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Sustainable Investment

June 2024

Investing in renewable energy infrastructure

As we mark World Environment Day, Deepesh Marwaha of the Sustainable Investment Fixed Income team looks at renewable energy and the vital infrastructure needed to deliver it.

Delivering renewable energy

Increasing the production of renewable energy has long been an area of focus for governments and businesses around the world, yet less attention has been paid to the need to invest in vital power grid infrastructure to deliver the energy, leading to concerns that this lack of investment could become a future restraint.

While increasing the production of renewable energy is essential, this energy is of little use without the necessary grid connections to transport it from generator to user.

One business that is focused on addressing this need is National Grid, a portfolio company that operates both electricity transmission and distribution lines in the UK and the States. The company recently announced a substantial £60 billion capital expenditure programme that will span from 2025 to 2029, with £7 billion of this coming from a fully underwritten equity capital increase.

Compared to 2020 to 2024, this represents a near doubling in planned expenditure. As well as responding to current needs, the initiative is aimed at anticipating the future demands of the energy sector.

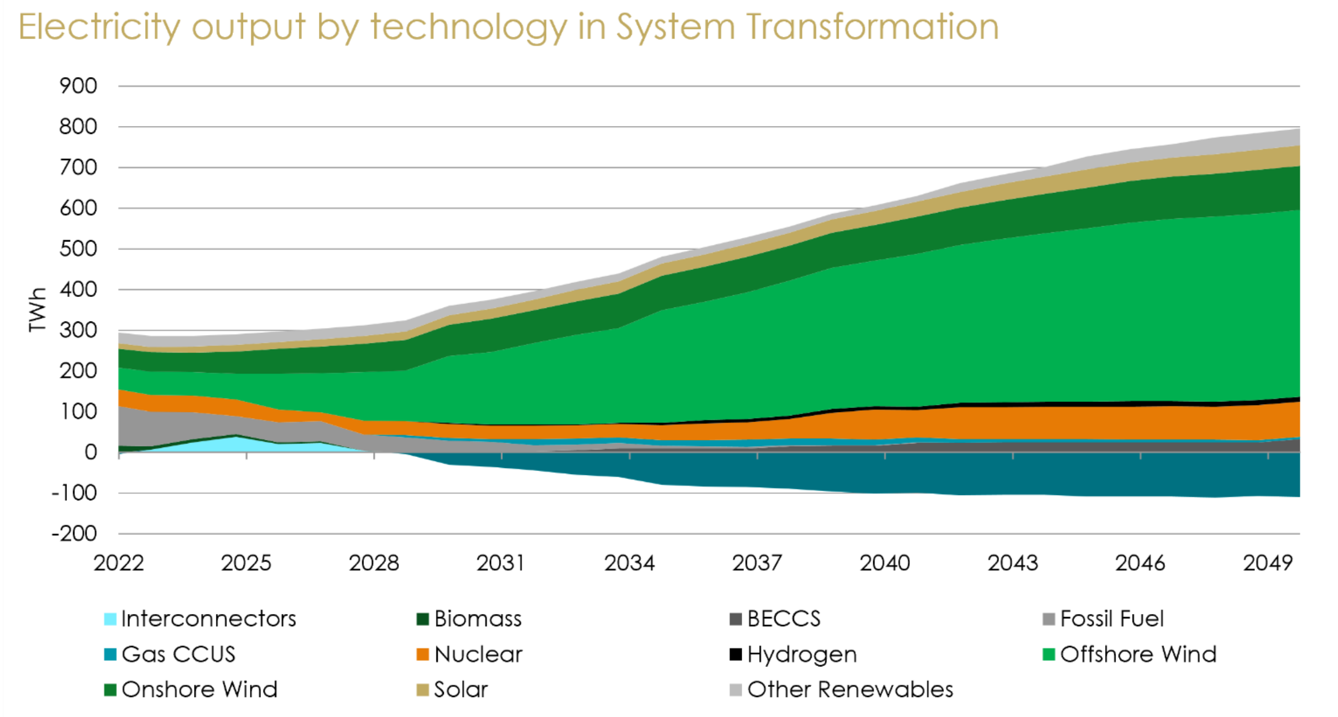

Figure 1: Source: ESO, 2023

The Energy Systems Operator (ESO), a legally separate business within National Grid, forecasts the UK's future generation outputs. The graph above (Figure 1) shows the ESO's 'System Transformation' scenario, in which we just reach the UK's net zero by the 2050 target. In this scenario, and indeed in each of its other scenarios including failing to reach net zero, offshore wind and other renewable sources become a major contributor to our generation mix – reinforcing the need to plan accordingly.

We believe increased spend on this scale announced by National Grid will be a clear signal to other stakeholders in the energy sector, highlighting the need for a collective effort. In a report published by the UK's independent Electricity Networks Commissioner following a year-long review, it warned that investment into transmission networks has failed to keep pace with renewables[1]. The queue for connections to the grid is extremely congested, with developers having to wait many years in some circumstances. These roadblocks will hinder the efforts of the UK government to decarbonise the grid by 2035 and eventually reach net zero by 2050. Meanwhile National Grid estimates that five times as many high-voltage transmission lines will need to be installed by 2030 as were built in the previous three decades combined, to meet demand.

In terms of driving the energy transition, the National Grid initiative and finance is a needed win for the environment. There will be more renewable generation connections, new connections for electric vehicles, and increased solar and battery storage among others. We hold National Grid bonds in the Liontrust Sustainable Future Corporate Bond Fund and Monthly Income Bond Fund, and the equity in our UK Ethical fund, and a substantial proportion of the funds' holdings, are clearly aligned with positive environmental progress, ensuring that the investments are directly supporting decarbonisation of energy networks.

Investors should also benefit. Our team's recent top-down thematic research on 'decarbonisation through electrification' highlighted the importance of the grid infrastructure and the positive momentum behind it. It seems inevitable that electricity usage will increase significantly, and the existing grid is ill equipped to deal with that due to lack of capacity, age and a need for refurbishment. Within a sustainable transition we need the infrastructure that can deliver this energy to homes, businesses, and industry both efficiently and reliably. National Grid is taking this opportunity to benefit from these tailwinds.

The focus on power grids as a key enabler for a sustainable transition should continue. While this capital expenditure programme is a positive step in the right direction, we should anticipate and prepare for more such initiatives. Ignoring the importance of grid infrastructure now could become a bottleneck down the line to increasing the availability of renewable energy. We are undoubtedly making strides in improving generation mix, but we must also ensure that we have the infrastructure to support it.

[1]Winser, N. (2023). Available at: https://www.gov.uk/government/publications/accelerating-electricity-transmission-network-deployment-electricity-network-commissioners-recommendations.

Figure 1:

Future Energy Scenarios (2023) ESO. Available at: https://www.nationalgrideso.com/future-energy/future-energy-scenarios-fes

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

The Funds managed by the Sustainable Future Team:

Are expected to conform to our social and environmental criteria.

May hold overseas investments that may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of a Fund.

Hold Bonds. Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result; The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

May encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.

May, under certain circumstances, invest in derivatives, but it is not intended that their use will materially affect volatility. Derivatives are used to protect against currencies, credit and interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The use of derivatives may create leverage or gearing resulting in potentially greater volatility or fluctuations in the net asset value of the Fund. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of a fund than if the underlying investment was held instead. The use of derivative contracts may help us to control Fund volatility in both up and down markets by hedging against the general market.

The use of derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short-dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

Outside of normal conditions, may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

May be exposed to Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

Do not guarantee a level of income.

The risks detailed above are reflective of the full range of Funds managed by the Sustainable Future Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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