Global Market Outlook 2022

Catch-2022

Fidelity Sustainable Water & Waste Fund

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Accelerated recognition of sustainable water and waste practices

The drivers of the water and waste investment theme will persist for many years to come. We expect to see an accelerating recognition of sustainable water and waste practices, as consumers, governments, and corporates shift to more sustainable solutions to save our planet.

Key points

- Water and waste investment drivers are likely to persist for many years to come. These include population growth, urbanisation, ageing infrastructure (that needs to be repaired or replaced), climate change and the effects of altering weather patterns on existing infrastructure, the sustainability of resource consumption, and changes in the volume and composition of waste.
- Key legislation changes – such as extended producer responsibility (EPR), the outcomes of the COP 26 conference, and the US$1 trillion infrastructure bill – will further accelerate the adoption of sustainable water and waste practices.
- We focus on companies operating in industries with attractive competitive dynamics, high barriers to entry, and strong pricing power. This is important in inflationary environments as these companies can price for higher input costs and offset inflationary pressures.

What is your investment outlook in 2022?

The water and waste theme is underpinned by a number of visible and long-duration megatrends. These drivers are not unique to 2022; the theme benefits from the *consistency* of these underlying factors, which we expect to persist for many decades. These include population growth, urbanisation, ageing infrastructure (that needs to be repaired or replaced), climate change, and the effects of altering weather patterns on existing infrastructure, the sustainability of resource consumption, and changes in the volume and composition of waste. Companies exposed to the value chains of these core themes should provide above-benchmark returns across the market cycle.

The FF Sustainable Water & Waste Fund aims to deliver long-term capital growth while contributing to the sustainability of global water and waste practices. Over the next year, we expect momentum for greener water and waste practices to accelerate as governments, consumers, and corporates shift to more sustainable solutions to help save our planet. This will create attractive investment opportunities for investors.

What do you think could surprise the market in 2022, either positively or negatively?

Extended Producer Reforms and associated legislation will start to impact the sector in a more meaningful way in 2022. These reforms intend to shift the full cost of collection, recycling, and the responsible end-of-life disposal of products onto producers. Europe is the leading region in adopting these reforms. For example, in April 2022, the UK is enforcing a mandatory plastic tax, which will be levied on the manufacturers and importers of all packaging containing less than 30 per cent recycled plastic. With the introduction of these reforms, firms have no choice but to address and adopt plastic recycling efforts, which presents risks for plastic producers and users but meaningful opportunities for those with recycling capacity.

Increasing focus on climate resilience, especially following the 26th United Nations Climate Change conference (COP 26), could provide meaningful tailwinds for the water and waste sectors. For example, climate risk mitigation initiatives could result in increased investments into flood risk prevention (sewer overflows etc.) and water infrastructure to help with droughts in response to extreme weather events caused by climate change.

Which themes, sectors, or regions offer opportunities or potential risks?

Within the water sector, the approved US$1 trillion US infrastructure bill will support around US$100 billion of water infrastructure investment. This includes upgrading infrastructure, disaster mitigation measures, modernisation, and water quality remediation to eliminate unwanted and persistently polluting chemicals.

Inflation will be an ongoing feature of 2022. We focus on identifying companies operating in industries with high barriers to entry and attractive competitive dynamics populated by rational players. Also, we look to own businesses with some kind of competitive advantage. This approach is particularly important in inflationary environments, as these companies are more likely to price for higher input costs and offset inflationary pressures.

Within your portfolio, where do you have the highest levels of conviction, and which areas are you avoiding?

Within the water sector, a few of our investments stand to benefit from the US infrastructure bill. One is Evoqua, a leading player in waste-water management and water treatment, which will be supported by demand for PFAS treatment as it is the dominant player in this market.

Within the waste sector, one of our core areas of focus is sustainable waste practices. We look to invest in "future waste solutions" – businesses that recycle, recover, reuse, and reduce waste, or legacy incumbent waste providers that are shifting their businesses towards more sustainable waste practices. We have a high conviction that the adoption of these solutions will increase. Furthermore, we continuously look for new ways to gain exposure to this, identifying future recycling winners or solutions that reduce waste.

Do you expect sustainability factors to influence returns, and how is this reflected in your portfolios?

We have a twofold approach to sustainability, focusing on sustainable company practices across all environmental, social, and governance (ESG) attributes and products that facilitate sustainable water and waste practices. Often, these two things go hand-in-hand: companies with products or solutions with an environmental benefit (which are heavily represented in our universe) tend to be more aware of sustainability factors, and 87 per cent of the portfolio is invested in companies with strong ESG characteristics* (i.e., those with an MSCI ESG rating $\geq$ BBB). By investing in companies with good sustainable practices, we believe that we can potentially protect and enhance investor returns.

Accelerated momentum into sustainable water and waste practices is expected over the near term due to increased regulation, changing consumer behaviour, and shifting corporate practices. As a result, increased earnings, elevated returns, and the subsequent higher multiples of companies exposed to the value chains of sustainable water and waste practices can be expected. By favouring businesses with strong and competitive dynamics due to superior technologies or solutions, returns will less likely be competed away. This could translate into high returns for our portfolio.