

Investing in climate change

Investing in climate change - another false start or time for a serious look?

Is green the new black in the world of sustainable investing?

Sceptics will say that the concept of investing in climate opportunities is not new, and early investors in areas such as solar energy have not realised the gains that have been promised to them by what was touted as a huge macro trend.

So, what has changed since the early 2000s, and why should investors be taking a second look at investing in climate change?

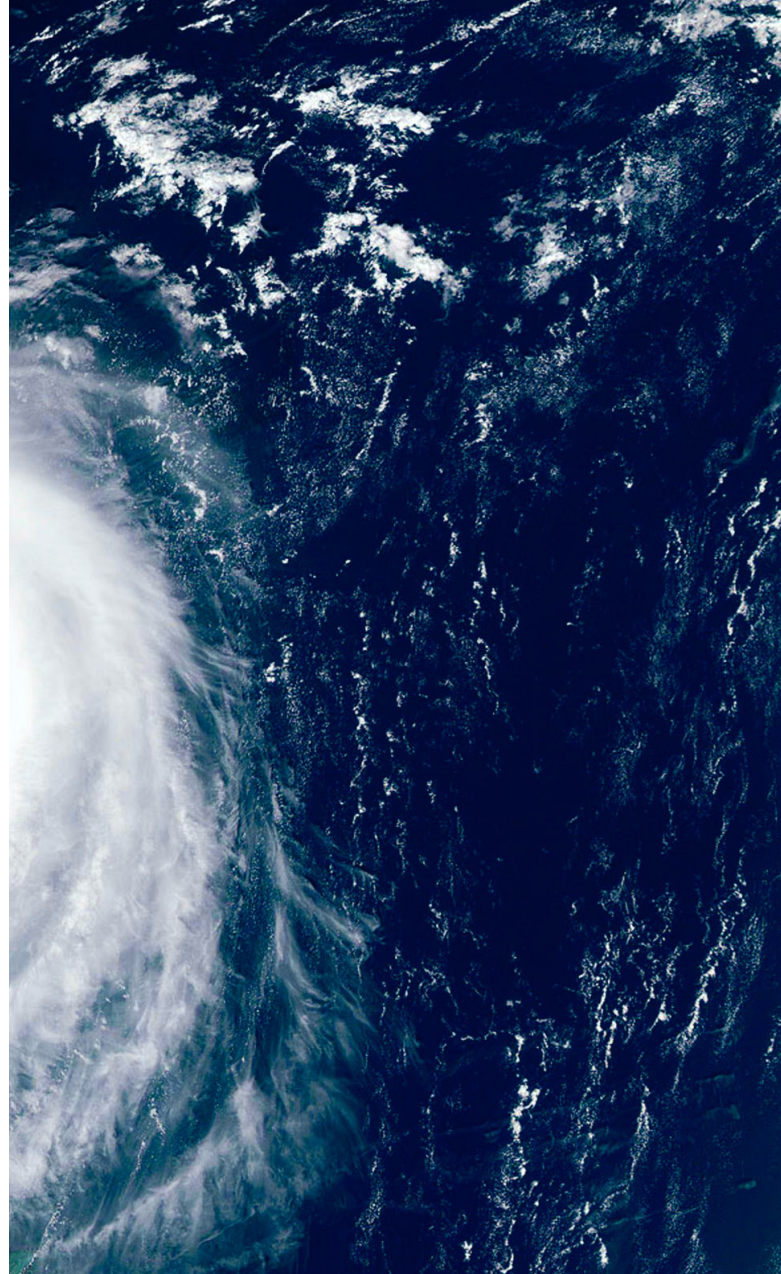


Understanding key terms in the context of potential impact to the global economy and financial markets

Navigating and making sense of the terms associated with climate change can be overwhelming. A basic knowledge of key terms within the context of risks and opportunities will be useful for investors.

- **1.5°C:** This is the figure provided by the Intergovernmental Panel on Climate Change (IPCC), warning of the impact of 1.5°C global warming above pre-industrial levels. Limiting warming to 1.5°C would reduce the number of people frequently exposed to extreme heatwaves by about 420m. Extreme weather is already affecting businesses. Cambridge University's Climate Change Business Risk Index estimates that climate change can add over USD 100bn of loss each year to the global economy. This includes disruptions in business operations and supply chains globally.
- **Decarbonisation:** This is the process by which countries, individuals or companies aim to achieve a zero fossil carbon existence, and typically refers to a reduction of the carbon emissions associated with electricity, industry and transport. It is estimated that the world needs to spend USD 2.4tn every year until 2035 to limit global warming to 1.5°C¹.
- **Transition to a low-carbon economy:** Transition refers to the process of changing from one state or condition to another within a given period. A low-carbon economy is one based on low-carbon power sources. Opportunities exist in the development of new technologies, products and services for both, which could capture new markets and sources of funding.
- **Transition risks:** These are risks that occur when moving towards a greener economy, where some sectors of the economy face either higher costs of doing business or a significant depreciation in their assets. Transition risks include policy changes, reputational impacts, and shifts in market preferences, norms and technology. Based on a 2019 Climate Disclosure Project report, the world's 215 biggest companies, representing nearly USD 17tn in market capitalisation, value the climate risks to their businesses at a collective c.USD 1trn.

¹ Source: United Nations International Panel on Climate Change



WHY IS NOW THE TIME TO LOOK FOR INVESTMENT OPPORTUNITIES RELATED TO CLIMATE CHANGE?

Significant government spending post COVID-19 on sustainable development

We expect that policy will continue to support the energy transition, despite any potential near-term delays due to the COVID-19 pandemic. The pandemic has altered national policy priorities and budgets, and some of these will accelerate the shift towards decarbonisation. For example, in unveiling its EUR 1.85tn European Recovery Plan, the European Union (EU) has put 'accelerating the shift towards a lower-carbon, more sustainable economy' at the heart of its post-pandemic stimulus strategy.

Beyond the EU, we also see momentum in many Asian countries. China is playing an increasingly important role in driving sustainable decarbonisation. In its New Policies Scenario, renewables are a key area of focus in meeting its growing energy needs. Both the People's Bank of China (PBoC) and Monetary Authority of Singapore (MAS) are Asian founding members of the Network for Greening the Financial System, working together to develop and share best practices to enable mainstream finance to support the transition to a sustainable economy. Even amid the COVID-19 pandemic, China and Singapore continued to make strides in green financing, despite daily number of new cases hitting fresh highs globally.

Increased support and actions taken by large corporates

Beyond policy makers, we see businesses across sectors launch ambitious commitments around achieving zero carbon emissions (commonly termed net zero).

More and more companies are not just looking at their own emissions and what they can control, but also carbon emissions from the use of their products and services, such as mobile phones, washing detergents and supply chain activity.

Big technology companies have announced plans to achieve net zero emissions across their entire business, including manufacturing supply chain and product life cycle.

The same is seen in the fast-moving consumer goods industry, where an industry leader recently announced USD 1.2bn of investments to help its suppliers adopt technologies to eliminate the use of fossil fuels in the production of cleaning products by 2030. This is the first large investment in the sector looking to replace oil in its production process with ingredients derived from wood or microbial fermentation, or even recycled carbon from other industries.

In the entertainment space, some theme parks are making investments in renewable energy across their operations, leveraging both geothermal and solar energy to power their theme parks and resorts.



WHERE ARE THE INVESTMENT OPPORTUNITIES IN A LOW-CARBON WORLD?

The focus on decarbonisation is here to stay, but the nature and speed of transition vary across companies and sectors, and there is often a spectrum in terms of readiness and progress.

Three key areas stand out as opportunities.

- **Renewable energy:** The shift to renewable energy continues to accelerate, and with technological innovation, solar and wind energy are now cheaper than fossil-fuel energy sources. In fact, solar and onshore wind are now the cheapest new sources of electricity in several countries, including the US, China and India – the three largest in terms of electricity consumption.² When it comes to clean energy innovation, Europe typically leads nascent technologies, while Asia tends to take the lead once costs come down and manufacturing gains scale. Right now, Asia is very much the hub for battery production, led by companies in China and Korea.
- **Electrification:** The electrification of energy consumption will open new opportunities within transportation, heating and industrial processes. Cleaner transport and logistics are among one of the focus areas in the EU Green Deal, including the installation of one million charging points for electric vehicles (EV) and a boost for rail travel and clean mobility in cities and regions. In Asia, China continues to be a global leader in EV, producing over 50% of EVs worldwide. The expansion of electric mobility in China is leading to lower EV prices and increasing accessibility.
- **Resource efficiency:** While renewables and electrification are more commonly associated with decarbonisation, driving **resource efficiency** is as important in the transition journey. At the most basic level, **resource efficiency** captures the notion of ‘doing more with less’ - from energy to water and material efficiency. As an example, material efficiency strategies, including recycling, can reduce emissions from materials and operational energy in housing by up to 70% in India and China³. Opportunities will be found in technologies enabling this, alongside recycling and waste management.

The cheapest sources of new energy (H1 20), USD/megawatt-hour



Source: BloombergNEF

² Solar and Wind Cheapest Sources of Power in Most of the World, Bloomberg, 28 April 2020, <https://www.bloomberg.com/news/articles/2020-04-28/solar-and-wind-cheapest-sources-of-power-in-most-of-the-world?sref=Vefqd1fk>

³ Resource Efficiency and Climate Change: Material Efficiency Strategies for a Low-Carbon Future, UN Environment Programme, International Resource Panel, <https://www.resourcepanel.org/reports/resource-efficiency-and-climate-change>



Two key questions investors can ask themselves when thinking about opportunities in climate transition are:

- Does the company or sector stand to benefit from a sustainable transition?
- For individual companies, do they seem to have the resources, capabilities and management support available to catalyse the change?

Decarbonisation will rise to structural growth opportunities across many sectors, from industrials to utilities, energy, technology, materials, chemicals and automotive sectors.

Leading companies across the value chain, from makers of components, to service providers, to end product distributors stand to benefit from this trend as they capture opportunities in this shift towards a low-carbon world.

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