Rothschild & Co
Asset Management

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A look back at three year of our Net Zero expertise

Three years after launch, Anthony Bailly and Nicolas Racaud, fund managers, respectively, of R-co 4Change Net Zero Equity Euro and R-co 4Change Net Zero Credit Euro, provide an initial assessment of these strategies that stand out in the vast world of "climate funds".

Anthony Bailly
European Equities
Fund Manager

Nicolas Racaud
Fixed Income
Portfolio Manager

What is a Net Zero fund?

Anthony Bailly: As its name suggest, "Net Zero funds" are based on an investment strategy aligned with the Net Zero objective and target a constant reduction in greenhouse gas emissions by portfolio companies. Stock-picking must therefore focus on companies that are committed to this goal. These funds are part of a family of investment solutions focused on climate issues. These are sometimes called "climate funds", of which "low-carbon" strategies are the main representatives. A corollary of low-carbon strategies is to invest exclusively in companies and sectors having low greenhouse emissions (e.g., software, capital goods, and pharmaceuticals). This orientation gives many of these funds a marked "growth" bias[1].

Nicolas Racaud: Our approach is somewhat at odds with these strategies. We aim to encourage economic agents, particularly the heaviest greenhouse gas emitters, to adjust their practices towards a significant structural transformation. So, we do invest in sectors that are generally excluded owing to their heavy emissions, but we are very selective.

Net Zero in short

In 2015, COP21 approved the Paris Agreement, whose goal is to limit global warming to less than 2°C by 2100 compared to the pre-industrial level, by continuing efforts to limit it to 1.5°C. This ambitious plan includes various provisions, including the "Net Zero" target, which requires a constant reduction in anthropic emissions of greenhouse gases with the goal of approaching a theoretical zero. The first stage consists of achieving a ceiling on emissions before reducing them as much as possible until 2050, after which residual emissions will be offset through various mechanisms, either natural or technological.

(1) A growth investor focuses mainly on companies' earnings growth potential in the hope that revenue and earnings growth are greater than those of its sector or the market average.

Why opt for a transition approach?

N. R.: As we just mentioned briefly, a transition approach consists of not automatically excluding but, rather, supporting each company that has demonstrated the willingness and capacity to make its business model more virtuous. We are confident that the most significant potential impact lies in those sectors that emit the most greenhouse gases. This approach does require thorough research but also offers the advantage of being adjustable to any asset class.

A. B.: Currently, 86% of global greenhouse gas emissions are concentrated in five sectors[2] (energy, utilities, commodities, chemicals and construction). Not investing in those sectors would be tantamount to saying that we can do without them or that they are unable to transform themselves. On the contrary, we believe that it is essential to support them in their commitment to reduce their emissions. This is a true business opportunity, as this major challenge constitutes a thematic of the future.

What are the pillars of your strategies?

N. R.: The first of these consists in attaining a carbon intensity[3] that is 20% lower than the funds' benchmark indices, in order to offer investment solutions that are necessarily less "carbon-intensive" than the indices, regardless of the context. What's more, we are committed to achieving annual average reductions in the portfolios' carbon intensity of 7% in the case of R-co 4Change Net Zero Equity Euro and 5% to 7% for R-co 4Change Net Zero Credit Euro. And, lastly, we pledge that 90% of our portfolio companies have had their greenhouse gas reduction targets validated by SBTi by 2030. In order to assess the trajectory of emitters that have not yet had their targets audited, we work with data from Carbon4 Finance, whose methodology helps us assess companies' carbon trajectories.

Science Based Target initiative (SBTi) is a group of scientists who seek to define, promote and validate best practices in carbon emissions reduction and "Net Zero" objectives. SBTi audits include all sources of emissions.

carbone4

Carbon4 Finance is a sister company of the Carbone 4 consulting firm founded by Jean-Marc Jancovici and Alain Grandjean. It supplies carbon data that include all emissions scopes in analysing companies' past, present and future climate performances.

A. B.: We also set targeted commitments alongside the main emitters and communicate regularly on our key indicators. We analyse their investments in order to set their ambitions against the resources brought to bear and thus judge the credibility of those ambitions. We have frequent and very frank discussions with portfolio companies. They can, for example, consult us on the thematics that they publicise, the data they disclose, and the level of transparency expected. We have established trust-based relationships with some of them in guiding them in their transition process. Few fund managers take our approach, and our expertise can assist these companies in their strategic planning.

Speaking of which, how does the market price the climate challenge into company valuations?

A. B.: We are quite confident that there is a link between financial performance and companies' capacity to reduce their carbon intensity. Many companies are being hit by higher risk premiums, when investors have doubts on their transition capacities. Reducing emissions means innovating and developing new sources of growth that ultimately can provide a competitive edge that helps companies consolidate their market shares. In addition to stabilising companies' growth models, this virtuous circle allows them to address their future challenges. And we have seen that, among the heaviest-emitting sectors, companies that have the greatest ambitions and demonstrate their credibility are beginning to be rerated considerably. This capacity to capture this potential rerating is an integral part of our strategy.

N. R.: Conversely, when a company falls short of its commitments, both its market liquidity and prices decline. The same thing happens when emitters fail to stick to their targeted trajectories or, worse, when a controversy emerges.

(2) Our World in Data (2020), MSCI ESG Research, Rothschild & Co Asset management Europe, 31 December 2021.
(3) Total emissions of year N (scopes 1 & 2) divided by revenues of year N.

What is your assessment after these three years?

A. B.: Over a relatively short lapse of time, we have experienced three exceptional periods. Shortly after the launch of the strategies, the Covid-19 pandemic in 2020 very quickly brought economies to a halt. This was followed by the blowout recovery of 2021, then, in 2022, by the outbreak of the Russo-Ukrainian conflict and the subsequent energy crisis. These events had a heavy impact on economic activity and company revenues.

N. R.: We have thus experienced periods when we had the feeling that revenues were falling faster than emissions, as if there were "fixed pollution" levels, similar to fixed costs. For 2022, we expect an increase in emissions after the government-mandated restarting and ramping up of coal-fired power plants. It remains to be seen how this ratio will evolve, given that the year was not disastrous in terms of financial results. Carbon intensity trends in these uncertain environments could be hard to track, as we are subject to price volatility and revenue trends, which are often driven by temporary factors that do not necessarily reflect the efforts that companies have made. Even so, despite these turbulences and thanks to our management choices, we have managed to meet our portfolios' carbon-intensity-reduction goals while, at the same time, raising our exposure to the heaviest-emitting sectors.

Sharing funds for the Polar POD expedition

R-co 4Change Net Zero Equity Euro and R-co 4Change Net Zero Credit Euro are sharing funds. As such, a partnership has been established with the association Océan Polaire whose purpose is to organize expeditions and mission of an educational and scientific nature in the polar regions. For all the shares of these two funds, 0.15% of the management fees will be donated to help finance the Polar POD expedition led by the explorer Jean-Louis Etienne.

Which sectors have improved the most environmentally since you launched your strategies?

N. R.: Utilities has fared the best over these past three years. They were a strong conviction when we launched these strategies. At that time, the portfolio's carbon intensity was around 150; we are now at about 110[4]. This is a decline of almost 30%, and much of that is due to utilities. That being said, there is far less room for improvement. In the future, we may be investing in sectors where potential improvement is greater, in order to meet our annual reduction target.

A. B.: It's exactly the same for the equity portfolio, with utilities that have halved their carbon intensity in three years. Overall, the portfolio's carbon intensity has fallen from almost 140 to about 100[4]. As a result, in late 2022, we were able to add a stock in the commodities sector, the last heavily emitting sector that was not in our portfolio, due to most companies' excessive carbon intensity, which generally keeps us from investing. We nonetheless felt it important to demonstrate our capacity to identify those companies in each sector that have good environmental performances.

And which sectors have disappointed?

A. B.: I'm thinking of the energy sector, where carbon intensity has fallen less than we might have expected, achieving mere quasi-neutrality over the three years. However, we have seen recently in companies' messages that the surplus cashflow they generated in the special context of 2022 could mean an acceleration, making the energy sector one of the top contributors in coming years.

N. R. : We have indeed seen that some companies' transition process could end up taking more time than we had expected, but there is still some catching-up potential in both carbon intensity and their financial profile.

What about fund returns?

A. B.: Over the past three years, the performance of R-co 4Change Net Zero Equity Euro has been penalised by the portfolios' more cyclical profile than those of other "climate funds". 2020 was indeed an especially challenging year. Since then, in a more favourable environment (with rising interest rates, higher commodity prices, etc.), our strategy has stood out in its exposure to sectors overlooked by "climate funds". The rally by European cyclical stocks has provided an especially large boost so far this year.

N. R.: The rather defensive profile of R-co 4Change Net Zero Credit Euro paid off during the 2020 crisis, but the context was less favourable thereafter. In 2022, however, its lower sensitivity gave it a true edge. We recently raised its sensitivity and sought additional yield by adding more high-yield[5] and subordinated[6] bonds, choices that we hope will pay off in 2023.

(4) Source: Rothschild & Co Asset Management Europe, 30/12/2022.

(5) High yield bonds are issued by companies or governments and have high credit risk. They are rated below BBB- by Standard & Poor's.

(6) A bond that does not possess priority repayment in the event of issuer bankruptcy. In return, it offers higher yield than an equivalent "standard" bond.

The financial sector is heavily weighted in your portfolios. Why is that?

A. B.: We had some good opportunities in the financial sector, without taking on too much carbon-intensity risk. On the whole, the sector is under considerable regulatory pressure, and many banks have made commitments and integrated Net Zero initiatives. Medium-term developments are forcing them to enter into binding frameworks. Moreover, in their scopes 1 & 2, financials' carbon intensity is almost non-existent, and in their scope 3, they have been transparent on the whole. By drawing on the expertise of our data providers, we have had the capacity of assessing and anticipating this potential risk.

N. R.: In the bond allocation, this exposure reflects the structure of the market. Financials are one of the most heavily weighted sectors. In addition to the aforementioned arguments, I would add that these companies are closely involved in corporate financing solutions, as seen in the increased proportion of sustainable bonds in their mix of product and services. Financially, they have the advantage of offering access to various market segments, such as subordinates, which offer additional yield.

Focus on scopes

Scope 1 : : Direct carbon emissions from fixed or mobile facilities located within the organisational perimeter.

Scope 2: Indirect carbon emissions linked to energy consumption.

Scope 3: Indirect carbon emissions linked to the various stages of a product's lifecycle.

What about integrating scope 3 in carbon-intensity calculations? Will that undermine your positioning?

A. B.: Integrating scope 3 could very well be a game-changer for many "climate funds". Even so, the risk looks smaller with our approach than with "low carbon" strategies, which are generally invested in "low-emission" sectors solely because their scope 3 emissions, which are often very high, are not included.

N. R.: Since we launched our strategies, we have had this parameter in mind, and we are trying to steer this datapoint. Integrating scope 3 emissions will be a big change for the industry, but we already have tools for estimating them for all sectors.

What is your outlook for the coming years?

N. R.: In 2021, we made a big move into real estate, which now accounts for about 7% of the portfolio(7). We are seeking in particular to position ourselves in clean energy and green building, two themes that are very important for the transition. This is a long-term conviction, even though these choices cost us a bit last year amidst rising interest rates.

A. B.: Despite the undeniable increase in emissions, 2022 was a year of transitioning towards greater energy independence. Stimulus plans in both Europe or the US will clear the way towards new investments and will unlock opportunities. The European companies that we have in our portfolios are well placed to benefit from this new context. As a result, our approach requires that we take on a relative view. We look at the overall dynamics and try to identify the innovative companies. There can be wide disparities within the same sector. Widespread rollout of low-carbon public transport, electrical equipment, insulation, and so on – through these examples, we find some true transition stories. Such measures take time to put through, but it's right now that we must position ourselves on these companies.
Many spin-offs(8) and IPOs will enliven the markets in the coming years. There is constant turnover and, within a few years, transition thematics may evolve. Our portfolios are designed to take part in this movement.

(7) Source: Rothschild & Co Asset Management Europe, 30/12/2022.
(8) A spin-off consists of carving out a new entity from a business unit within a Group.

For more information:

[Video] 3 minutes chrono…
To understand the “Net Zero” with Ludivine de Quincerot

R-co 4Change Net Zero Equity Euro

Performance	Since the beggining of the year	2022	2021	2020	Since inception[1]	Volatility 1 year
R-co 4Change Net Zero Equity Euro I EUR	11.5%	-10.8%	22.6%	-8.6%	11.4%	20.9%
Euro Stoxx ® DR[2]	9.3%	-12.3%	23.4%	-2.0%	16.0%	20.4%

(1) Inception date: 31/12/2019
(2) Benchmark.
Source: Rothschild & Co Asset Management Europe, 31/01/2023.
The figures quoted relate to past years. Past performance is not a reliable indicator of future performance and is not constant over time.The performance figures take into account all costs charged to the fund but do not take into account costs borne by the investor.

Share	I EUR	C EUR	R EUR
Code ISIN	FR0011994862	FR0010784835	FR0013102415
Dividend Policy	Accumulation	Accumulation	Accumulation
Subsequent subscriptions	5 000 000 €	-	100 €
Management fees (maximum)	0.83%	1.57%	2.38%
Entry fee (maximum)	3.0%	3.0%	-
Exit fee (maximum)	-	-	-
Performance fee	-	-	-
Transaction fee	0.81%	0.81%	0.81%
Registration country	CH – ES – FR – IT – NL	AT – BE – CH – DE – ES – FR – LU – IT	FR – IT – CH

Recommended investment period: 5 years

SRI risk indicator: 5
The synthetic risk indicator enables the risk level of this product to be assessed of this product compared to others. It indicates the probability that this product in the event of market movements or our inability to pay you. We have classified this product as a "risk indicator". We have classified this product in5 out of 7, which is a medium to high risk class and mainly reflects its high and mainly reflects its positioning in the European equity market. European equity market. This means that the potential losses from the future performance of the product of the product are in the medium to high range and, should market conditions deteriorate in the markets, it is likely that our ability to pay you will be affected. The risk indicator assumes that you hold the product for 5 years; if you do not, the actual risk may be very different and you may get less in return. Other important risk factors not adequately captured by the indicator: liquidity risk impact of techniques such as derivatives. This product does not provide protection against market fluctuations or a capital guarantee, and you could lose all or part of your investment.

Main risks
Capital risk, market risk, extra-financial criteria (ESG) risk, sustainability risk, counterparty risk, risks related to temporary acquisitions and sales of securities, foreign exchange risk.

Before investing, you should carefully read the PRIIPS DIC and the prospectus of the Fund, especially the section on risks and fees, available on the Rothschild & Co Asset Management Europe website: am.eu.rothschildandco.com

R-co 4Change Net Zero Credit Euro

Performance	Since the beggining of the year	2022	2021	2020	Since inception[1]	Volatility 1 year
R-co 4Change Net Zero Credit Euro I EUR	2.2%	-10.9%	0.0%	1.3%	-7.8%	5.2%
Markit iBoxx™ € Corporates[2]	2.1%	-14.2%	-1.1%	2.7%	-11.1%	6.8%

(1) Inception date: 31/12/2019
(2) Benchmark.
Source: Rothschild & Co Asset Management Europe, 31/01/2023.
The figures quoted relate to past years. Past performance is not a reliable indicator of future performance and is not constant over time.The performance figures take into account all costs charged to the fund but do not take into account costs borne by the investor.

Share	I EUR	C EUR	D EUR	P EUR[1]
Code ISIN	FR0010275644	FR0007393285	FR0007474010	FR0014004AX8
Dividend Policy	Accumulation	Accumulation	Accumulation	Accumulation
Subsequent subscriptions	3 000 000 €	1 share	1 share	2 500 €
Management fees (maximum)	0.425%	0.785%	0.785%	0.525%
Entry fee (maximum)	2.0%	2.0%	2.0%	2.0%
Exit fee (maximum)	-	-	-	-
Performance fee	-	-	-	-
Transaction fee	0.26%	0.26%	0.26%	0.26%
Registration country	AT – BE – CH – DE – FR – LU – NL	AT – BE – CH – DE – FR – LU – NL	AT – BE – CH – DE – FR – LU – NL	BE – CH – IT – FR – LU – NL

(1) Subscription of this unit is reserved for investors subscribing via distributors or intermediaries subject to national legislation prohibiting all retrocessions to distributors or providing an independent advisory service within the meaning of the European MIF2 regulation or individual portfolio management under mandate or to institutional investors with a minimum initial subscription amount of €500,000.

Recommended investment period: 3 years

SRI risk indicator: 2

The synthetic risk indicator enables the risk level of this product to be assessed of this product compared to others. It indicates the probability that this product in the event of market movements or our inability to pay you. We have classified this product in risk class 2 out of 7, which is a low risk class and mainly reflects its positioning on public and private debt products while having a sensitivity between 0 and 8. In other words, the potential losses associated with the future performance of the product are low and, should market conditions deteriorate, it is very unlikely that our ability to pay you would be affected. The risk indicator assumes that you hold the product for 3 years, otherwise the actual risk may be very different and you may get less in return. Other important risk factors not adequately taken into account by the indicator are: counterparty risk, credit risk. As this product does not provide market protection or a capital guarantee, you could lose all or part of your investment.

Main risks

Risk of loss of capital, credit risk, discretionary management risk, interest rate risk, credit risk, extra-financial criteria (ESG) risk, sustainability risk, counterparty risk, risk related to temporary acquisitions and sales of securities, securities lending, repurchase and reverse repurchase agreements, specific risk related to the use of complex subordinated bonds (contingent convertible bonds known as "CoCos"), risks related to the use of derivative instruments.

Before investing, it is imperative that you carefully read the PRIIPS DIC and the prospectus of the Fund, and more particularly its section on risks and fees, available on the Rothschild & Co Asset Management Europe website: am.eu.rothschildandco.com

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