The Quiet Sound Of Another Bubble Bursting

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Ronald Reagan was once asked what it took to be a great president. "It's easy," he answered. "You come in after Richard Nixon, Gerald Ford, and Jimmy Carter". Following on the heels of Boris Johnson and Liz Truss, it's likely Rishi Sunak feels much the same.

Highlighting how Britain's Conservative Party has once again demonstrated that "in the land of the blind, the one-eyed man is king," is not intended as a slur on the UK's current prime minister. That Sunak, the child of Indian immigrants from East Africa, made it to the top of the Britain's government aged just 42 is a testimony to his intelligence, political savvy and ability to adapt. But Sunak did not get where he is today by ever straying very far (if at all) from the Overton window of what the majority of the electorate deems politically acceptable.

The UK is watering down its green targets

This is significant because on September 20, Sunak did something that just a few months ago would have seemed out of character—even approaching the edges of the Overton window. Specifically, he announced an overhaul of policies designed to help the UK meet its legally-binding target of cutting its carbon emissions to net zero by 2050. While insisting that the overall target remains in place, the PM pushed back the planned ban on sales of new petrol and diesel cars from 2030 to 2035, relaxed targets for households to switch away from fossil-fuel boilers, and ditched plans for tougher energy efficiency rules for landlords.

Green energy plays are taking a beating in the markets

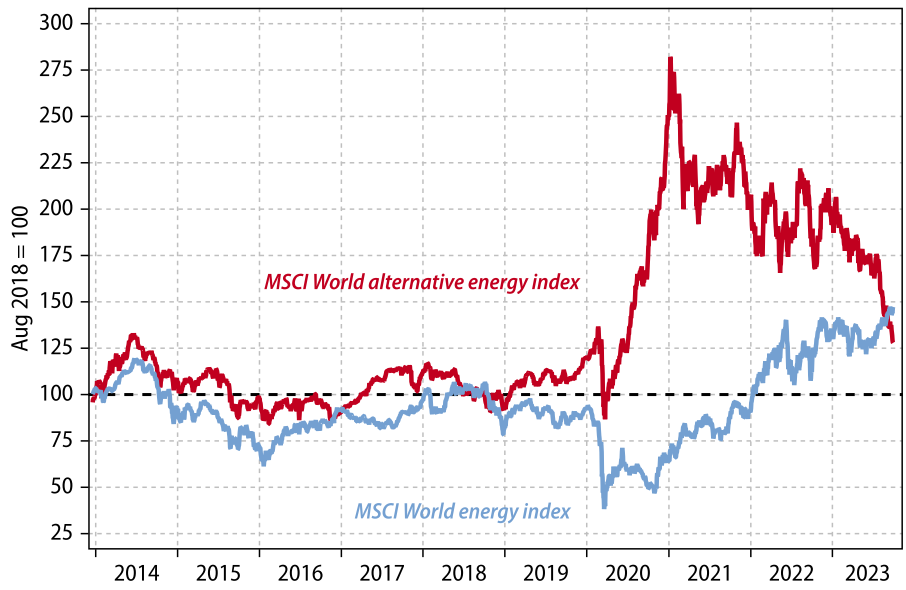
The market had not waited for Sunak to push back against the prevailing green political orthodoxy to start selling off alternative energy names. As the chart overleaf shows—apologies for publishing this yet again—alternative energy plays have now given back all their outperformance of the last five years over traditional carbon-based energy names. Worse still, the slump in alternative energy now seems to be picking up steam.

Checking The Boxes

Our short take on the latest news

Fact	Consensus belief	Our reaction
US pending home sales fell -7.1% MoM in Aug, versus 0.5% in Jul	Below -0.8% expected	Housing data has been mixed, but high mortgage rates mean caution is warranted
Eurozone Sentix economic confidence index fell to 93.3 in Sep, from 93.6 in Aug	Above 92.4 expected; industrial confidence up to -9.0, vs -9.9; services down to 4.0, vs 4.3	Confidence remains weak with indicators deteriorating in southern Europe
German CPI rose 4.3% YoY in Sep, versus 6.4% in Aug	Softer than 4.5% expected; services rose 4.0% YoY, vs 5.1%; goods rose 5.0% YoY, vs 7.1%	Price pressures easing but 3m/3m CPI shows inflation still well above target strong
India's current account deficit widened to US$9.2bn in 2Q, from US$1.3bn in 1Q	Wider than US$8.9bn expected	Higher oil prices set to cause external deficit to widen further; expect weaker INR

Alternative energy has given up all its putperformance since 2018



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This might appear surprising. Following Russia's invasion of Ukraine, the consensus expected Western countries to increase subsidy payments for alternative energy companies out of a concern for energy independence as much as a desire for a greener future. Today, with Russia increasingly looking as if it is set to weaponize energy prices (see **The Next Phase Of The Ukraine War?**), and with energy prices grinding higher around the world, you might think alternative energy counters should be thriving. Instead, they are among the world's worst performers this year. So, what gives?

Expensive green goals were fine when the cost of capital was close to zero

The most obvious explanation is that embracing lofty alternative energy goals was fine when states enjoyed unlimited funding at near-zero interest rates. In such an environment, why not placate single-issue voters with expensive promises? But this dynamic changes rapidly once capital is no longer free. So perhaps the simplest explanation for the alternative energy face-plant is that in a world in which the cost of capital is on the rise, projects whose returns consist largely of virtue signaling go out the (Overton?) window.

However, given the zeal with which Western policymakers and media have pushed the carbon-emergency narrative over recent years, simply walking away is a challenge. This brings us to the interesting aspect of recent market developments. Just as the alternative energy bubble seems to be imploding, the nuclear energy space has caught fire. Clearly, nuclear plays are currently enjoying a "shift in the zeitgeist" moment.

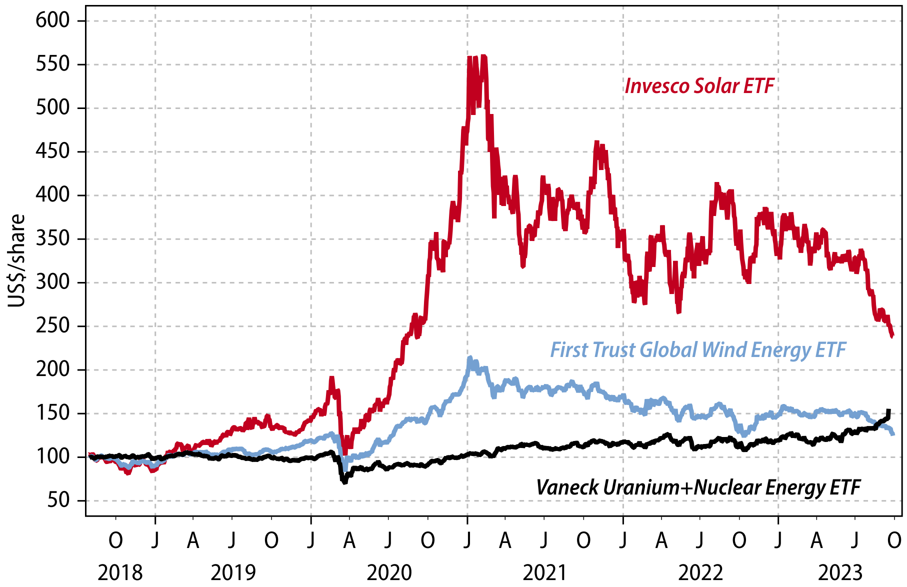
Much green energy isn't really that green

This may be for ecological reasons. When you account for mining rare earths, the coal burnt in China to produce solar panels and so on, it turns out that green energy is often not that green.

Or it may be for geopolitical reasons. Once your nuclear plants are operating, your need for more uranium drops drastically. And uranium can be bought long in advance and stored at relatively low cost, cushioning you against possible geopolitical dislocations.

Nuclear energy is gaining, wind and solar failing

The shift in the zeitgeist



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Or it may simply be because of reasons of efficiency; countries running wind, solar and nuclear side by side have by now figured out which of the three power sources is most reliable, most productive, and least costly to maintain.

Still, the alternative energy face-plant leaves us with the perennial question every investor should ponder when contemplating a bubble implosion: who will be left holding the bag?

After years of investment to get rid of carbon energy, the cost of carbon energy is rising

Over the last decade, Western countries have collectively malinvested trillions of dollars in alternative energy in the hope that wind and solar power would end their dependence on carbon energy. Now, 10 years on, the price of carbon energy is rising on a daily basis. This is probably not a coincidence. Nor is it consequence-free. As we never tire of pointing out, economic activity is energy transformed. A higher cost of energy means lower productivity, which is problematic at a time when the cost of capital is rising and societies aging (another productivity killer). In short, the costs of the imploding alternative energy bubble will be with us for a long while to come.