BNP PARIBAS WEALTH MANAGEMENT

2021 Investment Themes

Half-Year Update

June 2021

BNP PARIBAS
WEALTH MANAGEMENT

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world

02

Cash in on carbon credits

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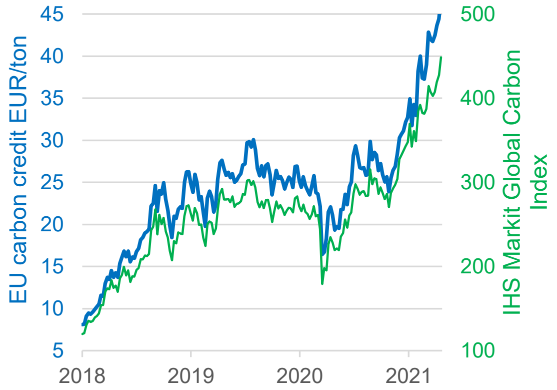
MEDIUM-TERM, HIGH RISK

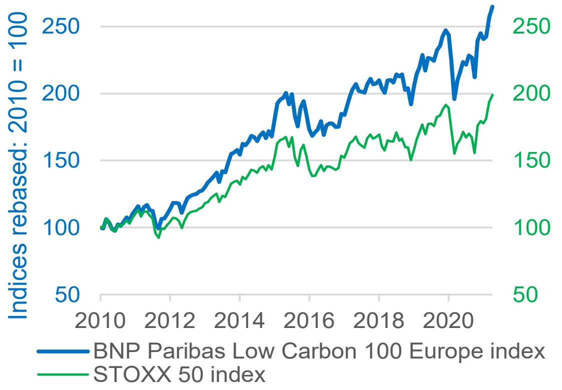
- Global carbon pricing is in vogue. The EU carbon credit market is growing in importance, with prices having doubled to EUR45/tonne since last November. Tighter regulations will boost this carbon pricing in order to make net zero-carbon targets achievable.
- Europe, the US and China are ramping up investments to lessen their energy reliance on fossil fuels, via a combination of solar, wind, biomass and nuclear power generation.
- An increasingly electrified world will require greater large-scale industrial battery storage capacity to supply electricity when the weather does not allow solar and wind power to be generated.

EU Carbon credit pricing has doubled since November 2020



Source: Bloomberg

Low carbon equities have outperformed consistently



Source: Bloomberg

The race to meet net zero-carbon targets hots up

Europe and the US prepare to invest even more to achieve zero carbon: post the US rejoining the Paris Climate Accord, President Biden's Jobs Plan is targeted at green infrastructure improvement, i.e. cutting US greenhouse gas emissions by 50% from 2005 levels by 2030, and 100% by 2050. Funded by hikes in personal and corporate taxation, this plan should be a clear boost to the renewable energy sector in the US over the next eight years.

Similarly, the EUR750bn European Union Recovery Fund also targets a green transition (EUR225bn over three years) in the European economy, boosting investment in solar, wind and biomass energy production as the world is increasingly electrified.

Renewable energy stocks now less overvalued: clean energy ETFs have corrected hard since mid-February, with a 35-40% fall to the recent low in the main S&P Global and Wilderhill Clean Energy indices. While admittedly these solar, wind and biomass energy stocks were overvalued at peak earlier this year, this is much less the case today.

Fund flows continue to flood into ESG-themed funds in the year to date: this structural long-term trend shows little sign of abating. The correlation between clean energy indices and US Big Tech stocks (in the form of the Nasdaq 100 index) remains very high - so it should be no surprise that as the tech sector rallies, so do clean energy stocks.

Carbon credits take off: a market which has quietly enjoyed a vibrant bull market since last November is the EU carbon credit market, driven in part by prospective EU plans to put in place another, tougher emissions trading system to cut carbon output. Since November last year, the December-2021 EU carbon credit price has doubled to EUR45/tonne.

Putting a price-tag on carbon emissions is not just a European project – carbon credit schemes exist in California, the US North East and Quebec. In addition, China has launched its own carbon allowance market this year, which is expected to be the largest in the world and involves c. 3.3 billion tonnes of CO2. This will put additional pressure on economies to move to low-carbon sources of energy, and to promote carbon capture systems and carbon offset plans.

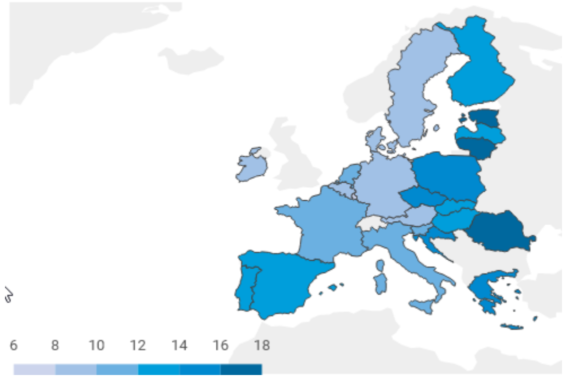
25 May a key date: European Union leaders gathered in Brussels for a special session to discuss how to achieve the EU bloc's collective 2030 target of cutting greenhouse emissions by at least 55% compared with 1990 levels. They have considered creating an additional system of pollution-cutting incentives for buildings and road transport, boosting EU carbon credit demand.

Watch German Greens in September: a Green party victory in the upcoming 26 September German legislative elections (in which the former could become a key ruling coalition partner) could hasten the country's move to phase out Internal Combustion Engine or ICE vehicles (thus cutting oil demand) and boost support for higher CO2 pricing.

Going green in stages

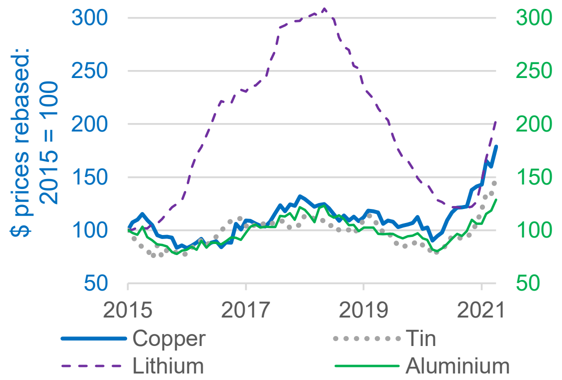
- Do not assume that all fossil fuels will be abandoned in the near term. With the average age of European cars being 11.5 years, we will not all be driving electric or hybrid cars before many years to come.
- Biofuels, such as biodiesel and bioethanol, remain a greener medium-term solution for existing Internal Combustion Engine (ICE) vehicles.
- Invest in: low carbon companies, Energy Efficiency, companies positively exposed to carbon credits, biofuel refiners, carbon offset programmes including blue carbon, carbon capture technologies and battery/"electrifying" metals focused on electricity storage.

Average age of EU cars is 11.5 years!



Source: ACEA

Battery metals rising fast on strong demand



Source: Bloomberg

Electrifying the global economy will take years

We will not all be driving Teslas overnight: aside from the fact that Teslas are still relatively expensive and relatively unreliable (according to JD Power's 2021 survey), recall that we do not all drive new cars. The average age of cars on the road today is 11.5 years in Europe, and 12 years in the US. If anything, the average age of cars is likely to grow this year, given the shortage of semiconductors slowing new car production around the world.

Biofuels remain an important pre-electric step: used cars and heavy vehicles can still go greener by using more biofuels, in the form of bioethanol or biodiesel made from wood pulp, wheat or corn. Biofuel refiners within the Oil & Gas sector are thus "green" oil-related companies, crucial in making existing cars and lorries more environmentally-friendly.

Platinum group metals to cut pollution: stricter vehicle emission regulations in Europe and China are accelerating demand for the key precious metals used in car catalytic converters used in ICE cars in order to reduce pollution in cities - platinum, palladium and rhodium.

Battery metals in demand for electric vehicles, green infrastructure: the prices of key "electrifying" base metal commodities, such as copper, nickel, aluminium, lithium and tin, have all gained at least 50% since April 2020, thanks to electric car and renewable energy needs.

According to the World Bank, increases in demand of up to 500% are estimated for some of these metals, particularly those used in energy storage technologies, such as lithium, graphite and cobalt. By 2050, annual demand for nickel solely from energy technologies could equal the global total nickel production in 2018. The incremental demand for the base and precious metals used in energy production and storage (e.g. silver) will be huge.

Carbon Capture & Storage (CCS) and Carbon Offset, e.g. Blue Carbon: investing in carbon capture and carbon offset projects are two practical solutions for reducing carbon footprints today. Carbon capture refers to a chain of different technologies that can prevent the CO2 produced by major factories and power plants from being released into the atmosphere and contributing to global warming. The first step is to fit factory chimneys with solvent filters, which trap carbon emissions before they escape. The gas can then be piped to locations where it can be used or stored. Most carbon dioxide will be injected deep underground (e.g. into disused mines or oil wells).

Carbon projects are a way to offset carbon emissions by investing in natural habitats offsets including Blue Carbon that can absorb CO2, for instance by financing in the planting of new forests, or in the creation and maintenance of coastal blue carbon ecosystems, such as mangrove swamps, tidal marshes and seagrasses.

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