# The transition for performance

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A popular sustainable investment theme, the transition is at the heart of building our sustainable investment strategy, embodied in particular by the R-co 4Change Net Zero Equity Euro fund. Four years after its launch[1], Anthony Bailly and Ludivine de Quincerot draw up a balance sheet and explain how they reconcile sustainable and financial challenges in their management.

## How to define your investment strategy?

**Ludivine de Quincerot :** the transition approach has been at the heart of the fund's strategy since inception. It was a contrarian positioning at its launch in 2019. At that time, when sustainable investment was talked about, the debate looked simple and often amounted to investing in themes such as solutions or renewables that seemed to offer structural growth in view of the necessary investment needs which, therefore, would necessarily be profitable. The financial logic has resumed its rights and the accumulated increases in inflation and interest rates that followed have significantly affected these sectors and led to very disappointing stock market performances. We were not exposed to these players whose valuation levels seemed excessive in view of their fundamentals. The high representation of these stocks within the ESG portfolios was also an additional risk.

**Anthony Bailly:** the particularity of our approach is that we allow ourselves to invest in all sectors[2], including the most issuers. Globally, five sectors (chemicals, commodities, utilities, construction, energy) account for 86% of CO2 emissions[3]. We are convinced that we will achieve a more significant environmental impact by accompanying them in their transition, rather than by promoting exclusion, when we select players with the most credible and ambitious decarbonation trajectories. The opportunity to invest in all sectors also has the advantage of avoiding style biases and gives us the flexibility to navigate through the economic cycle.

## How is the transition theme bringing about?

**L.d.Q.**: the massive state aid plans on both sides of the Atlantic (IRA in the US and the Eu Green Deal) are accelerating a deeper movement already initiated by large groups and innovative companies through the transformation of their business models. The subsidies granted have particularly benefited certain sectors such as utilities, in particular by accelerating the evolution of the energy mix.

**A.B.** : Thus, there are different ways to position themselves on the value chain and benefit from these incentives. Several sectors and companies in the portfolio, such as Alstom, are thus expected to benefit, among other things, because the place of rail transport will become increasingly important in the coming years. There are also examples in the energy sector with Vallourec or Technip Energies that will be able to benefit from the transition and subsidies thanks to the carbon capture, sequestration and storage methods developed by the first or the transformation of its production sites for the second. In the Paris Accord alignment scenarios announced by governments, these techniques would represent 15% of CO2 reductions[4]. It is therefore a very strategic issue. Siemens Energy is also benefiting from the development of wind farms and Saint Gobain in the renovation of the housing stock.

**A strategy that relies on reference providers**

MSCI ESG Research analyzes of more than 8,500 issuers and 680,000 equity and bond instruments as well as 53,000 funds and ETFs. The best and worst players by sector are rated between AAA and CCC.

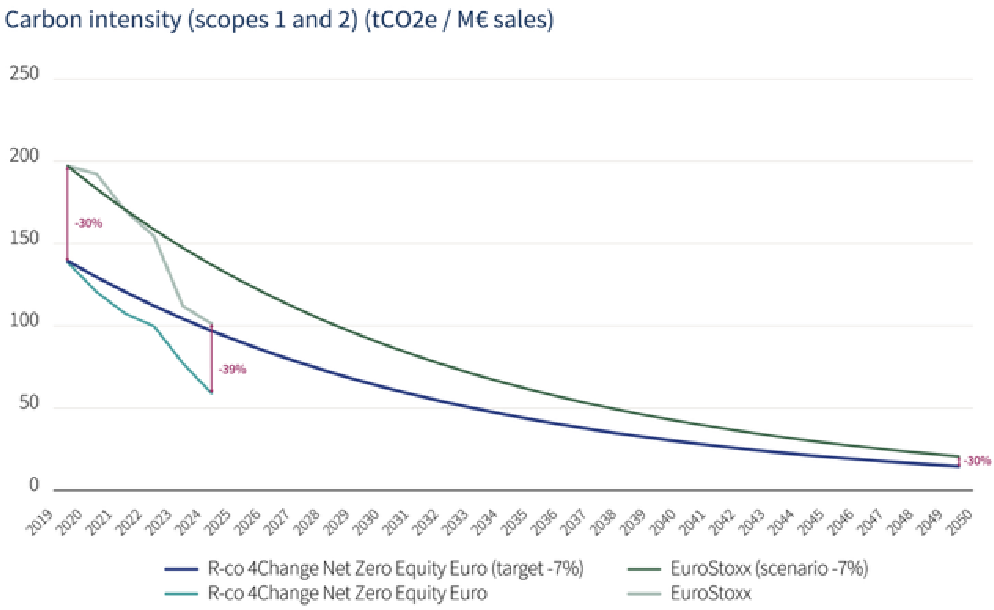
SBTi, a group of scientific experts whose purpose is to define, promote and validate best practices in reducing carbon emissions and 'Net Zero' objectives with a consideration of scope 3.

Carbon4 Finance to collect companies' carbon data by considering all emission scopes 1, 2 & 3 in past, present and future climate analysis of issuers

## How does R-co 4Change Net Zero Equity Euro fit into this theme?

**A. B.** : R-co 4Change Net Zero Equity Euro is an Article 9 SFDR[5] fund, SRI labelled[6] and already aligned with the last version of the label. We have defined three impact levers to drive our investments and monitor the achievement of our environmental objectives: The carbon intensity of the portfolio must at all times be 20% lower than that of our benchmark[7], we must obtain a decrease in the carbon intensity of the portfolio of at least 7% per year on average and, finally, 90% of the portfolio companies must have validated their alignment trajectory with the Paris Agreement by the SBTi by 2030.

**L.d.Q.** : four years after the launch of the fund, we can demonstrate that we have gone beyond our commitments: 71% of companies validated by SBTi (vs. 21% in 2019), a carbon intensity that has fallen by more than 7% a year and is now 39% lower than its benchmark[8]. These results have been achieved even though we have increased the cumulative weight of the issuing sectors in the portfolio, which is currently 25% compared to 19% at the launch of the fund8. The utilities sector is the main contributor to this decline, with EDP first and foremost rising from over 1,300 tCO2/€ m in revenue in 2019 to 280[9] this year. Across the portfolio, absolute issuance has fallen by 30% since inception[8]. In keeping with our philosophy, as the carbon intensity of the portfolio has fallen faster than anticipated, we continue to select new companies within the emitting sectors to support them in their transition.



Source: MSCI ESG Research, Rothschild & Co Asset Management, 30/04/2024.

## You mentioned a transition grid, what is it?

**L.d.Q. :** We have created a transition analysis grid that makes it possible to homogeneously assess the transition dynamics of companies with three objectives. The first is to assess the transition potential, the measures put in place, the credibility of the objectives and their relevance. The second is to establish a constructive dialogue with issuers through in depth qualitative and quantitative analysis. The third aims to meet the requirements of labels, regulations and our clients who ask us for more and more concrete evidence of the state of progress of companies' transition plans. This grid is evolves around six pillars and is an analysis and engagement tool that allows to monitor companies' progress over time.

**A.B. :** Our qualitative and quantitative analyses are updated at least annually, but may also be updated on a timely basis, mainly following an exchange with a company's management. We apply this grid to all companies in the portfolio with particular attention to the most emitting sectors. A number of industry players are taking advantage of the enthusiasm around the transition to position themselves on this theme. Appreciating this theme is nevertheless particularly demanding. We have been deepening and strengthening our expertise since 2019, in particular through working groups and regulator consultations. Our transition analysis grid is largely in line with the spirit of the work carried out.

**The six pillars of our transition grid**

- Governance of climate issues and fair transition
- Reporting of emissions on all scopes
- Climate commitments and SBTi validation
- Objective robustness
- Measures and investments
- Results achieved

## Is engagement an important dimension in the management of this portfolio?

**L.d.Q :** We vote on 100% of our equity holdings[10] and we participate in Place initiatives, either coalitions or working groups. Our transition analysis grid is based on the result of this work. Finally, we have a regular and constructive dialogue with the companies we know in depth because of the concentration of our portfolios. In this context, the analysis grid is a tool for exchange and to underpin our engagement with companies. Many of them want to exchange on this subject, understand our assessment and try to improve on the points we have identified

**A.B. :** Specifically, since 2021 we have met two thirds of the companies in the portfolio and in almost 40% of the cases7, the questions we asked were accompanied by a request for action from the company. For example, we have had to exchange with Alstom on the calculation of avoided CO2 emissions (so called ‘Scope 4’). We conducted thirteen individual dialogues with society between 2021 and 2023 and we hope to publish these data for fiscal year 2025. Other issues relating to environmental issues were also addressed, in particular the opportunities linked to the development of the hydrogen train (current control levels and future investments, etc.). In another case, Vallourec decided to add two new objectives to those already approved in 2020 by SBTI. We exchanged views on this with the Sustainability Department pending SBTi's decision. Last example regarding Carrefour: Since 2021, we have been talking about the publication after independent audit of its Scope 3 greenhouse gas emissions. This point was finally included on the agenda of the 2023 general meeting of shareholders and was adopted.
**A sharing fund for the scientific expedition Polar POD**

R-co 4Change Net Zero Equity Euro is a sharing fund. A partnership has been established with the association Océan Polaire, an association of law 1901 created in 1991 and recognized of general interest, whose purpose is the organization of expeditions and missions of an educational and scientific nature in the polar regions. For all units of the

FCP, 0.15% of the management fees will be returned to the association Océan Polaire in order to contribute to the financing of the Polar POD expedition

## What are your investment guidelines for the coming months?

**AB :** Over the past three years, in very different market configurations, the financial performance of R-co 4Change Net Zero Equity Euro has allowed it to stand out within the climate funds universe, demonstrating its ability not to be captive to sector rotation. Thus, until recently, we have avoided investing in companies specialized in the production of renewable energy for valuation issues. However, we included Siemens Energy, the largest wind turbine producer in Germany, in the portfolio at the beginning of the year and are thinking about other investments in this sector, valuation levels now looking much more attractive.

**L.d.Q. :** Given the sharp fall in the carbon intensity of the portfolio, we are still looking for players in transition both in high emitting sectors such as utilities or real estate, but also in others such as automotive where scope 3 emissions are very significant and the transformation issues of business models are particularly strategic.

**The Net Zero in Brief**

In 2015, COP21 ratified the Paris Agreement with the aim of limiting global warming to a level below 2° C by 2100 compared to the pre industrial level, continuing efforts to limit it to 1.5° C. This ambitious plan incorporates various provisions, including the 'Net Zero' objective, which causes the continuous decline in anthropogenic greenhouse gas emissions with the aim of approaching a theoretical zero. The first step is to reach the ceiling on emissions and then reduce them as much as possible until 2050, and then offset residual emissions through various mechanisms, whether natural or technological.

*Learn more about the fund(s)*

R-co 4Change Net Zero Equity Euro

*Check this document on our website*

(1) The fund's name and strategy were changed on 11/02/2020 to include sustainable criteria, and the name was changed again on 15/10/2021 to reinforce its sustainable investment strategy. The FCP was converted into a sub-fund of the ‘R co2’ Sicav on 17/09/2021.
(2) Excluding regulatory exclusions.
(3) Sources : Our World in Data (2020), MSCI ESG Research, Rothschild & Co Asset Management 31/12/2021. Scope 1 & 2 by breakdown of greenhouse gas emissions by sectors of the MSCI World ACWI Index.
(4) Source : United Nation Climate Change, décember 2015.
(5) The SFDR regulation defines 3 product categories based on the sustainability objective. Article 9: Products whose objective is sustainable investment. The SRI label is a French label, the aim of which is to give greater visibility to investment funds governed by French law that respect the principles of socially responsible investment.
(6) The labels only attest to the responsible and sustainable nature of the management and should not be considered as a guarantee of capital security or of the fund's financial performance. The management teams are subject to change.
(7) Euro Stoxx ® NR
(8) Source : Rothschild & Co Asset Management, 29/04/2024.
(9) Source : EDP, Rothschild & Co Asset Management, may 2024.
(10) Source : Rothschild & Co Asset Management, 29/12/2023.

**Recommended investment horizon: 5 years**

**SRI Risk Indicator: 5/7**

The synthetic risk indicator makes it possible to assess the level of risk of this product compared to others. It indicates the likelihood of this product recording losses in case of market movements or an inability on our part to pay you. We have classified this product in risk class 5 out of 7, which is a risk class between medium and high and mainly reflects its positioning in the European equity market. In other words, the potential losses related to the future results of the product are between medium and high and, if the situation deteriorates in the markets, it is likely that our ability to pay will be affected. The risk indicator starts from the assumption that you keep the product for 5 years; if not, the actual risk may be very different, and you could get less in return. Other important factors of risk, not taken into account adequately by the indicator: Liquidity risk, impact of techniques such as derivatives. As this product does not provide protection against market risks or capital guarantee, you may lose some or all of your investment.

**Main risks**

Capital risk, Market risk, Non-financial criteria (ESG) risk, Sustainability risk, Counterparty risk, Risks associated with temporary purchases and sales of securities, Currency risk. Before any investment, it is imperative to carefully read the PRIIPS CID and prospectus of the UCI, and more particularly its section relating to risks and charges, available on the Rothschild & Co Asset Management website: Am.eu.rothschildandco.com

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