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The Future is Green

The exponential growth in awareness and accountability about how we spend our money and contribute to a socially responsible world aligns with our investment decisions. ESG (Environmental, Social, Governance) has been a developing pillar in our investment valuations over the past 10 years, specifically from a climate change perspective. **A metric that was once an afterthought seen as a detractor on portfolios is now imperative to the long-term success of the global economy.**

Environmental Social and Governance are the three main factors that socially responsible investors measure when deciding whether to invest in a company. It is a generic term used in capital markets.

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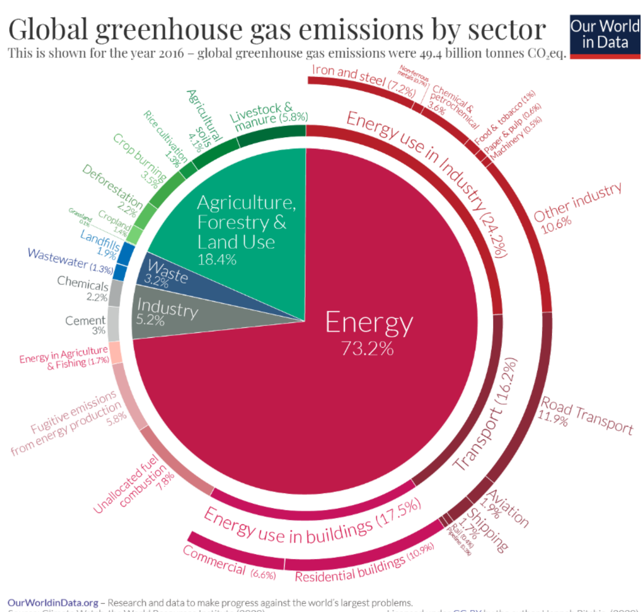
As indicated in the illustration above, in consideration of the changing purchasing triggers for investors, the environmental, social and governance attributes must be top of mind for well functioning companies and the future growth of our financial markets. In this discussion, I would like to focus a little more on the Environmental factor.

Given the potential acute and extensive impact to our well-being, it is imperative that investors and society as a whole address the issue. It certainly does not seem enough to have a fleeting conversation about global warming by the coffee machine during a heat wave.

By choosing to focus on the Environmental factor, in no way am I dismissing the Social and Governance factors. The last two are often masked by other major issues such as transparency of supply chain operations. They are addressed at annual shareholder meetings in which most of us would not engage in. More broadly speaking, the Environmental discussion is front and center and ranges widely from climate change, carbon dioxide emissions, violent weather patterns, pressures on natural resources (water, biodiversity, forestry, etc), to pollution and waste management. These are all interrelated issues that, when tipping points are reached, intensify the other factors.

To put this in context, greenhouse gases in the Earth's atmosphere contribute to the greenhouse, or blanket effect. These gases surround our planet and insulate it, having the same metaphorical effect as a blanket. The sun naturally warms the surface of the Earth and the blanket traps this energy preventing it from naturally escaping back into space. Mounting evidence demonstrates that human activity in capital intensive and carbon emitting sectors has increased as populations continue to grow. This in turn disrupts the balance in our atmosphere and results in increased temperatures.

Global Impacts will be far-reaching and not limited to increased heat, rendering living conditions uninhabitable in parts of the globe, violent storms and rising sea levels.



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Let us look at some recent data demonstrating the seriousness of this issue:

- 295 billion potential work hours lost because of heat waves in 2020
- 345k deaths of people age 65 or older due to heat waves (80% increase since 2000)
- 570 million people living less than 5 meters above sea level, exposed to risks of flooding/infectious disease due to rising sea levels
- 178 billion dollars to cover the costs of acute weather events attributed to climate change in 2020

Quantifiably speaking, if left unmanaged, the cost of climate change will be in the trillions internationally putting some sectors on the fast track to insolvency.

Almost overnight, climate change and climate risk have become a significant factor that investors must address within their portfolio allocations. **With systemic and global impacts, neglect of climate change regulation poses a grave threat to financial systems and global production**. We now have many international regulatory bodies in place to mitigate, adapt and build a secure future. Most notably, over 190 countries have joined The Paris Agreement with the common objective to combat climate change. This Agreement has created a standard to reduce greenhouse gas emissions, to limit the total temperature increase well below 2 degrees Celsius above pre-industrial levels, and to limit that increase to 1.5 degrees Celsius. Since this global consensus has come to fruition, the objective is to have net zero carbon dioxide emissions by 2050 to achieve this temperature target. It has created a domino effect for governments, multinational companies, and retail/institutional investors to work together to achieve this goal.

As a result, there is an increasing number of investment products tailored directly to ESG factors, particularly green practices. Whether it is ETFs optimized to passively track a core ESG index, or research nuanced to rank specific securities on their contribution to reduce emissions or transition out of carbon intense practices, the growth has been exponential. Investors have the ability to invest in trusted products that follow a specific environmental theme or to use standardized resources to understand the environmental risks in each of their individual securities. At the highest level, there are distinguished research platforms that determine the environmental factors with the most impact or financial significance. They can also assess the exposure of certain companies to sector-specific environmental factors (more capital-intensive energy companies are likely to be at a higher risk of greenhouse gas emissions) and how these risks are managed. Finally, supply chain issues related to the company's operations are taken into account. The results of this framework will fundamentally impact future valuations of one's specific holdings.

Increasing awareness of environmental and climate impacts is reflected in mandatory corporate disclosures, investor coalitions calling for structural change, and an accelerated transition to a greener economy. If one invests in carbon intensive sectors, one should review the transition plan of these companies, which will be under increasing scrutiny. This will impact returns over the long-term. Companies that do not comply with guidelines to meet the Net Zero goal will be left behind. Understanding emerging risks and new demands will allow companies and investors to convert and redirect their positions to above-market performance. The way forward is green.

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