

Green light ahead

4 December 2020

As we all know, for most of this year our lives, economies and financial markets have been steered by the unfolding nature of the COVID-19 pandemic and the global response to fight it. It is, of course, the healthcare and medical science professions that deserve the most credit for working tirelessly to control the spread of the disease and develop a longer-term solution. As this update is written, the first regulatory approval of a vaccine has been announced, so there is now some genuine light appearing at the end of what has been a long and dark tunnel.

We also know that significant resources have been diverted by governments across the world, not only towards containing the pandemic itself but to supporting businesses and workforces, particularly in the most impacted sectors. Central banks have also played their part in setting a monetary policy framework that has facilitated the movement of liquidity through the financial system, helping to keep things afloat. With all the immediate pandemic responses and distractions, governments might have been forgiven for putting other policies and longer-term priorities on the back burner. But this has not been the case: the global pandemic has resulted in such a huge fiscal response that it has actually created policies and facilitated the channelling of funds and investment into areas that have lifelong implications. The most obvious area involves the global effort to tackle climate change.

Far from falling victim to the global pandemic, the environmental agenda has, if anything, been given even greater prominence over the past year. Many priorities and perspectives on things of real importance have changed materially over the past year, and this mood is echoed in the numerous international 'green' policy initiatives that have been announced across the globe, some of which we touch on in this update. These initiatives should help pave the way for some increased momentum in reversing the threats posed by climate change on our planet, whilst creating attractive investment opportunities along the way, particularly in the areas of sustainable energy, resource efficiency and renewable infrastructure.

A global agenda

According to some estimates, over US\$2 trillion needs to be invested globally on an annual basis if climate change and the rise in greenhouse gas emissions is to be arrested. America will need to up its game: it is encouraging to learn that president-elect Biden's priority will not only be to focus on the post-pandemic recovery but also more pro-environment policies than seen under the Trump administration. On day one of his presidential tenure, Biden has already pledged to rejoin the Paris Climate Accord, the central aim of which is to strengthen the global response to climate change by keeping a global temperature change this century well below 2°C above pre-industrial levels, whilst pursuing efforts to limit the rise even further. Biden has also pledged a US\$2 trillion stimulus package aimed at reducing US emissions and moving towards net-zero emissions before 2050. Tighter regulation and tougher fuel economy standards are also in the offing. Biden has proposed tax credits on electric vehicles ('EVs'), renewable power and energy storage projects, and intends to announce significant spending on green infrastructure projects.

All of this stimulus is in addition to the broader catch-up the US needs to play in terms of some serial underinvestment in its infrastructure; of the 600,000 or so bridges in America, more than 40% currently exceed their expected lifespan of 50 years. Some of Biden's ambitions may be restrained or thwarted by political divisions in the Senate, the control of which will be decided in the new year, but we can still expect significant investment and momentum on both environmental issues and key infrastructure spending with the incoming US administration, in contrast to the inertia created by the outgoing one.

The UK government has recently made similar pledges to reinvigorate its environmental stance with what Boris Johnson calls his 'green industrial revolution' 10-point plan. This includes significant commitments towards offshore wind power and low-carbon hydrogen production, but also provides initiatives for more energy-efficient homes and support for the increased roll-out of EVs. The government's intention to ban all diesel and petrol car sales by 2030 is certainly ambitious, but will also require substantial investment in EV charging infrastructure for example. Globally, EVs currently account for just 3% of car sales, but forecasts suggest this could rise to 20% by 2025 and to 50% in just ten years. The UK will be playing its part in the transition from liquid fuels to electric, but globally it is a huge project that will touch a wide range of sectors and companies involved in both the innovation and manufacture of clean-energy technology and infrastructure solutions.

In China, addressing climate change has also become much more central to the country's economic roadmap, with the next 5-year plan (due early next year) likely to place further emphasis on reducing emissions. President Xi Jinping has already committed China to becoming net-zero carbon by 2060 and having CO₂ emissions peak by 2030. Thankfully, China is not starting from scratch but it will certainly need to build on its expansion of renewables and energy efficiency if it is to come anywhere near hitting these targets. China already hosts many companies involved in the renewable energy and associated technology supply chains, including several world leaders in lithium-ion battery production, control sensors, solar glass and wind turbines. But it will be important for China not to squander the opportunity by allowing the positive environmental impact being made by such businesses to become eroded by the slow implementation of domestic policy on climate change.

It is hoped that Japan's new Prime Minister will also be more proactive than his predecessor on reducing emissions; he has already committed to cutting greenhouse gases to zero by 2050. Aside from these domestic commitments to reduce emissions, some pressure will undoubtedly be placed on Asian businesses by the west. Apple, for example, has set a net carbon zero target from all its suppliers over the next ten years, which will force many of its component manufacturers, plenty of which are in Asia, to sharpen their environmental credentials.

Several European economies are already much further advanced than other developed world nations on the topic of putting the environment first. Denmark can hold its head up high, having placed climate action as one of its highest priorities, and expects to be entirely reliant upon renewable energy in under ten years from now. Germany is leading the market for plug-in electric car sales, whilst in Norway fully electric cars already account for around 65% of all new vehicle purchases. The recently announced €750 billion European pandemic recovery plan will ensure that around 35% is spent on 'green' projects.

Representation in portfolios

Shortly, clients will find many of the aforementioned trends captured more overtly within their portfolios. Several of the themes are already represented in the stock ideas of many of our existing active stockpicking managers, but we now wish to accentuate our commitment to environmental, sustainable energy and renewable infrastructure initiatives. This has been made possible following the emergence of more specialist investment funds that are specifically targeting the diverse range of investment opportunities in this area. These funds tend to be global in their remit, typically searching for the leading companies in each sector that are helping to steer us away from our reliance on fossil fuels and the knock-on effects on climate change.

Investment in sustainable energy and environmental funds will give access to companies at the forefront of the transition towards electrification (e.g. electric vehicle technology, batteries and energy storage), renewable energy (e.g. solar and wind energy equipment and renewable power providers) and resource efficiency (e.g. water, waste, recycling, heating and insulation).

In terms of infrastructure, our allocations will not just focus on renewable initiatives but also involve directing capital towards listed, global companies providing critical infrastructure in the developing world as countries deal with urbanisation and population growth. This includes investment in utilities (i.e. the poles, wires and pipes needed for essential services such as electricity, water and waste management), transport, housing, hospitals, education establishments and vital communication services. Infrastructure investment frequently sees cashflows that are underpinned by regulation or long-term contracts, or revenues that are often linked to inflation, so this area can not only produce high levels of dividend income but can also introduce diversification benefits to a portfolio by being less correlated to more mainstream equity market investments.

Participating in the journey

Containing and addressing the COVID-19 crisis has quite rightly been – and remains – the number one priority this year and will no doubt continue to be the case well into 2021. But as noted, there are also some other big challenges and a plethora of important global policy initiatives running concurrently beside the pandemic that are also shaping our future. Some of the ambitious government targets and timelines may well fall short or be pushed further out, but what once seemed like an impossible journey towards arresting key issues such as climate change now seem much more achievable as government policy, finance, investment and changes in societal behaviour all unite for the common good of creating a more sustainable future. We hope that clients too will feel an increased participation in this journey through our making of more targeted fund-based investments that support these global initiatives and access the longer-term opportunities presented by them.

The light at the end of the pandemic tunnel is not just shining more brightly, it is also green.

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CL6336/20201203/1.01