

## Low-carbon world webinar

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**Investors abandoning fossil fuel stocks need to recognise that obvious low-carbon alternatives, like wind farm companies, carry their own valuation risks, James Hambro & Partners (JH&P) has warned.**

JH&P Portfolio Manager [Mark Leach](#), speaking during a low-carbon world webinar organised by the wealth manager, said: “Investment managers are moving aggressively away from carbon-intensive stocks and into the renewable sector, mainly because of the pressure being put on them by their clients and investors.

“In 2019 we saw a 250% increase in assets held in sustainable funds. In the first three quarters of this year we’re going to see around £190 billion flow into sustainable funds, relative to £157 billion last year.

“As the capital has flown out of fossil fuel stocks, it has moved into these renewable plays – and usually the pure plays that are ahead of the curve in generating renewable options. That’s mainly offshore wind and wind turbines. We feel that’s now a risk as well. If you look at the valuations of companies like Ørsted, for example, they’re at over 50 times earnings, relative to Shell on less than 10 times. That’s pricing in an awful lot of growth when we see the potential for higher levels of competition in the market from the big oil companies transitioning to renewable energy, potentially lowering returns. So it’s an area where we see a quantum of risk.”

[Doyne Farmer](#), Baillie Gifford Professor of Mathematics at the University of Oxford, explained how rapidly costs

of producing renewable energy are falling. “Solar photovoltaic energy has dropped by more than a factor of 5,000 since its advent in 1958,” he told the webinar. He projected that the cost of renewables will come down so fast that it will be possible to reach a net-zero world in just 20 years by using photovoltaics and wind to satisfy a large proportion of the global demand for electricity and hydrogen as a long-term energy storage mechanism.

“We just need to embrace renewable technologies and we’ll get there quickly,” he said, arguing that this is also the cheapest solution – one that is likely to save the planet something in the order of \$10 trillion or more over other solutions.

“Even if we didn’t have climate change, it’s going to make energy cheaper than it has been for a century and a half. Fossil fuels can be phased out substantially over the next 20 to 25 years. And that’s actually the most cost-effective solution. The stickiest part is hydrogen – it looks good, but we’ll need to ramp it up very substantially.”

James Evans, Director at Exane BNP Paribas, an expert on hydrogen, said that if the EU is to meet its target of net zero by 2050, even allowing for the use of carbon capture and storage, there is no room for emissions beyond agriculture – “which, frankly, is just cows doing what cows do”. He said: “That means all coal, oil – whether it’s in gasoline, diesel, jet fuel or natural gas – has to come out of our system.”

He said renewables may provide up to 80% of power but battery technology has limitations in practical applications like transport. “I worked out the amount of energy that





you'd need for a Boeing 737. The batteries would actually fill the entire cabin and make the plane weigh more than four times as much. So hydrogen is an important part of the solution."

## Hydrogen

Hydrogen is the most common element in the universe. However, because it is highly reactive, it is seldom found on its own.

Hydrogen fuel cells produce electricity by combining hydrogen and oxygen atoms, which react across an electrochemical cell similar to that of a battery. The only by-product is water. Hydrogen can also be used as a carrier to transport energy created elsewhere – perhaps from solar farms in Spain. The problem with hydrogen is that it is not as energy-dense as other fuels. That means that it may be a viable solution in buses, lorries, ships and even planes. It is less likely to become a popular fuel for cars.

The other issue is cost. At the moment it costs four to eight times the price of natural gas or two to four times the price of diesel.

But Evans argued that research – backed by government investment – is likely to see costs come down quickly and ways developed to improve hydrogen's energy density.

JH&P Assistant Portfolio Manager [Sarah Goose](#) commented on the importance of government in driving change. She said: "I think regulation is absolutely key and presents the final piece in the jigsaw in terms of the push towards full decarbonisation across the spectrum. Europe has been particularly prominent in this area, and it has been impressive to see the amount of subsidy and backing behind some of these technologies."

So how do investors benefit from the transition to a low-carbon world? Leach said: "In the classic JH&P way, we've looked across the value stack. Rather than take the call as to whether it's going to be solar or wind or whether it's going to be BP or Ørsted, we're taking the view that, whatever happens, you need network grids that can deal with variable demand on electricity, as well as variable supply. So we look at the network players as being a really interesting place to invest, because they have a natural monopoly.

"Yes, it's a regulated monopoly. But the regulator and the government are absolutely incentivised to invest in these businesses. We need to upgrade the Western networks, which are anything over 50 years old, to cope with a changing energy construct where you've gone from very centralised production to very diversified and decentralised production. So we like the utility companies.

"We're also looking at other parts of the decarbonisation story. We like the transport sector and the building sector. Transport is responsible for around 25% of CO<sub>2</sub>; buildings for around 12%. There's a huge amount of pressure to decarbonise. We're seeing this huge shift in terms of forcing people to buy electric vehicles (EVs). We don't have to bet on VW or Tesla. All these cars are going to have more semiconductors on them, because they're having to deal with electrification of the drive train, so we can own companies in that space instead. And within the building sector we know some chemical companies that are helping to reduce the carbon intensity of cement and making buildings more efficient by using membranes that go on roofs to make them more effective in reflecting or retaining heat. So we prefer to play the theme in that way. And we've got some really interesting ideas in this space."

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