



INVESTMENT INSIGHTS

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Editorial View

Clean hydrogen's moment?

- Building a hydrogen eco-system will be key in attaining carbon-neutrality targets
- Investors have been flocking into companies that promise a revolution in transportation
- For less hyped and more indirect investment opportunities, look rather to the industrial space

US equity indices are defying main street woes, propelled by the high-tech behemoths largely – but not only. The current hype extends also to anything hydrogen related. Nikola, for instance, has seen its market value soar this year (at one point even surpassing that of Ford Motor), despite planning to release its first hydrogen-powered trucks only in 2023.

Why is hydrogen seen by investors as the new green “must have”? The short answer is that, while it burns just like diesel fuel or natural gas, hydrogen generates no carbon dioxide emissions – only water. As such, satisfying regulatory constraints and reaching ambitious climatic targets will necessarily involve greater usage of hydrogen.

The catch is that, in order to be used, hydrogen first needs to be produced which, without delving into the scientific nitty-gritty, still commonly entails the chemical processing of coal or natural gas. Obviously, if you burn fossil fuels, even to produce hydrogen, emissions remain significant. Suppliers are resorting to the capture (and underground sequester) of carbon exhaust as an interim solution, but the new frontier involves producing “green” hydrogen from renewable energy sources. On 8 July the EU highlighted hydrogen as an investment priority within its economic recovery plan, detailing the path towards a European hydrogen eco-system. This calls for the installation of at least 6 gigawatts of renewable hydrogen electrolyzers by 2024, producing up to 1 million tonnes – numbers that are intended to increase to 40 gigawatts and 10 million tonnes by 2030. China, Japan and Korea also have ambitious targets in this space.

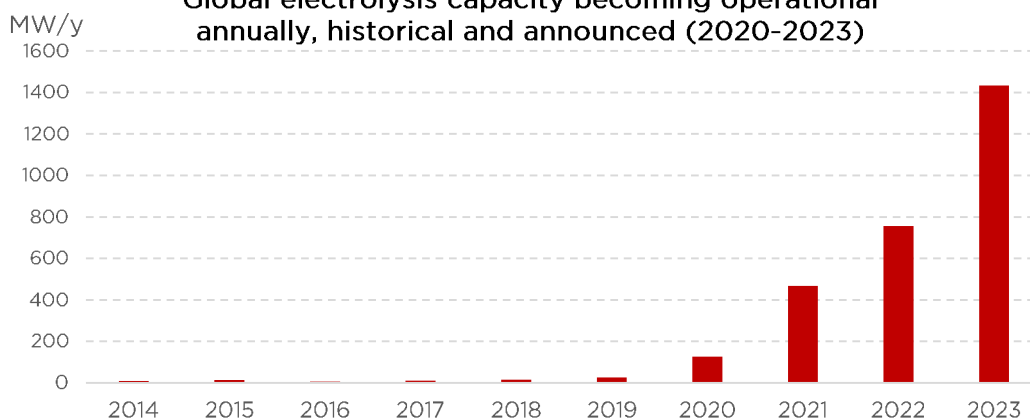
And then there is the question of cost. For the transportation market, a kilogram of hydrogen sells for around USD 16 today. In terms of energy content, this is equivalent to a gallon (3.8 litres) of gasoline, currently priced at only \$2. So, while hydrogen has the benefit of being more energy-dense, it does face a steep price disadvantage. Nikola claims that the gap can be closed, promising a revolution of heavy-duty trucking. But that remains to be seen, beyond having probably already been largely priced in by investors.

Industry is a less touted, but in our view more fascinating, opportunity. In the iron and steel sectors, notably, a shift towards electric furnaces stands to significantly boost hydrogen demand over time. To the benefit of companies such as Air Products, an US industrial and medical gas company that commands a 40% control of the global industrial hydrogen capacity. Amongst others, it is busy building hydrogen facilities that “plug into” clients’ factories, meaning that they are literally situated on the same premises. These investments take their toll on current cash flow, but will serve, over time, to lock in clients – particularly as fines on carbon dioxide emissions ratchet up.

All told, we fully concur with the long-term hydrogen investment thesis. Still, as with all technological revolutions, we would caution that the ultimate winners may not be the most hyped stocks, nor indeed only the obvious direct beneficiaries. Careful fundamental analysis remains essential, valuation considerations should not be overlooked and, of course, timing is key!

Chart of the Month

Global electrolysis capacity becoming operational annually, historical and announced (2020-2023)



Please see appendix at the end of this document for information on sources, important disclosures, and disclaimers



Global Strategy

So far so good... on average

- The recovery continues despite a second wave of Covid-19
- Very accommodative monetary policies are supporting risk-on assets overall
- Beware of market polarisation and investor complacency

The latest economic data suggests that activity is still recovering, but some signs of plateauing - below the level at the onset of the year- are already visible. The dreaded second wave of Covid-19 in Europe and Asia continues to act as a major drag on well-identified tourism-related sectors, thus preventing a quick return to "normality". At this stage, given current hospital capacity, apparently less severe cases and overall improvement in treatments, a full economic lockdown is highly unlikely. In the meantime, the worldwide race for a cure remains intense, indeed may be approaching its goal. The availability of a vaccine - probably before year-end in our opinion - could be a true game changer for financial markets and lead to a rotation in favour of laggards.

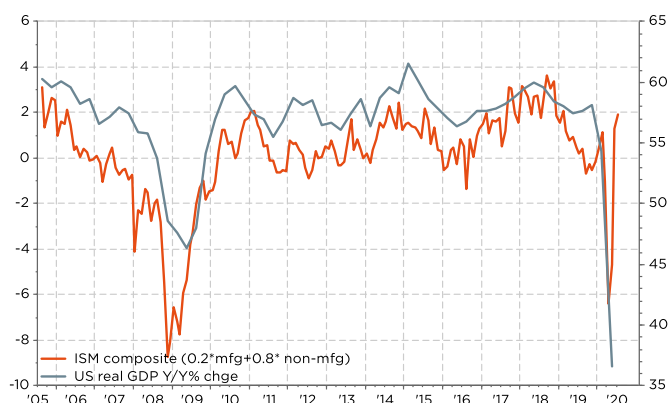
Committed to supporting the recovery, central banks will likely remain extremely accommodative for an extended period. Together with improved earnings revisions following a better-than-feared Q2 earnings season, this abundant liquidity should support equity markets, as well as other risk-on assets such as credit. There are, however, some important caveats. First, not all boats are being lifted equally by these tailwinds. In fact, it is a market of two tales: growth vs. value stocks, "stay-at-home" vs. more traditional businesses and, in fixed income too, non-BEACH vs. BEACH bonds. Secondly, the positive monetary policy backdrop does not preclude equity market corrections, given that several valuation metrics have already reached rather rich levels. This would become particularly true if the recovery starts to peter out in September or October (and no vaccine is found), since peaks in economic momentum often coincide with weaker market performance.

The US government's failure to agree on new stimulus might only increase this risk, alongside additional socio-political instability in a challenging context. Some segments of the markets are priced for perfection, but they are still part of the same overall economy. Note that improving sentiment towards the "old" economy on the back of a vaccine discovery may lead to violent sector rotation and greater market volatility, as well as rising interest rates. Finally, our contrarian indicator, which has just moved into "overbought" territory, suggests that investors are becoming complacent.

In this light, our cautiously constructive stance still translates into a slight underweight and underweight allocation to equities and bonds, respectively. Within equities, we keep our preference for more resilient diversified markets such as Switzerland and the US, while favouring high-quality large cap stocks with a growth bias. Meanwhile, on the sector front, we have rebalanced our positioning to a more-pro-cyclical stance during recent months, so as to better withstand market rotations. Moreover, we still consider tactical hedging strategies on an opportunistic basis.

In fixed income, we are still light on duration and credit risk and remain very selective, both on govies -with a preference, however, for linkers as inflation expectations are creeping up faster than nominal rates- and credit. With negative real bond yields, safe haven alternatives are becoming ever scarcer, a phenomenon that also benefits gold. Chairman Powell's latest speech, outlining the Fed's new inflation targeting framework, served to confirm our favourable stance on gold as financial repression is here to stay.

US ISM composite and US real GDP (Y/Y%)



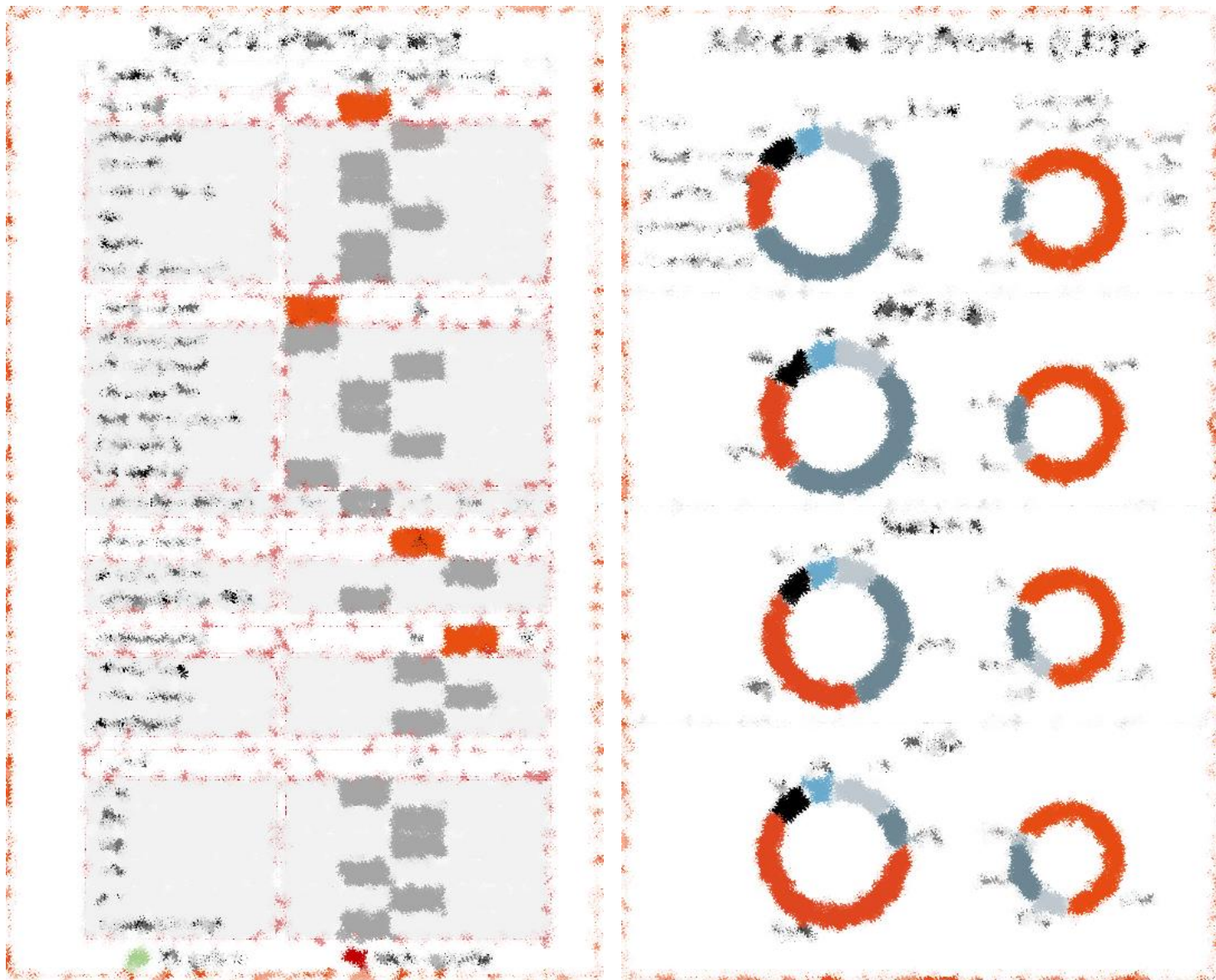
S&P500 equal weighted index is lagging



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Asset Allocation



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External sources include: Refinitiv Datastream, Bloomberg, FactSet, IEA
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