

Spotlight on environmental challenges

Targeting solutions for the planet through impact investing

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From toxins in the air we breathe to heavy metals in our rivers, there is no shortage of environmental challenges that need to be addressed.

Awareness of these issues is undoubtedly rising, as is interest in solving them. Yet despite this progress, a rising population that consumes more is heaping unsustainable strain on the planet's limited natural resources.

There is persistent tension between fostering global economic development and reducing the cost to the environment. Addressing this issue is at the heart of the United Nations Sustainable Development Goals (UN SDGs), which codify the world's most pressing sustainability issues.

Where companies can develop solutions that enable the modern economy, while at the same time lowering our environmental footprint, we believe there are powerful opportunities for successful investments that deliver a positive environmental impact.

The urgency to find solutions

Even before the Covid-19 pandemic, the UN had called for accelerated responses to meet the SDGs by 2030¹. Meeting this challenge demands a "Decade of Action"² to deliver viable solutions to society's greatest challenges on a global scale.

As governments balance the protection of public health and the stimulation of economic activity while vaccination programmes are rolled out, there is risk that environmental challenges are overlooked. Yet despite the pandemic, we urgently need to act.

According to the World Health Organisation (WHO), air pollution accounts for an estimated seven million premature deaths every year³, with more than 80% of the

world's urban population living in places where air quality levels exceed WHO guideline limits.

Another threat to the health of people and the planet comes in the form of unsafe water. The UN has estimated that every day, two million tonnes of sewage and other effluents drain into the world's waters⁴. Contaminated water is estimated to kill more people each year than all forms of violence, including war⁵.

Have we reached a turning point?

Each year, Earth Overshoot Day is an inauspicious reminder of the pressure heaped on the planet by modern human activity. In 2020, the Global Footprint Network calculated that we overshoot our ecological boundaries for the year on 22 August.

Earth Overshoot Day is a useful indicator because it covers all the natural resources that humanity has its disposal, as well as the planet's ability to cope with human activity.

While we are currently using our natural resources 1.6 times faster than ecosystems can regenerate, we can take some heart by the fact that Earth Overshoot Day 2020 was fully three weeks later than in 2019. While not entirely cause for celebration given the circumstances, it offers hope that this represent a turning point and that the trajectory we've been on is reversible.

It points to the opportunity we have to rebuild the global economy with a greater focus on sustainability. As we look to recover economically from the pandemic, it is perhaps a unique opportunity to consider how we can recast the model for creating shared prosperity in a way that better harnesses the planet's resources over the long term.

¹ UN Sustainable Development Goals, The Sustainable Development Agenda.

² UN, "The Sustainable Development Goals Report 2020".

³ World Health Organisation (WHO), Air pollution.

⁴ UN, "Water quality and sanitation – Media brief".

⁵ UN News, "Unsafe water kills more people than war, Ban says on World Day".

In our view, we have a responsibility to ensure that the recovery is both sustainable and fair. By building a post-pandemic economy that is more resilient, global society can become less vulnerable to future shocks.

The power of ‘enabling solutions’

Companies whose products or services produce or run on clean energy, improve energy efficiency or the quality of air or water, among other environmental solutions, can help us live within our ecological boundaries without leaving people worse off.

Some provide the tools for others to deliver positive environmental impacts. When it comes to investing for impact in listed equities, we consider these types of companies ‘enablers’.

It can be challenging to quantify and distil the positive impact delivered by these companies since they allow other companies to deliver impact to society. Being one step removed from the end impact and end consumer can make measurement of their impact especially difficult.

Yet we believe these ‘enablers’ can be among the most impactful companies to invest in, since their positive impact can be amplified by other companies that utilise these products or services.

By way of illustration, take a company whose technologies enable many companies across a range of sectors to become more energy-efficient in their processes and operations.

Opportunities to make the systems underpinning the modern economy are growing as they become increasingly automated and digitised. Being connected to the ‘internet of things’ means critical data can be collected from across smarter systems and then analysed with real-time information, then used to optimise processes.

More efficient systems that reduce electricity use not only save money for the company’s customers, but also result in demonstrable environmental benefits. At scale, innovative solutions that improve efficiency have the potential to cut global carbon emissions by millions of tons each year.

Targeting measurable impact

By investing in listed equities to deliver a positive impact, alongside the pursuit of financial returns, we can invest in companies that offer solutions to the world’s most pressing challenges. To identify impactful stocks, fund managers may look to gauge the extent to which companies explicitly aim to address societal and environmental issues. Their impact must be intentional, not accidental.

Impact investors can look to gauge the positive impact that a company delivers against the SDGs. In the case of those providing environmental solutions, these could be:

- **Goal 6** – ensuring the availability and sustainable management of water and sanitation for all
- **Goal 7** – ensuring access to affordable, reliable, sustainable and modern energy for all
- **Goal 9** – building resilient infrastructure, promoting inclusive and sustainable industrialisation and fostering innovation
- **Goal 11** – making cities and human settlements inclusive, safe, resilient and sustainable.

We can map a company’s activities to a primary SDG and quantify its contribution towards achieving it. There also are likely to be secondary SDGs that a company delivers impact against, perhaps as a corollary of its principal activity.

By establishing key performance indicators that are pertinent to that company delivering an impact against that SDG – for instance, carbon emissions or water saved by using its products – we can assess whether we are making a positive contribution through our investment.

Investing in long-term solutions

While there remains a clear gulf between words and deeds, a growing number of companies recognise that they have a role to play in helping deliver progress against global sustainability challenges.

In a 2019 study by consultants PwC⁶, nearly three-quarters (72%) of the 1,141 companies analysed publicly mentioned the SDGs in their reporting. However, only 25% did so in sections that discussed business strategy. Ever fewer, just 14%, stated specific targets relating to the SDGs.

Nonetheless, more chief executives are engaging with the Global Goals. As more companies wake up to the urgency of making real-world progress, and their responsibility to act – individually and collectively – towards the 2030 targets, companies that can enable that change stand to deliver an enormous positive impact. We believe they also stand to be very successful commercially in the coming years.

Conceivably, there are multi-billion-dollar opportunities for innovative companies that can successfully deliver viable products and services that help solve some of the world's most pressing environmental challenges.

Where active investors can successfully identify these companies, they can therefore not only target a demonstrably positive impact for the planet and its people, but sustainable long-term returns for their underlying investors.

⁶ PwC, "Creating a strategy for a better world."

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