BERENBERG INVESTMENT REVIEW Q4 2021

Advisory, Baskets, Equity Funds

FOREWORD

It feels right to be more optimistic about the future than twelve months ago. Notwithstanding the recent emergence of restrictions due to Omicron, we have greater societal and technical commitment to tackle COVID head on. We also remain hopeful that 2022 will bring a more equitable spread of treatment to countries and communities who have not benefitted from a rapid vaccination rollout like that seen in the UK.

New variants are probable but so are evolving vaccines and business models. The adoption of new technologies in business has accelerated in the last couple of years and alongside the focus on decarbonisation and economic changes post pandemic, it is not an exaggeration to suggest that we have entered a new phase for financial markets.

An increasing caution on the outlook for risk assets follows naturally after three years of rising equities. Inflation has risen sharply recently and how central banks react will be crucial for markets this year. Long term investors are having to select from a reducing list of investment options.

As my colleagues write, this year will see corporate profitability become more important, rotation between asset classes become more pronounced and policymaking in economics and politics become more decisive and diverse. Investors will face more tough decisions and tests of nerve this year.

Despite the significant uncertainties of 2021, we enjoyed a successful year both in terms of portfolio performance and business growth. Although it is likely to be similarly challenging, we are confident that together we will enjoy similar success in 2022.

Yours sincerely,

Richard Brass

Head of Wealth & Asset Management, UK

ADVISORY

IN A NUTSHELL

- Inflationary concerns still persist and interest rate hikes loom
- New virus variant Omicron emerges
- Strong quarterly results from portfolio holdings
- Exited Swatch Group and Whitbread PLC

Overview

We finished Q4 on a positive note following strong quarterly results by our portfolio holdings. This leaves us with double digit returns for 2021 overall.

In early autumn, COVID-19 cases were falling, which meant the prospect of economic recovery was again in focus – and cyclical assets outperformed to the middle of October. Monetary policy prognostications and procrastinations from the Federal Reserve and the Bank of England respectively created enough uncertainty to give markets pause for thought just in time for the emergence of the Omicron variant to spook markets.

The Bank of England raised rates for the first time since the outbreak of the virus, increasing its main interest rate to 0.25% from 0.1% previously, making it the first of the major developed banks to begin hiking rates. The move caught markets largely by surprise, as in November, the Monetary Policy Committee was overwhelmingly against raising rates contrary to market expectations, by a vote of 7-2. Therefore, the complete U-turn in December, which saw votes in favour of raising rates come in at 8-1, signalled a stark change in stance from the Bank in its approach to tempering inflation pressures, which was stated as a medium term concern with the headline rate hitting 5.1% in November, the highest level in 10 years.

In the event, returns for equities were positive in Q4 in both local currency and sterling terms, except in the emerging market segment. Gilts and corporate bonds struggled to make any headway whilst gold enjoyed a strong quarter on the back of a difficult year. After a volatile year, sterling ended stronger.

As our equity quota has increased over the year on the back of the rise in equity markets, we took profits by fully selling out of longstanding positions Swatch Group and Whitbread. Both have a relatively cyclical business model. Whitbread is the leading hotel operator in the UK with a growing arm in Germany. As we believe business travel will remain subdued for the foreseeable future and the winter season is historically the weakest for the business, we have become more cautious. Furthermore, finding qualified employees is increasingly an issue in the hospitality sector and is leading to personnel cost inflation.

The Swatch Group is a well-known Swiss watch conglomerate including not only its Swatch brand but also prestigious brands such as Blancpain, Breguet, Longines, Tissot, and Harry Winston. It has strong cashflows and an excellent balance sheet with hardly any debt. However, the competition from disruptors such as Apple is gradually visible. Furthermore, Hong Kong used to be their key market for years generating c.15% of sales, but with the political developments and travel restrictions over the last years, this has changed materially.

Heading into 2022, we don't envisage any material changes to our holdings. We are very much sensitive to the urge for corporates to become more sustainable and the need for cleaner energy generation. As a consequence, we have been exploring companies in the field of new energy and resource management.

THEMATICS

As indicated in our initial Quarterly Review, every quarter we discuss a key topic within one of our four core themes[1] to raise the awareness of them and display how these trends feed into our stock selection. For this quarter we delve into the theme of New Energy and Resource Management, in light of COP26 which took place this quarter.

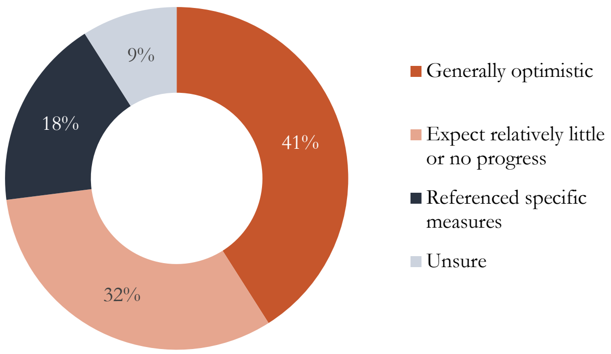
Background to COP26

The UN Climate Change Conference (also referred to as Conference of the Parties or COP), was held in Glasgow from 31 October to 12 November. The Summit is attended by those who have signed the UN Framework on Climate Change treaty.

Much attention was paid to the COP26 this year, having been postponed from 2020. Under the Paris Agreement, signatories must communicate or update their 'nationally determined contributions' (NDCs) every five years, with 2020 being the first of these five-year cycles.

Earlier this year, Berenberg Wealth & Asset Management conducted an ESG survey 'Exploring Investor Sentiment'[2], part of which sought to gauge participants' views on COP26 ahead of the Summit as per the chart below.

What progress are you expecting, following the UN Climate Conference (COP26) this year?
N=95



Source: Berenberg (2021)

The responses comprised entirely of freely written answers, with a slight majority being generally optimistic. Of those that were generally optimistic, just under half cited that the US Administration and/or international co-operation are needed to provide impetus for progress regarding emission reductions.

Further, respondents who cited specific measures tended to suggest a 'stick' over 'carrot' approach, i.e. promoting measures to disincentivise environmentally damaging behaviour than incentivising environmentally friendly measures.

What had transpired from the Conference is broadly the same sentiment. The final agreement resulting in the Glasgow Climate Pact[3] received a mixed reception, with media headlines quipping 'more than expected, less than hoped'.

Key Outcomes and implications

There were two main pledges on **fossil fuels** at the conference – the first to stop public financing of overseas fossil fuel projects by the end of 2022, and steer spending to clean energy, and the second to phase down (as opposed to the initially hoped phasing out) domestic coal production in the 2030s for major economies and 2040s for poorer nations. Further, more than 40 countries agreed to work together to support the development of clean technologies (UK Government, 2021).

[1] (i) Demographic change (ii) Innovative and disruptive technologies (iii) New energy and resource management (iv) Future health and wellness

[2] The 'Berenberg ESG Survey: Exploring Investor Sentiment' (2021) report can be found here: https://www.berenberg.de/fileadmin/web/asset_management/news/esg-news/Berenberg_ESG_Survey_Exploring_investor_sentiment_2021.pdf

[3] The full document can be found here: https://unfccc.int/sites/default/files/resource/cma2021_L16_adv.pdf

Notably during the second week of the Conference, **Velocys** rallied over 40% after the announcement of two deals related to the provision of sustainable aviation fuel (CNBC, 2021). After the end of the Conference (12 November) there was also a visible increase in the price of **EU Carbon Permits**, a subject which Berenberg's Utilities Equity Research Team has extensively discussed for some time.

The UK COP Presidency published the Climate Finance Delivery Plan which noted that the $100bn per year developed countries' contribution to developing countries to support their climate targets would be met however not until 2023 (UK Parliament, 2021).

Beyond the agreement, a framework on carbon markets as well as the methane and deforestation pledges signposted much commitment to making progress in managing each of these respective issues. This will likely affect stocks within the consumer/retail sectors where dependency on packaging is high. One of the long-term positions in our portfolio, **Unilever**, for example attended the Conference and noted their Climate & Nature Fund to enable brands to invest in projects they help to protect nature and build resilience to the effects of climate change as well as partnering with Google to identify risks of deforestation along their supply chain (Unilever, 2021).

In addition, 450 financial institutions that have committed to net-zero targets as part of the Glasgow Financial Alliance for Net Zero (GFANZ) control a combined $130 trillion in assets. In the near term, this could lead to greater engagement with companies, particularly through the use of voting at Annual General Meetings (AGMs) for example **AXA IM** has already warned companies that they will implement a 'three strikes and you're out' policy if their climate change expectations are not met (FN London, 2021).

In terms of wider reporting, the International Sustainability Standards Board was launched, providing a global baseline of sustainability-related disclosure standards. In doing so, this should help in part to promote comparability of companies for the analysis of their ESG credentials.

Egypt will host next year's meeting COP27 where adaptation and resilience are expected to be high on the agenda, and of course, finance.

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