Investing in Energy Efficiency to Fight Climate Change

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As part of our search for sustainable growth, we identify broad secular themes that in many cases recognise issues of social importance, such as climate change, health care for aging populations, nutrition and wellness, and expanded access to technology. Indeed, many years ago, our research into the serious environmental consequences of air and water pollution led us to formally develop an investment theme centered on the environment. The environment theme has remained prominent in our global equity portfolio in recent years. The increasing evidence that greenhouse gases created by human activity is driving climate change—including higher temperatures, more droughts, extreme weather and melting glaciers—has created a call to action for public and private-market solutions to slow these trends. Presently, the European Union is leading the way on climate change mitigation. In 2019, the EU proposed the European Green Deal—a set of policy initiatives aimed at achieving climate neutrality by 2050. Achieving this objective will undoubtedly mean prioritising energy efficiency and developing a power sector based largely on renewable resources.

The COVID-19 pandemic has given the EU additional motivation to accelerate already planned green investments as it seeks to bolster the 27-nation bloc's economy. Of the EU's €1.8 trillion euro stimulus package, €1.1 trillion is budgeted for a recovery plan, funding initiatives over 7 years (2021-2027), with 25% allocated toward climate action. A priority under the European Green Deal and the recovery plan is its *Renovation Wave* initiative aimed at accelerating the renovation of existing buildings to decarbonise the building stock. Buildings are the largest single energy consumer in Europe, accounting for roughly 40% of EU energy consumption and about 36% of greenhouse gas emissions. Further, 75% of building stock is considered energy inefficient. The labor-intensive nature of building renovation should help sustain millions of high-paying jobs to support the EU's economic objectives while also aiding in the achievement of its climate goals. Building-focused capital expenditures are also attractive from a business perspective as they offer relatively quick paybacks.

These multiyear building renovation capital expenditures may serve as substantial tailwinds for companies that supply these markets. Examples include NIBE Industrier, Johnson Controls and Siemens. NIBE is a Sweden-based global heating technology company whose climate division (70% of EBIT) focuses on the design and manufacturing of heat pumps—an essential product in the sustainability and energy efficiency trends. A heat pump is the only heating technology that can use static/ambient energy and convert one unit of energy input from outdoors into four units of energy output (heat) indoors. Heat pumps are well-penetrated in a country like Norway, where cheap electricity is driven by vast wind power; however, other parts of Europe and the US are in the early innings of heat pump adoption as governments push this greenhouse gas-friendly heat source via regulations and subsidies. Heat pumps are not a new technology, but the world has awakened to the fact that this technology is essential in the global attempt to reach specific greenhouse-gas targets.

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Johnson Controls is an operator in the building services market, providing building controls, HVAC systems, fire and safety, and power solutions. Johnson Controls' solutions for enhancing buildings' energy efficiency and sustainability may see greater demand as government regulations and stimulus plans increasingly address the sources of climate change. Additionally, in a post-pandemic world, new air quality standards and demand for touchless technologies, remote monitoring and digital automation have the potential to drive new investments in renovating existing commercial office buildings.

Siemens is an engineering and manufacturing company focused on electrification, automation and digitalisation. The company is transitioning from a classic German industrial conglomerate that is complicated and overdiversified into a holding company structure with three high-quality verticals (Digital Industries, Smart Infrastructure and Mobility). The company spun-off 55% of Siemens Energy in September 2020. That may allow management to better focus its attention on driving growth and operational performance in the remaining business lines.

Like buildings, data centers are a large consumer of power globally. Just one data center can consume more electricity than a small city. In fact, approximately 2% of world electricity is being consumed by data centers. Considering the tens of billions of dollars annually invested by big tech companies like Facebook, Google and Alibaba, data centers could consume 10% of world electricity in 10 years, based on our calculations. Companies like Vertiv Holdings, a leading provider of power, thermal and infrastructure management equipment and solutions for the global data center market, are well-positioned to address the environmental implications of data center industry growth.

In conclusion, we are on the cusp of a multiyear investment wave focused on green initiatives to curb climate-changing emissions. Innovative companies providing solutions for more energy-efficient buildings and data centers are well positioned to help mitigate the climate crisis.

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