



Energy security and Future Quality

Impact of energy security on global decarbonisation efforts

By Johnny Russell
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2023 was a great year for markets. Yet the world that year recorded its hottest day on record¹ and we witnessed numerous climatic catastrophes such as wildfires in Hawaii, droughts in North Africa and a combination of floods, dry spells, earthquakes and landslides in South America. The list goes on. My point is that while central banks appear to be able to control financial risk and markets in the short term, they do not have a patch on mother nature. It is human behaviour that will determine the impact and risks posed by climate change.

What we do know is that over the next two decades, spending on the energy transition should treble. But with over 1.5 billion voters going to the polls globally in 2024, high interest rates and falling energy prices, there is a risk that large decarbonisation projects fuelled by fiscal programs like the Inflation Reduction Act in the US will get delayed.

The truth is the world is not moving away from carbon any time soon. The use of coal—well recognised as the dirtiest fossil fuel—continues to grow. The International Energy Agency predicted that global coal production would peak in 2021 at 7.7 gigatonnes (GT), yet we are likely to consume almost 9 GT by the end of 2024. The wealthiest one billion



Source: Shutterstock

people in the world are estimated to use approximately 28 megawatt-hours of energy per person annually—which is more than the combined consumption of the remaining seven billion people. Add in wars and greater geopolitical tension around the world and unsurprisingly “energy security” has become the number one priority for most people. In many of the voting country agendas geopolitical resiliency is going to become a crucial driver of sentiment in 2024 as energy security drives political needs. Considering this more uncertain environment, what are investors to do?

¹ According to the University of Maine’s [Climate Reanalyzer](#), which uses US National Centers for Environmental Prediction data, the global average daily temperature reached a record high in July 2023.

Given the above uncertainties, it seems more likely that projects that may be well-suited to surprise in 2024 are ones that are more economically attractive, have short-cycle economics and lower up-front capex.

Energy security and resiliency require a focus on infrastructure, efficiency, expanding domestic resources and diversification. In our view, some of the best placed companies to deliver this sit in the industrial sector. We believe that those with the skills to develop and manage energy projects—both fossils-based and clean tech—are in a strong place to grow returns given the lack of skilled labour capacity globally.

At Nikko AM, we follow our Future Quality investment philosophy with rigour. We look for companies that have pricing power, possess management teams that will invest appropriately, boast strong balance sheets and offer opportunities that are not yet priced in by the market. All our investments are reviewed through that lens and we expect them to deliver high and rising cash flow returns. In that regard, our approach in 2024 will be no different. However, we are acutely aware of the importance energy security will have this year as the world shifts to a decarbonised energy platform.

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