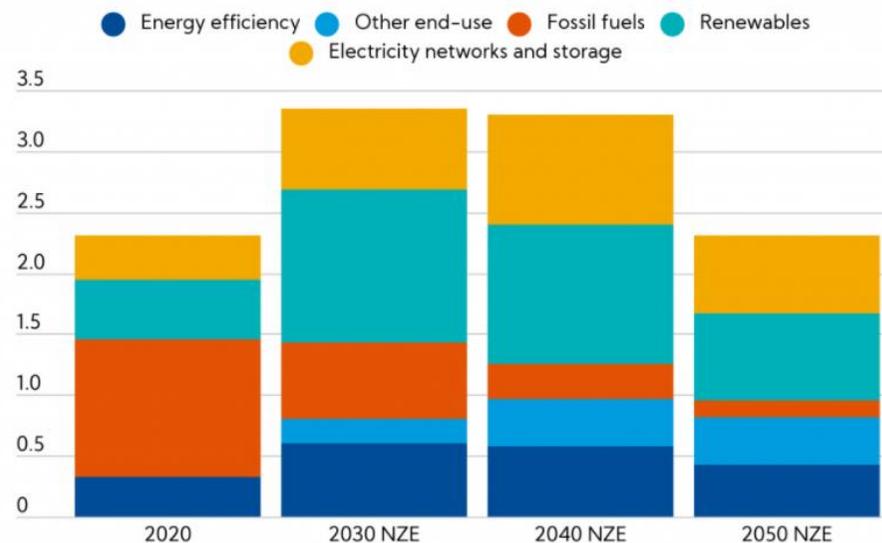


\$6-10 trillion needed in the next 10 years to mitigate climate

An upfront investment

The transition to a green energy system will require a higher level of investment over the next 20 years but should come back down thereafter.

(investment as a percent of GDP, annual average per decade)



Source: IEA (2021), Net Zero by 2050, IEA, Paris
<https://www.iea.org/reports/net-zero-by-2050>

Note: The bars represent the annual average over the decade except for 2020 (the average of 2015-2020); i.e. 2030: the annual average of 2021-2030. NZE=Net Zero Emission scenario.



Policy summary



Positives	Negatives
Global growth and earnings remain strong despite slowdown.	Deceleration in growth momentum and earnings growth anticipated in 2022.
Vaccines have been effective against variants so far.	Valuations very stretched; ERP has declined, CAPE at extreme levels
Financial Repression: Despite taper, Fed and ECB to purchase \$2.25trillion of assets in the next 12 months, suppressing interest rates	Policy error risk high in US/China. Current rate hike assumptions of 4 Fed hikes in 2023 is above market consensus.
Real bond yields to remain sharply negative	Political risks rising in the Indo-Pacific

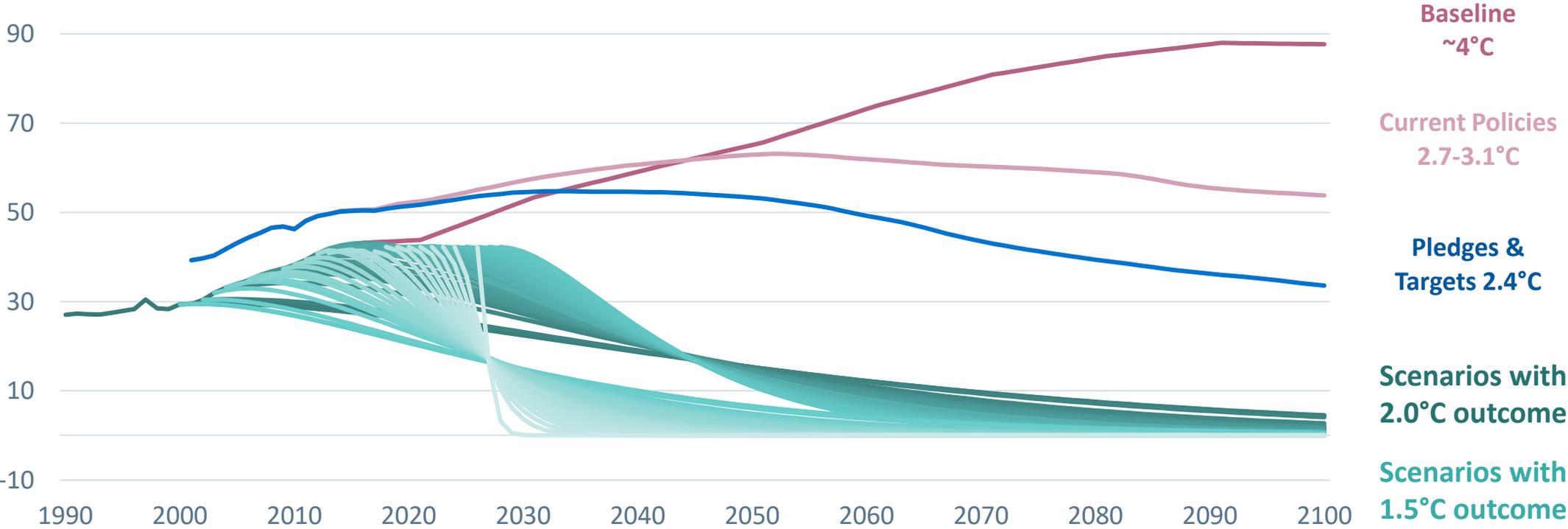
Investing for a changing climate

Climate outcomes depend on emissions action

We need to bend emissions curves and soon



2100 warming projections & emissions reduction scenarios necessary to limit global average warming to 1.5°C & 2.0°C



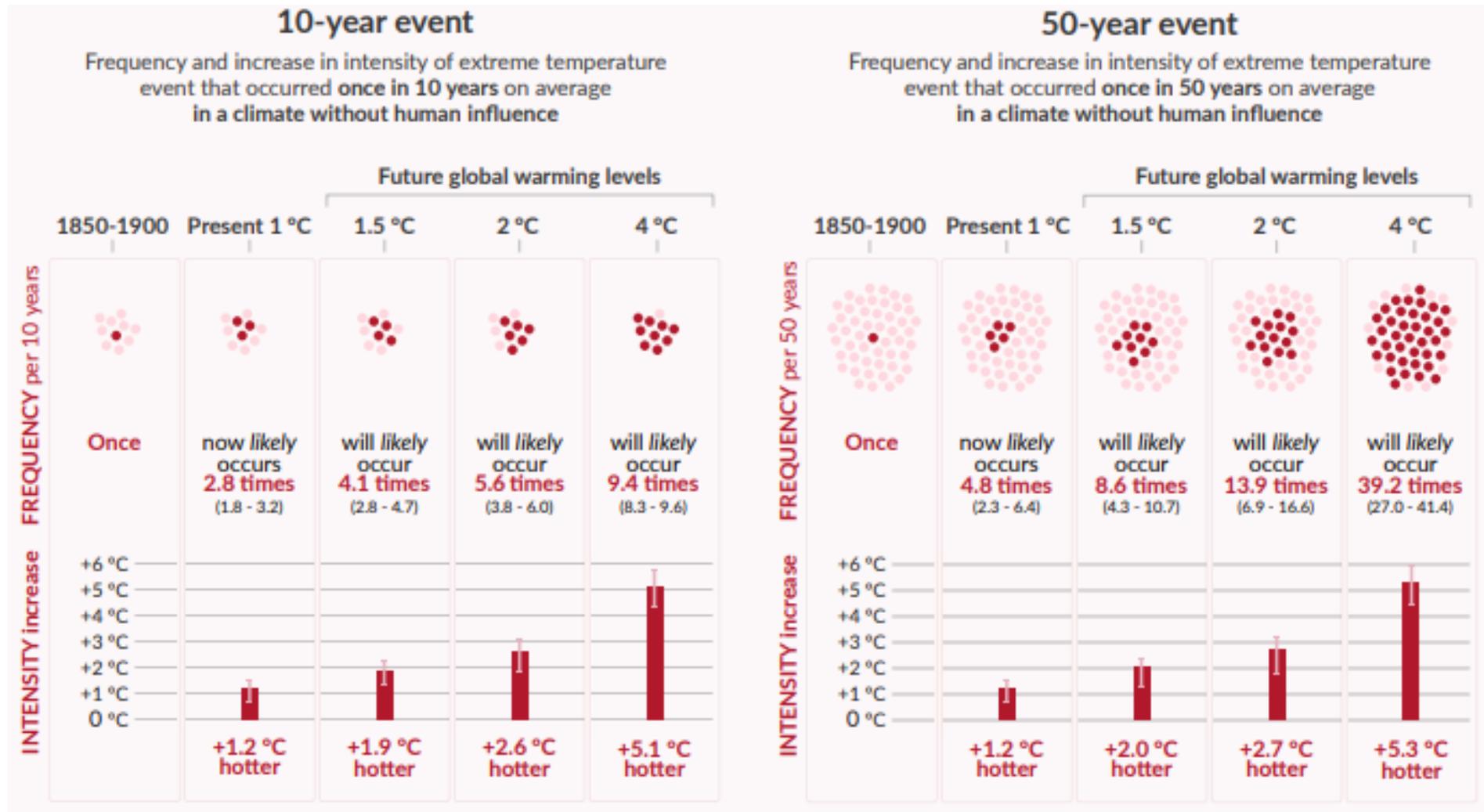
Source: Climate Action Tracker & Global Change Data Lab, 2019

What's locked in and how bad could it get?

Projected changes in extremes are larger in frequency and intensity with every additional increment of global warming



Hot temperature extremes over land



Source: IPCC, August 2021

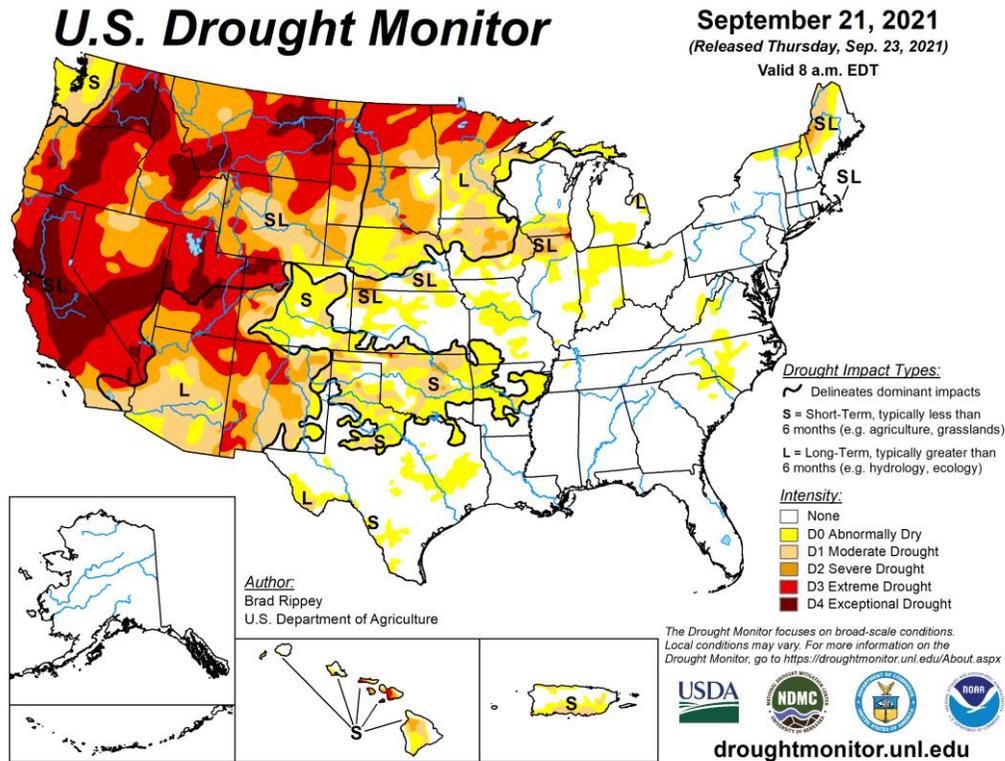
Worsening drought conditions in North America



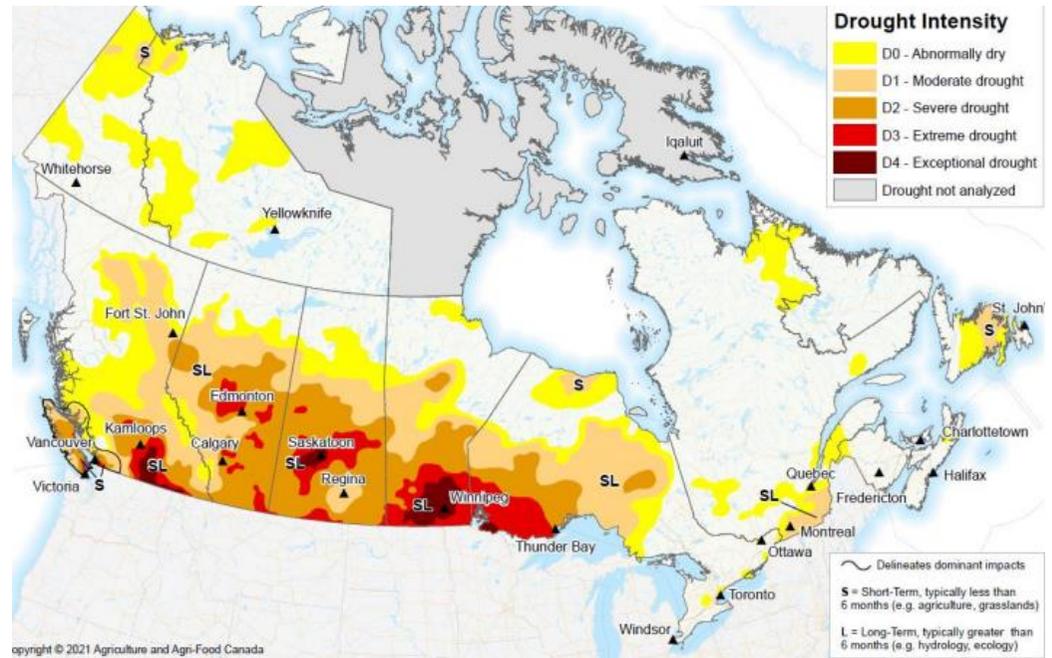
US Drought Monitor, September 21, 2021



Canadian Drought Monitor Conditions as of August 31, 2021



NOAA



Agri-Food Canada

We have added the world's leading water design and consulting firm to our equity buy-list

EM climate risk – Philippines

THE WORLD BANK GROUP

PHILIPPINES

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE

CLIMATE CHANGE AND ENVIRONMENTAL RISKS AND OPPORTUNITIES

The Philippines' financial sector is highly vulnerable to climate risks. The country has high exposure to natural hazards (typhoons, landslides, floods, droughts, volcanic eruptions), strong dependence on a climate-sensitive agricultural sector, and vast coastlines where all major cities and the majority of the population reside. It lies in the world's most cyclone-prone region, averaging 20 cyclones each year, of which 8 make landfall. In addition to the cost in terms of forgone output, productivity losses and fiscal and external sustainability, climate change poses risks to the soundness of financial institutions and stability of the overall financial system. Already, regression results show typhoons have significant impact on non-performing loan ratios for banks, confirming the significance of credit risk materialization brought on by typhoons. Additionally, severe operational disruptions are reported by banks following typhoons, while insurers have been affected by high claims following natural disasters in the country. The impact of climate change on weather-related events and sea level rise, is expected to further increase such financial losses and business disruptions.

We divested a Pilipino Bank from our equity buy list 2 years ago

European carbon prices

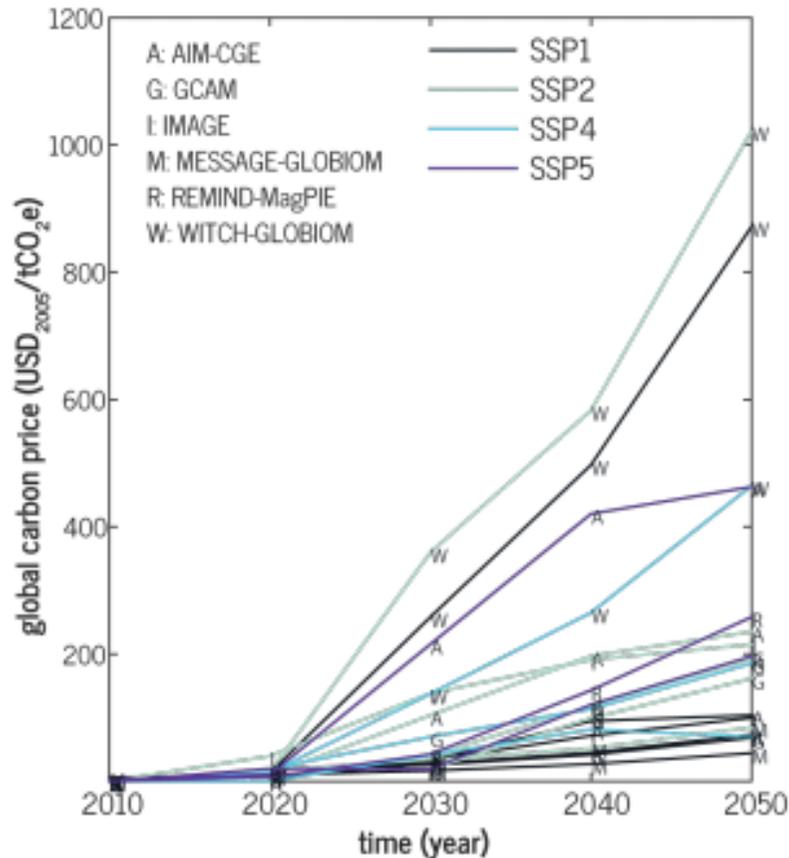
You think €60/t is high...what about \$1,000/t by 2050?



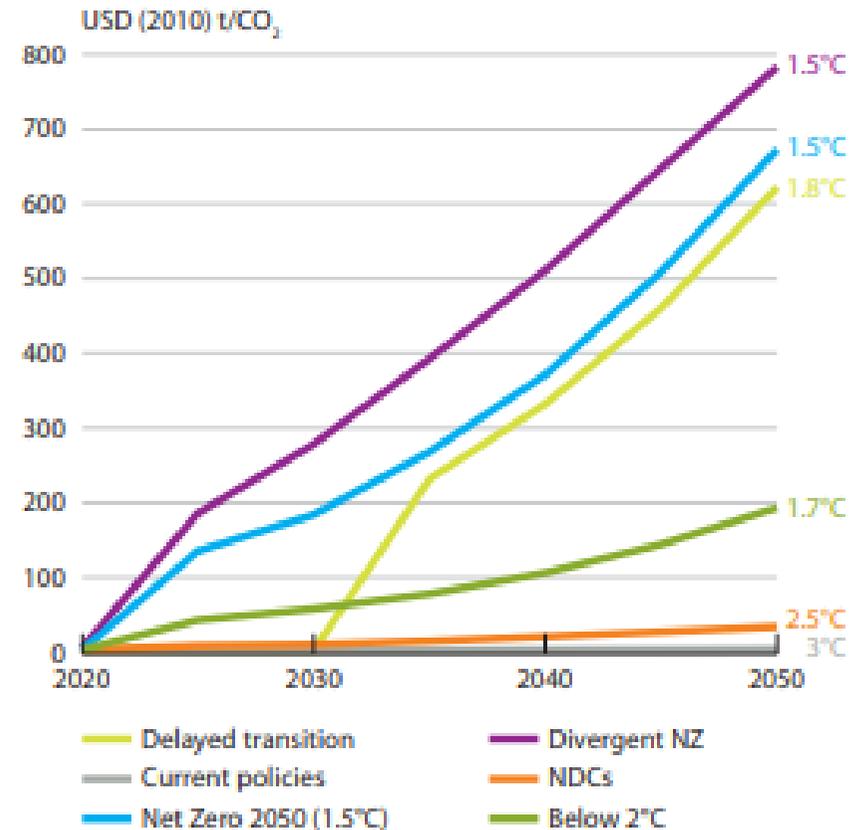
Carbon-Price Trajectories Limiting Warming in 21st Century below 2°C



Carbon price development



Report of the High-Level Commission on Carbon Prices – Stern and Stiglitz 2017



IASA NGFS Climate Scenarios Database, REMIND model. Carbon prices are weighted global averages. End of century warming outcomes shown.

We added exposure for portfolios

The role of natural capital offsets



Burgeoning cash flow additionality?

BUILDING A \$100 MILLION BUSINESS

Growing EBITDA as Carbon Markets Develop



Weyerhaeuser

NATURAL CLIMATE SOLUTIONS

Adjusted EBITDA⁽¹⁾



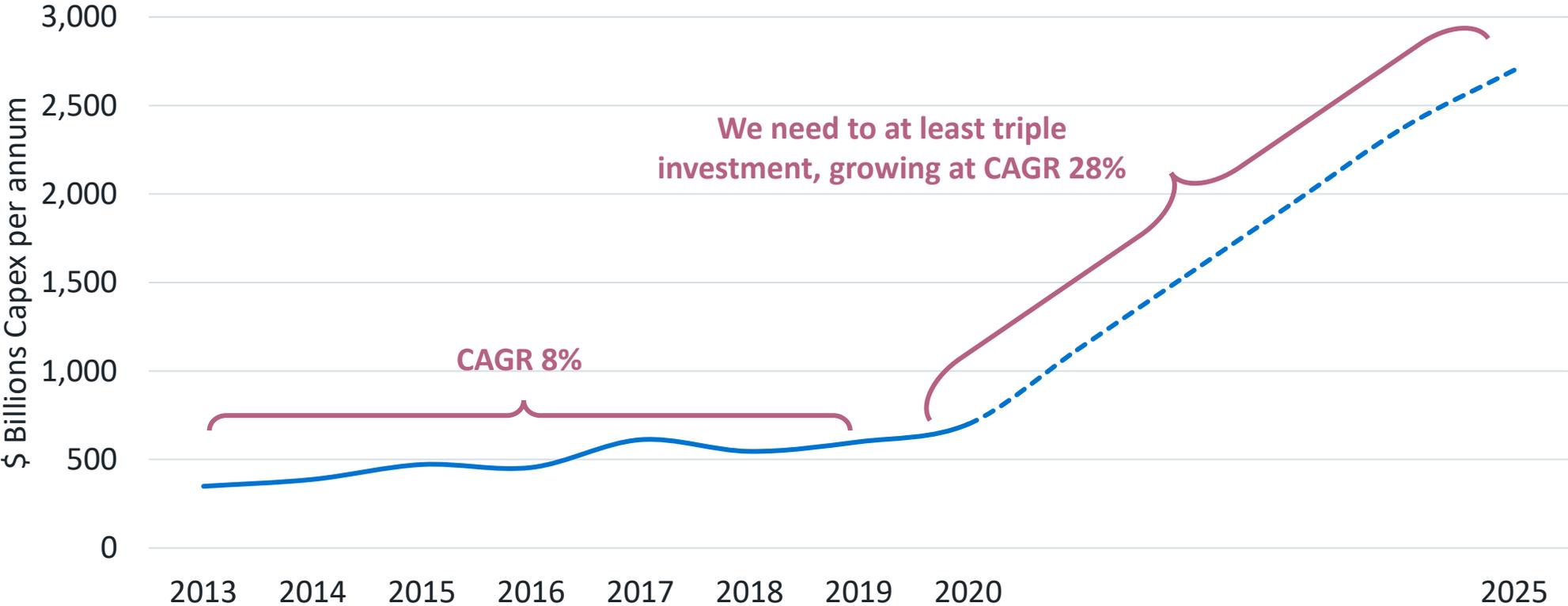
- Targeting nearly \$80 million of Adjusted EBITDA growth in Natural Climate Solutions
- Primary growth from new Forest Carbon and Carbon Capture and Storage (CCS) opportunities
- Also expanding current mitigation banking, conservation and renewable energy businesses
- Future upside beyond 2025 as markets continue to develop

Examining our exposure to largest North American timberlands firm

Investment requirements are unparalleled

Global investment in climate finance (mitigation and adaptation) needs to rise into trillions

 **Historic and required investment in climate related finance**



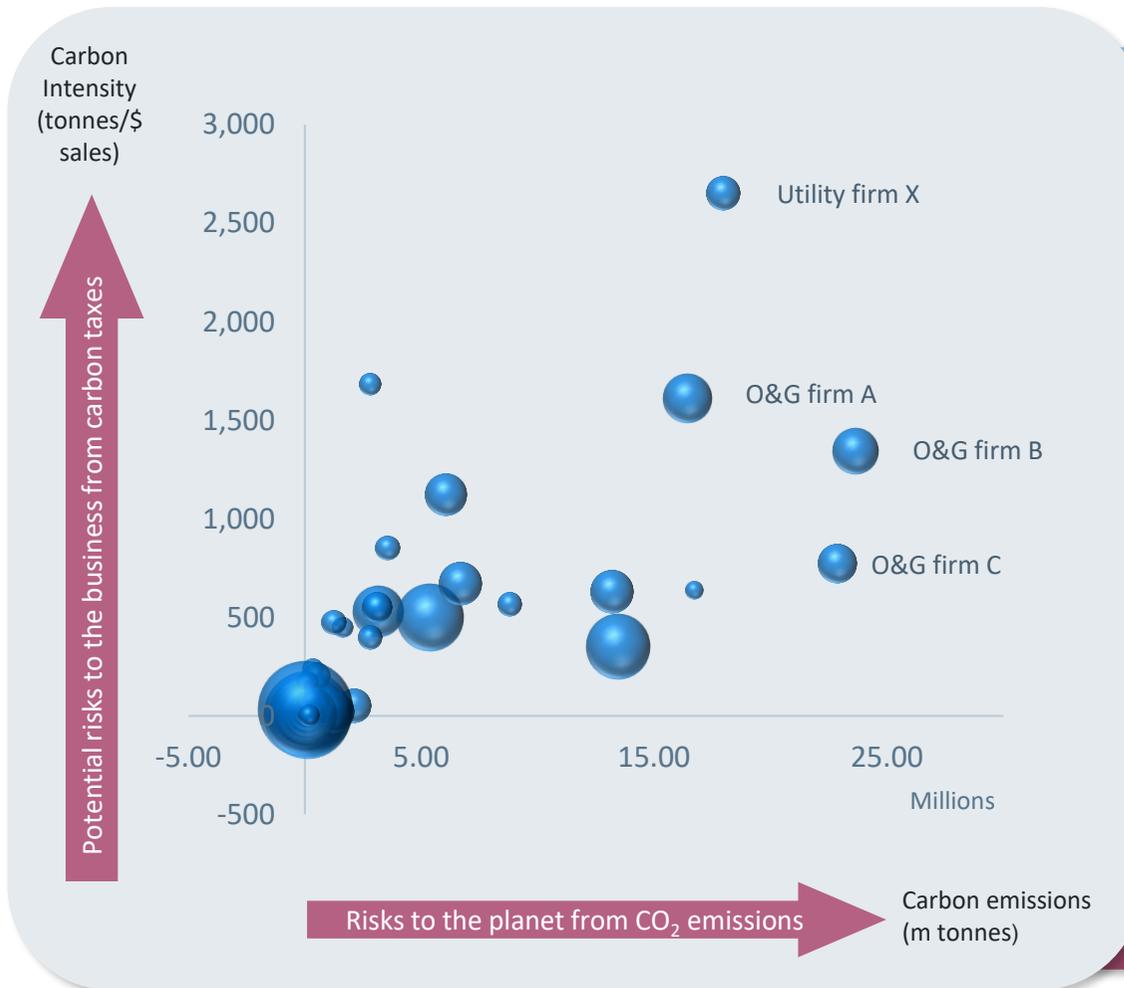
Source: Global Landscape of Climate Finance 2019 & IPCC

Are carbon footprints contributing to the mispricing of climate risk?

What do they tell us from an investment perspective?



Carbon footprint of TSX60



Ignores scope 3 emissions due to data constraints

Ignores sector specific decarbonisation pathways, some pathways are slower than others (“hard to abate”)

Ignore sector specific dynamics, e.g. ability to pass through carbon taxes/costs

Ignores jurisdictional differences, i.e. probability of carbon pricing in DM vs EM

Ignores direction of travel, capital allocation is the key to mitigating risk

Ignores the need to allocate capital to climate solutions

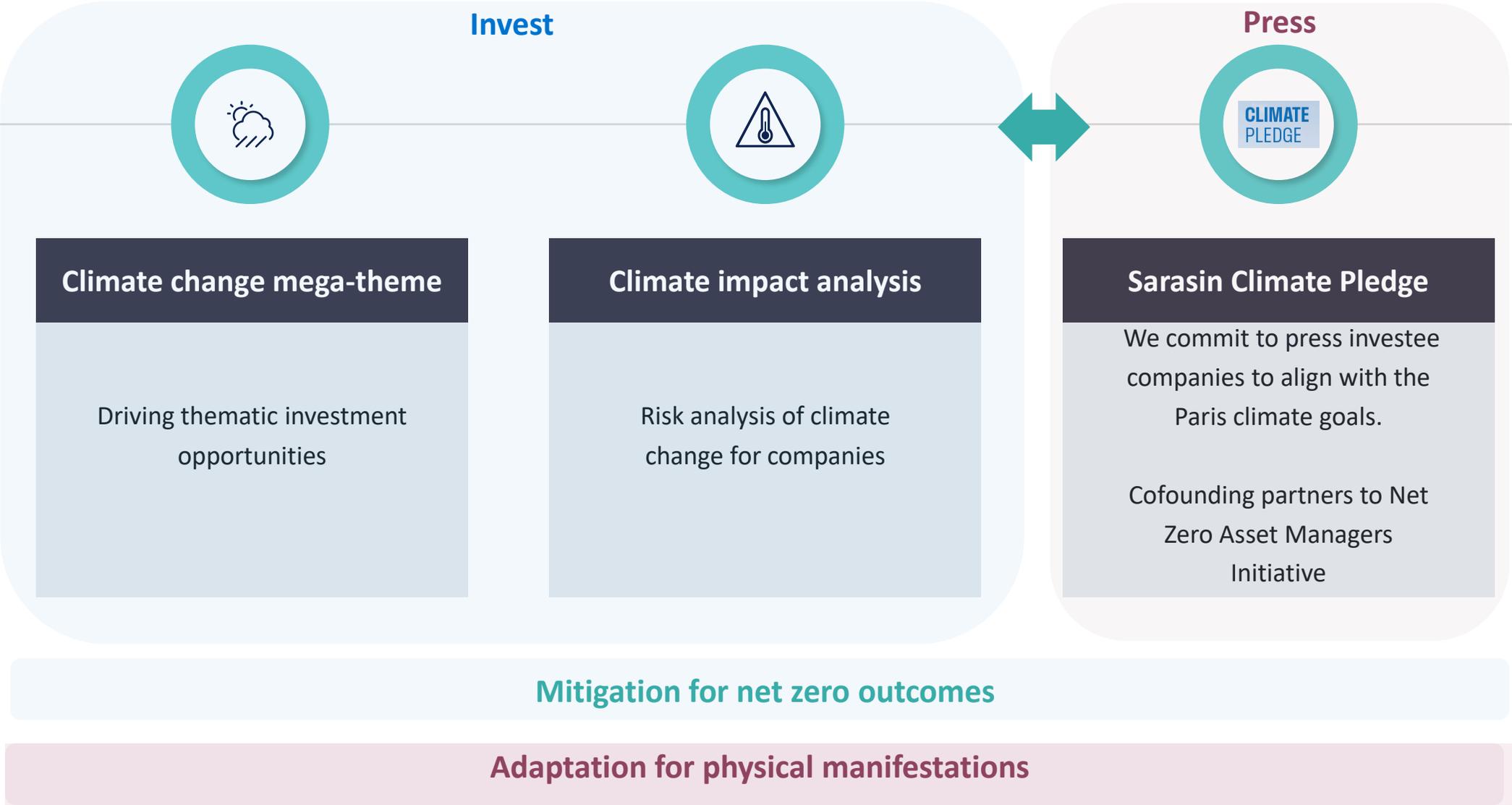
Ignores physical risks

Ignores engagement – who fixes the emissions problem?

Source: Sarasin & Partners, MSCI ESG Research. Data as at 30 June 2021 based on available data for 91.0% of the portfolio, grossed up to 100%. The size of the bubbles represents the % weighting in the portfolio. The data represents Scope 1 and Scope 2 emissions. Scope 1 are direct emissions from sources owned or controlled by the company, including emissions from fossil fuels burned and emissions from owned or leased vehicles. Scope 2 are indirect emissions from consumption of purchased electricity, heat or steam and any associated transmission and distribution losses.

Rather than focus on footprints, focus on financial transmission channels

Sarasin's approach to protect client capital and enhance returns



Understanding company-specific net zero implications

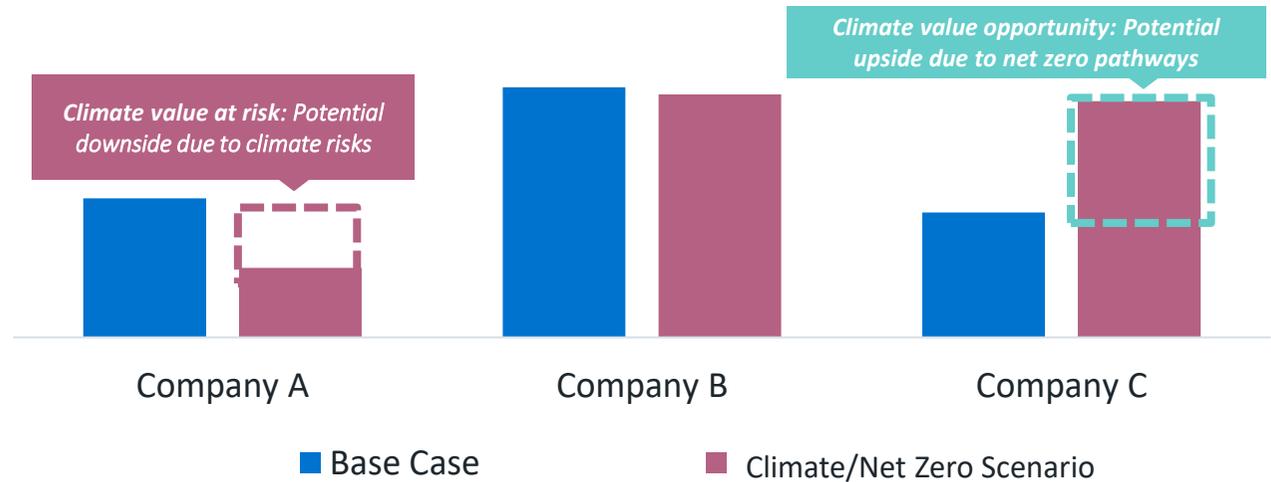
Climate value at risk (CVAR) translates risk and opportunity into investment perspectives



Valuation adjustments due to:

- Changes in pricing of goods and services
- Impairments / stranded assets
- Change in CAPEX requirements
- Impact of higher carbon prices
- Other impacts

What climate value at risk shows us (hypothetical data)



Positives

Captures economic value at risk from ignoring climate change and policy response

Gives a numerical measure of risk avoided

Permits easy measurement over time of the portfolio to demonstrate falling CVAR

Source: Sarasin & Partners, hypothetical data, 2021

How climate analysis shapes investment decisions



Climate impact analysis and stress testing outputs



Positive exposure

Companies best placed to benefit from opportunities linked to climate change adaptation and mitigation

Increased conviction and potential position sizing

EG. +25% CVAR stocks:
Air Liquide, Enel, Nextera



Neutral exposure

Limited materiality of climate-related issues

Monitor to ensure continued management or positive exposure



Negative exposure

Companies with heightened vulnerability to climate-related issues

Engage where vulnerable, but opportunity to build resilience

EG. -30% CVAR stocks:
CME, Equinor, HDFC

OR

Fail list / Divestment where vulnerable & not building resilience for zero-net-emissions goal

Important information

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