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THE CASE AGAINST OIL BASHING

EDITORIAL VIEW

The case against oil bashing

- Under mounting pressure, Big Oil is struggling to shake off its negative image
- Yet, many producers – notably European – are actively transitioning their business
- Being invested means having a say in this change… and reaping attractive returns?

Owning oil stocks is hardly fashionable – indeed acceptable – these days for obvious environmental reasons. Nor has it been particularly rewarding in recent years. But what if the sector's strong 2021 performance to date was more than just a reflection of the post-pandemic rebound in the crude price, and impact investing a better option than divesting?

The pressures on oil majors coming from many sides: governments (now including the US administration) with their target of net zero CO2 emissions by 2050, environmental activists, pension funds, the broader public and even the courts. Big Oil bashing is certainly an easy and popular call – albeit not necessarily the best way to save our planet.

Make no mistake. Of course, it is vital for the world to move away from fossil fuels, but it is a transition that will take a number of years – and require also significant changes in consumption patterns. In the meantime, demand for oil will subsist and there are many large unlisted producers, in some cases active in countries where climate change and ESG concerns have much lesser sway, that will readily supply it.

Even with respect to publicly traded companies, simply offloading their shares means putting them in the hand of other, perhaps less well-meaning, investors. True, it would make it harder for oil majors to obtain new financing in the equity markets, and may also increase the cost of debt, but how potent are such arguments given the amount of cash that they generate.

One need also recognise the efforts made by energy companies to limit their environmental impact, both direct (eliminate their own greenhouse gas emissions) and indirect (reduce the carbon-intensity of the fossil fuels they produce). Perhaps, just perhaps, Big Oil can be part of the solution.

This seems particularly true in Europe, where producers are directing large amounts of money into alternative energy sources (wind and solar) as well as emerging opportunities such as carbon capture or green hydrogen. Royal Dutch Shell, Total (now renamed TotalEnergies), BP and Equinor are now all aligned with the 2050 net-zero goal. Aker BP, a smaller independent exploration & production company active on the Norwegian continental shelf is arguably even further ahead in the transition, with emissions at less than a third of the global industry. In fact, in a good example of how energy companies can apply their legacy skills to new areas, Aker just joined forces with BP and Statkraft to develop offshore wind power in the North Sea.

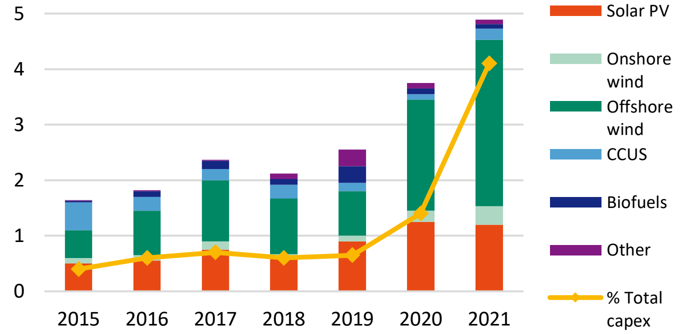
US counterparts, Exxon Mobil and Chevron notably, are admittedly lagging. While having also announced plans to bring down their CO2 emissions, neither have committed to net-zero. Nor have they indicated participation in large-scale solar or wind projects. Exxon has been under particular focus: it was ejected last year from the mighty Dow Jones index – of which it had been a member since 1928! – and recently faced a challenging annual meeting, at which activist investment fund Engine No. 1, supported by some large stakeholders (unhappy about the company's financial performance), forced two new directors onto the board. Still, there are other US companies more engaged in the necessary energy transition, for instance Occidental Petroleum in the field of carbon capture

All told, investors who choose to simply ignore the oil sector may be guilty of severe misjudgement. By remaining involved, shareholders have more sway and power to truly drive change. And they may even find it financially rewarding…

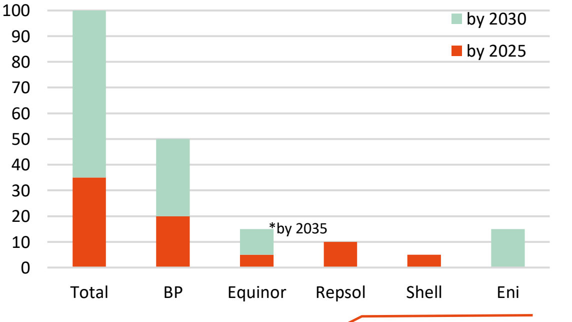
Written by Andrea Biscia, ESG Team

GRAPHS OF THE MONTH

Clean Energy Investments by Selected Oil Companies ($bn)



Oil majors expand clean energy options Renewable Capacity Target (in GW)



*Companies include Majors, as well as ADNOC, CNPC, CNOOC, Equinor, Gazprom, Kuwait Petroleum Corporation, Lukoil, Petrobras, Repsol, Rosneft, Saudi Aramco, Sinopec and Sonatrach

GLOBAL STRATEGY

A small step towards tapering

- Peaking US growth/inflation, but a brightening outlook elsewhere
- The Fed's hawkish pivot has capped US inflation expectations and long rates…
- …while providing support to the greenback

Despite the Fed's recent hawkish pivot and some concerns about the delta variant, there have been no major changes to our economic scenario, which can be summarised as such: steadily improving health situation, ongoing strong economic growth, transitory price pressures, and still ultra-easy monetary and fiscal policies. More specifically, although US activity momentum is now (unsurprisingly) peaking, it will nonetheless remain at elevated levels in the coming quarters thanks to pent-up demand (given improving labour market dynamics), projected capex growth, as well as healthy corporate and household balance sheets. Further, with Europe gradually reopening, the time has come for our continent to take the lead of the global recovery, before handing it over to emerging markets ex-China next winter – assuming the pandemic is brought under control.

As regards the inflation scare and odds of a taper tantrum, which represent the major risks for markets since higher interest rates would drag down the valuation of most asset classes, we view them as having receded recently. Investors are now more relaxed about the transitory nature of current upward price pressures, especially acute in the US. And the Fed's reaction to the current growth and high inflation environment, with talk about talk of tapering, cut the tail off some extreme scenarios whereby it would have fallen well behind the curve. Put differently, it has regained control over long rates by capping inflation expectations.

This small step towards tapering does not really modify the Fed's tightening timeline, as full employment remains a far stretch. But the lower long bond yields have provided a welcome support to global equities, with new highs and a pause in the growth-to-value rotation. While acknowledging that this idyllic scenario continues to fuel some investor complacency, we maintain a modest pro-risk stance.

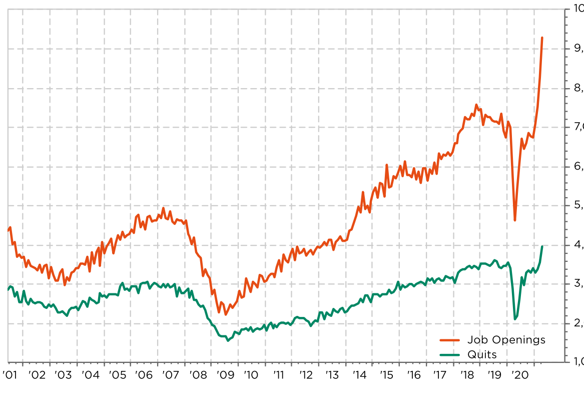
In particular, we remain slightly overweight equities, having, over the past year, complemented our core equity portfolio allocation with selective satellite regional assets in order to recalibrate sector/style biases to a more balanced positioning – even though our long term structural preference still goes to more resilient and higher quality diversified growth markets such as the US, China and Switzerland.

We also remain underweight bonds, noting that US TIPS outperformance vs. Treasuries has likely been ended by the Fed's hawkish pivot, which reinforces our conviction as to some roll-down value on the steep US yield curve. Consistent with our constructive view on risky assets, we keep a slight overweight on high yield and EM debt. In particular, we have upgraded EM local currency debt exposure from slight underweight to slight overweight, with valuations still among the cheapest in the fixed income universe, expected health and economic improvement, some tightening already by EM central banks (limiting inflation and currency depreciation risks), and the global strong growth/low rates backdrop, combined with decreasing odds of a taper tantrum. In other words, the catch-up potential – for those countries with favourable structural fundamentals – could now be unlocked. Still, selectivity being as crucial as ever in this space, active management is warranted.

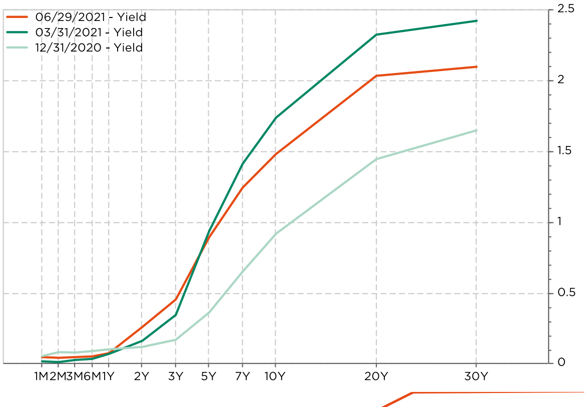
Elsewhere, we confirm our underweight on gold as it may suffer from higher US real rates. In the same vein, we are turning more constructive on the greenback: a Fed unlikely to fall completely behind the curve reduces risks of fast and sharp depreciation. Finally, consistent with our upgrade of local currency EM debt, and considering their cheap valuations, we are also warming up to EM currencies (upgraded by one notch to slight underweight). Here too, though, selectivity remains key.

Written by Fabrizio Quirighetti, CIO, Head of multi-asset and fixed income strategies

Job openings are at historical highs in the US



The US yield curve has flattened recently



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