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PERSPECTIVE

Green bill or green bubble?

US elections 2020

September 2020

For investment professionals only

This week's debate turned into a brawl between Biden and Trump, giving hardly any clarity on important topics for the United States and the rest of the world. The outcome of the US election still represents one of the key uncertainties for among others the European stock markets. While listed in Europe, many of the European companies are active in the US. In fact, 23% of pan-European sales are generated in the US (5-50% range on a per sector level) and, therefore, will have a high exposure to changes in US regulations and policies.

Given the diametrically opposed climate policy in the candidate's campaigns, how would a Biden (or Trump) victory shape the performance of the European sustainable stocks in our universe?

In this article, we will focus on the impact of a Biden victory with enough of a majority to push through his proposed "Green Bill" legislative changes.

STRONG ESG MOMENTUM LEADS POLICY CHANGE

Before we move to the evaluation of Biden's Green bill itself, it is important to recognise that not only does this policy entice the younger generation to vote Democrat, it also allows Biden to capitalise on the growing global ESG momentum to advance the Democrat agenda in America.

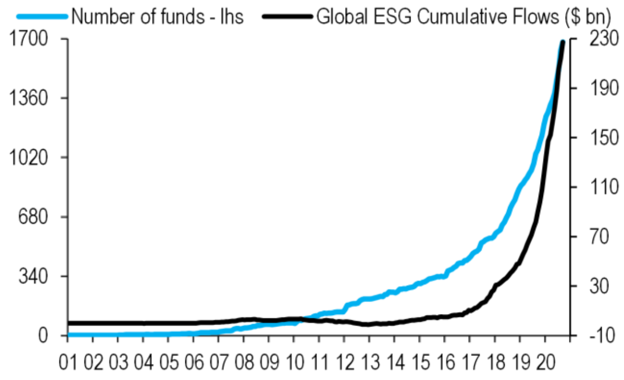
Globally, an increasing number of companies (and especially in Europe) have been embracing the ESG criteria and incorporating sustainability into their strategies, business models and management compensation metrics. Even perceived climate dinosaurs such as BP have jumped on the bandwagon and announced ambitious new strategies to deliver on their net-zero ambitions by 2025.

Already, public opinion and governmental focus has shifted, resulting in a Green Recovery plan in Europe. Furthermore, the Chinese government has announced its ambition to being climate neutral by 2050 and we now see the potential in the case of a Biden win, for the American focus to also shift towards a more environmentally conscious model. This shift is unprecedented, with climate becoming one of the key issues for global security and foreign policy.

There are several factors that accommodate the transition to a positive mindset regarding sustainable stocks, for example: the drastic fall in clean energy costs, the rapid progress of clean technologies, low interest rates and the impact of the COVID-19 pandemic.

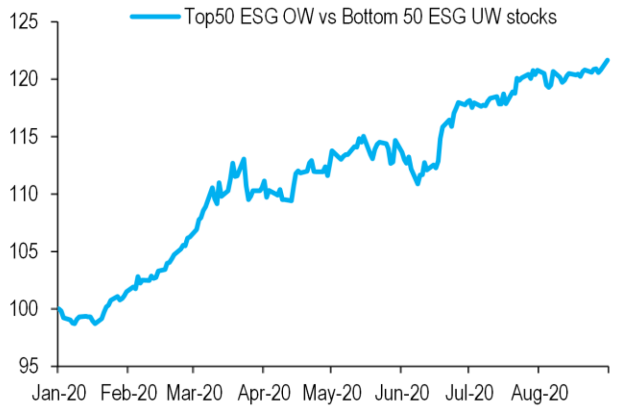
On the investor side, sentiment towards companies with a sustainable focus have become far more positive, resulting in circa USD100 billion inflow to global ESG funds YTD almost half of the cumulative inflows over the last 20 years according to BoAML analysis.

Global Weekly ESG Flows update



Source: EPFR Global, BofA European Equity Quant Strategy

YTD performance of most overweight ESG stocks vs most underweight ESG stocks in Europe



Source: BofA European Equity Quant Strategy; Factset Ownership

Whilst demand is increasing, the amount of available sustainable stocks – even in Europe - is still limited, which has led to a decoupling of performance of sustainable stocks from the broader market and their stretched valuations. The MSCI ESG leaders index has outperformed the broader MSCI Europe index by 4.8% YTD and by 8.4% since the end of 2017. The Top 50 most overweight ESG stocks vs the Bottom 50 most underweight index tracked by BofA generated close to a 20% outperformance YTD. Going forward into the elections, we should ask ourselves the questions whether the current premia for sustainable stocks is maintainable or will there be a prolonged sell-off?; and what are the additional drivers in the US that can act as a support for the European companies beyond the impact of the European Recovery fund?

The general consensus is that whilst ESG stocks will benefit from a Biden win, the broader market will be negatively impacted due to his "Green Bill" and the need for funding this via tax increases. On the flip side, a Trump win would likely be favoured by the broader market but have a negative effect on ESG premia, leading to a sell-off of sustainable stocks.

If indeed we witness a burst of the ESG bubble and a strong contraction of the ESG premia, it will provide a great opportunity for longer term investors (including [ACTIAM Duurzaam Europees Aandelenfonds]) that feel that the current ESG trends are irreversible and that companies with high sustainability scores will be the winners in the long term, generating above average shareholders returns.

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THE PROPOSED GREEN BILL AND TAX RATE IMPLICATIONS ARE THE KEY

The infrastructure bill

Passing of their respective Infrastructure bills will be the key for both candidates as a path to overcoming the COVID-19 crisis and job creation. Biden bets on the sustainable infrastructure developments and transition to green energy, while Trump prefers to put more focus on existing infrastructure.

Below you can see a comparison of Biden and Trump's proposals. Biden's proposals are much broader, detailed and "green" oriented, in line with his ambition to achieve a net-zero emissions economy by 2050.

Trump's Infrastructure bill	Biden's infrastructure bill within "The Green Bill"
Surface transportation: upgrade of bridges, roads, airports, rail	Surface transportation: create zero emission public transportation, expand high-speed rail, metro network
Improve the electric grid	Upgrade the electric grid; install 500k EV charging points; deploy utility-scale battery storage across the US
Not explicitly described	Clean electric power: utility-scale solar, offshore wind, nuclear and hydropower
Housing (improve and build new)	Sustainable housing: Upgrade 4m, weatherize 2m and build 1.5m sustainable homes; install advanced HVAC systems
School infrastructure	School infrastructure (upgrade + new energy efficient schools)
Broadband internet	Complete broadband access including tribal land, rural areas
Healthcare facilities	Not explicitly described
Not explicitly described	Agriculture: climate-smart; voluntary carbon market; reclamation of abandoned oil& gas/coal/etc mines
Not explicitly described	New technology: green hydrogen, carbon capture, batteries
Total: USD 1.5 trillion, no timeframe	**Total: USD 2 trillion over 4 years**

Other Biden policy plans that can impact the European stock market

- Taxes: On the flip side of the Biden's plan is the necessity to pair the green investments with tax increases for corporations (from 21% to 28%) and rich Americans (from 37% to 39.6%). We believe that only a 4% corporate rate hike is realistic, leaving a gap in financing. Trump advocates for a further decrease in individual and corporate rates, which would bolster the broader stock market sentiment.
- Biden has reaffirmed that he wants to re-join the Paris Climate Agreement.
- Both candidates have stressed the need for a more firm approach to US-China relations, so we don't expect much changes on this front, except for an absence of sharp market reactions on Trump tweets.
- Biden criticizes Trump's tariff wars as bad for US consumers and farmers. Therefore, we can expect a softening or rolling back of some tariffs. As a reminder, the current tariffs impact exports on certain categories of products from China, Mexico, Japan, and Europe (cars).
- Stronger action is expected on competition policy, antitrust enforcement and privacy policy, as well as healthcare reform and drug pricing reviews.

WILL EUROPE BENEFIT?

From the sector perspective, the European industrials would benefit the most from a Biden win. While industrials in total generate only 26% of revenues in the US, some high ESG names have the right thematic exposure to the proposed green construction and infrastructure themes, including grid upgrades, EV and telecom infrastructure upgrades, building renovations and equipment for energy transition.

Examples of potential winners

For instance, in the space of increasing energy efficiency of existing buildings, **Ferguson** could benefit since its activities in the HVAC market are almost all US facing (>95% of EBITDA is generated in the US), and **Kingspan** could gain from innovative insulation for building upgrades. **Alstom** could potentially grow its US facing business if the rail infrastructure proposal goes through.

Siemens Gamesa and **Siemens** Energy would be the names to watch on the equipment side. Siemens Gamesa has an offshore wind focus and circa 25% of its business in the US. In case Biden wins, a number of offshore projects that are currently waiting for Trump's approval, can get green light within the first month after the elections. Most of the projects are located off-shore of the democratic states and Biden won't need Congressional approval, making it an easy business win.

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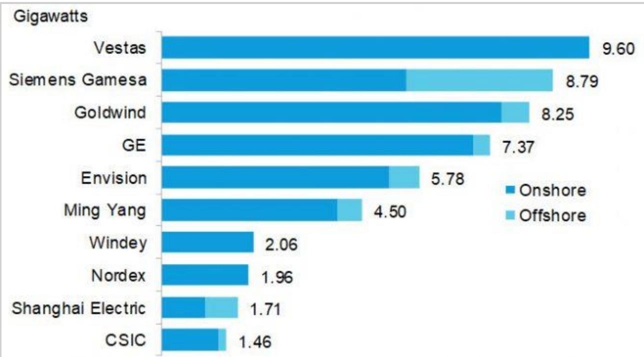
European utilities sector could benefit from its experience with renewables, especially offshore wind, as the European companies were early adopters of the technology. Therefore, the offshore wind generation theme could be played by the European utilities **Orsted** (market leader with 90% of power generation through renewables), **RWE** and **Iberdrola** due to their existing experience with offshore wind farms. If the US tenders start moving forward, these names will definitely participate.

2020-2029 offshore wind projections

Source: Wood Mackenzie, as of 12.05.20

2019 wind turbine market installed capacity



Source: Evwind, News menu, Uncategorized, Wind Energy

The European Building Materials industry has circa 35% EBITDA exposure to the US Infrastructure and construction markets. For CRH this number is close to 70% EBITDA and an uptick for surface infrastructure could lead to new business opportunities.

Regional exposure of the European sectors	N. America	Europe	ROW	Our thoughts
Communication services	16	68	16	Telecoms - low US exposure; Media - only a few names, -ve tax increase
Consumer discretionary	26	50	25	Mixed; +ve will try to stimulate GDP; -ve taxes, traditional Autos
Consumer staples	22	50	28	Neutral to -ve impact due to tax, change of regulation for Tobacco
Energy	26	48	26	Biden will tighten regulations/higher taxes/potential ban on new fracking
Financials	20	65	15	Banks - limited US exposure; -ve taxes/ bank regulation/capital requirements, Diversified Financials
Health care	49	31	20	Review of pricing policies for Pharma; Medtech is less effected
Industrials	26	53	21	Biden will boost infra & construction spending, +ve for names exposed to green themes
Information technology	26	37	37	Taxes & changes in privacy/untitrust/policies; +ve for telecom equipment
Materials	23	36	41	+ve for building materials (infra & construction boost), Chemicals through hydrogen focus; -ve taxes, more environmental pressure for Mining
Real Estate	21	78	1	Limited impact, possible change in taxes & the 1031 exchange exemption
Utilities	5	81	14	Low direct exposure, but can benefit from Biden's renewables focus

Source: ACTIAM, Factset

Sectors with a net negative impact from Biden's policies would include:

- **Energy:** A realistic probability of a carbon tax and/or a clean energy standard, new restrictions on fracking and energy exports, stringent regulation of emissions changes and changes to federal land leasing/permitting policies - are the likely consequences of a Biden win for the US oriented oil & gas companies.
  If adopted, the proposals will likely restrict the US's future oil and gas production growth. **BP, RDS, Equinor, Repsol** and **Total** are exposed to the US shale and Gulf of Mexico. Their combined mid-term effect should be net negative, despite some support that might come from uplift in renewable activities.
- **Tech sector:** The European tech sector is home to a number of high ESG names. It will likely feel pressure from changes in regulation related to stronger action on competition policy, antitrust enforcement, privacy policy, cybersecurity, Section 230 reforms and a potential hike in corporate tax. Most of the European large cap names with high US direct and indirect exposure (through clients), as well as strong competitive position in America are likely to feel a negative impact.
- **Pharma:** The European pharmaceutical industry could feel some pressure from the renewed drug pricing scrutiny and higher corporate tax rates. The fear of a negative impact of the reforms weigh on the sentiment of most of EU pharma due to a high exposure to the US (more than 50% of revenues), especially **Roche** and **Novo Nordisk**.

CONCLUSION

In conclusion, there will be a mixed bag for the markets no matter which candidate prevails, but in the case of a Biden presidency there will be a clear progress on the global climate agenda benefiting the companies in the ESG universe. To support the further valuations of “green” stocks, we will need to see his plans unfold and expand to reality. As an active investor, one needs to monitor closely all the relevant developments and continue being vocal on the ESG front through direct contact with the companies in the relevant universe.

Will there be extra upside coming from companies in transition with an extra leg of support in valuations coming from upgrades in growth profiles and EPS estimates? We certainly hope so. In the meantime, if the market experiences a sell-off in the ESG names, we can use it as a short-term investment opportunity to enter great stocks.

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