How to play the clean energy revolution

By Chris Greenland, Fund Manager.

When the wind blows and the sun shines, we get paid.

These are two events that make us happy and help to explain why close to 30% of the Sanlam Real Assets fund is currently invested in renewable energy assets. It is a sector that has experienced significant change over the past 10 years – and one that we expect will make further progress over the next few decades.

For example, solar energy module costs have decreased by 84% since 2010 – and they are forecast to fall by a further 52% over the next seven years.**[1]** Likewise, wind energy has become cheaper: turbine costs have fallen by 32% since 2010.**[2]** While global demand for clean energy continues to grow, solar and wind energy production have become cheaper than coal and gas across a number of major markets. By 2050, it is estimated that wind and solar will account for close to 50% of the world's electricity supply.**[3]**

The clean energy revolution is well under way – and this represents a theme that we are playing in the Sanlam Real Assets fund. After years of subsidies, renewable energy is on the verge of becoming self-sufficient. This could represent a significant milestone for the sector in the not-so-distant future. For example, the UK could start to host onshore wind and solar projects subsidy-free from the early 2020s.**[4]**

We invest primarily in operational assets (rather than those in development) for the simple fact that we want to get paid when the wind blows or the sun shines. Our investments provide exposure to onshore and offshore wind, solar, hydro assets, anaerobic digestion, biomass and landfill gas through companies based in the UK, Europe, Asia and America.

These investments produce a stable cash flow and a healthy income stream via regular dividends. What's more, there is a level of predictability in the cash flows they provide: the sun continues to shine and the wind blows. They also offer a degree of inflation protection over the long-term because the subsidy regime is inflation-linked. There is much to be said for this in the low interest rate environment we find ourselves in today, particularly with inflation above 2%.

Looking ahead, the sector is likely to experience further change. Battery prices have fallen by 79% since 2010, which represents a significant development for renewable energy production.**[5]** As Battery storage becomes commercially viable renewable energy producers will be able to deliver clean wind and solar energy even when the wind isn't blowing and the sun isn't shining. We would expect to see further improvements to renewable energy production, monitoring and maintenance on the back of technological developments.

It's incredible to think how far the renewable energy sector has come in a relatively short space of time. Ørsted estimates that an 8MW turbine – the V164-8.0MW produced by MHI Vestas – is able to generate enough electricity in one revolution to power a house for 29 hours. Walney Extension, the UK's newest and largest operational wind farm, currently hosts 40 of these turbines.

The renewable energy sector has already come a long way, but we believe the clean energy revolution still has a long way to go.

The Fund has holdings which are denominated in currencies other than sterling and may be affected by movements in exchange rates. Consequently the value of an investment may rise or fall in line with the exchange rates.

The Fund may invest in derivatives for the purposes of efficient portfolio management and hedging only . There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The Fund's expenses are charged to capital. This has the effect of increasing dividends while constraining capital appreciation.

Part of the fund may invest in fixed income securities. The government or company issuer of a bond might not be able to repay either the interest or the original loan amount and therefore default on the debt. This would affect the credit rating of the bond and, in turn, the value of the fund. Investment in bonds and other debt instruments (including related derivatives) is subject to interest rate risk. If long-term interest rates rise, the value of your *shares is likely to fall.*

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[1] Source: Bloomberg NEF, New energy outlook 2018

[2] Source: Bloomberg NEF, New energy outlook 2018

[3] Source: Bloomberg NEF, New energy outlook 2018

[4] Source: **https://www.telegraph.co.uk/business/2018/07/15/wind-change-reshape-energy-landscape-renewables-start-pay-way/ < https://www.telegraph.co.uk/business/2018/07/15/wind-change-reshape-energy-landscape-renewables-start-pay-way/>**

[5] Source: Bloomberg NEF, New energy outlook 2018