SUSTAINABLE INSIGHTS: 2014

Sustainable Insight
CAPITAL MANAGEMENT

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1. What could surprise many in the West is that **China** will set the pace on environmental policy. Persistent smog in many Chinese cities cannot be disguised and rising concerns over the long-term health impacts will continue to worry many urbanites. Expect more restrictions on vehicle registrations and financial penalties on the worst industrial emitters. Watch for the development of the new pilot carbon trading schemes. Economic growth at any cost will be seen as increasingly unacceptable in the same year that China completes the world's tallest building and after the recent launch of a lunar mission.

2. We believe that the financial markets will become increasingly nervous about the issue of **stranded carbon assets**. In 2013, warnings about "unburnable carbon" were chiefly heard from the NGOs. Major banks (e.g. the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development) are phasing out lending to fossil-fuelled power plants. Some investment banks' research departments are examining the threat of stranded assets causing this issue to creep ever closer to being priced into securities and financial instruments.

3. Work is continuing by the Sustainable Accounting Standards Board (SASB) to develop **sustainable accounting standards** for ten sectors and 80+ industries. With the Health Care standards completed, we expect more releases this year, including heavyweights such as financials, technology & communications, oil & gas as well as metals & mining. We expect further debates on whether auditors should be required to include further sustainability risks in company reports and accounts, before signing-off.

4. We believe the condition of the **Earth's oceans** will receive significantly more publicity this year. With the total size of Marine Protection Areas set to increase, proposals due from the Global Ocean Commission and a range of high-level conferences (including one on the development of Arctic environments), a growing media interest looks inevitable to us. Whether or not we get bar codes on fish, informing the consumer of their source, may just be a step too far.

5. We believe the debate about **genetically modified organisms** (GMO's) will continue. Labelling requirements for products will also rise whether it is for GMO's or sugar content. However, we believe the march of techno-food development will continue, with new innovations on drought resistance, heat tolerance and yield improvements almost inevitable. Responsible Palm Oil will also march past 15% of total world production, while the world's chocolate supplies will dwindle due to lower production.

6. We anticipate that little progress will be made by politicians on **climate change policy**. Instead, we believe that the EU will focus on European Parliament elections in May. The US will spend much of the year focused on mid-term elections (November). Emerging markets will concentrate on growth initiatives. From Rio (Brazil), do not expect to hear about sustainable development; instead anticipate a cacophony about the presidential race and the football World Cup. We believe there is a glimmer of hope this year as the UN hosts a conference on the small island developing states, who understandably have rising sea levels as a major agenda item, and a re-kindling at the year-end as environmental ministers gather in Lima, Peru for the UN's annual Climate Change Conference (December, 2014) .

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7 Despite some heavyweight reports, the **Intergovernmental Panel on Climate Change** (IPCC) has struggled to get more than a few days of positive media attention in recent years. Past highlights comprise the original Rio Earth Summit back in 1992 and winning the Nobel Peace Prize in 2007, with Al Gore. Since then, it has been a struggle. But we believe this year really could be different. With important papers due for release in March, April and October, there is hope that more of the analysis will stick in the mainstream, this time around. We concede that moves towards a meaningful agreement are a long shot, but we are cautious about writing-off the chances completely. Remember that the World Trade Organization has just agreed a multilateral trade agreement, after 12 years of negotiations.

8 The **oil majors** could surprise investors by opening up the renewables investment tap, most likely in biofuels. Sure, we have recently seen a number of high profile withdrawals from alternative investments – witness BP withdrawing from US wind – but clean fuel standards are heading only one way, so Big Oil's search for lower carbon fuels will continue. With oil industry upstream capex totalling over $2 trillion from 2006-2010 and their biofuel spend accounting for 0.2% of this (source: NRDC) clean energy remains an attractive hedge for the oil majors.

9 Sticking with the oil majors we forecast that some of them will drop their objections to a **carbon tax**. Expect those companies with a higher proportion of natural gas exposure to lead the way as they foresee a competitive advantage over the more crude oil-based operators. With the recent revelation by CDP (formerly known as the Carbon Disclosure Project) that a number of oil companies are already using internal carbon pricing in their business planning, evidence of preparations for the arrival of a carbon tax are clearly underway.

10 Finally, we predict that the most hard-nosed financial sector – **the long-short hedge fund strategies** – will see the emergence of the first sustainable funds. Along with other hedge fund types, these long-short funds have kept their distances from the ESG and sustainable world. Their relentless focus on shareholder returns has made them unlikely bedfellows with the ESG screeners who talk of "non-financial" returns and "triple bottom lines". However, the explosion of ESG data and its subsequent analysis has suggested that stock returns can be influenced by particular ESG factors. This may yet attract these hedge fund bloodhounds.

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