January 20th, 2019

Global Warming comes to Davos

- **The rise of ESG as a dominant theme in investment management will be clear this week**
- **A genuine commitment is required. The time of superficial efforts to quell dissent is over**

Davos starts on January 21st with an agenda entitled 'Stakeholders for a Cohesive and Sustainable World'. While the agenda title is set, there is little hope that it will turn into a statement of intent. As Micah White, the Co-creator of Occupy Wall Street (who incidentally has been invited to Davos) points out that the world needs stakeholders to commit to planting one trillion trees or targets that decrease carbon emissions by 7.6% per year for a decade.

Donald Trump is due to attend Davos. The contrast between the US leaving the Paris accords later this year and the EU pushing their new European Green Deal will be very apparent. The German government in the past week sowed its green credentials by announcing Euro 4.4bn deal to phase out coal power by 2038.

ESG matters are clearly taxing the minds of money managers; however, many talk a good story but struggle to deliver the change within their companies. Larry Fink, the CEO of Blackrock in his annual letter, makes climate change a primary focus of his insights. However, as the FT points out a report by Majority Action found that Blackrock supported just 12% of climate change resolutions at company AGMs. Also, the environmental issues caused by Blackrock's stewardship team were only discussed with 15% of businesses they met in 2019. Such ratios were some of the lowest in the industry.

As a further sign that financial services companies still drag their feet on 'green' issues, in the past few weeks, California State Teachers' retirement formally rejected calls to divest from fossil fuel investments. Calpers, the larger California state fund, announced late last year that it too was not going to divest from fossil related investments. Calpers global equity holdings alone were responsible for at least 23.5 million tons of carbon dioxide emissions in 2019. Calpers is currently aiming to have a carbon-neutral portfolio neutral by 2050 - a bit late to save the planet. As Greta Thunberg wrote recently "we don't want these things done by 2050, 2030 or even 2021, we want this done *right now*".

The higher likelihood is that people at large will have to make a difference in addressing climate change. This past week a study showed that passenger numbers flying through Swedish airports fell 4% in 2019, led by a 7% fall in domestic traffic. Train traffic, by contrast, was up 17% year-on-year through the summer months. To be fair, previous years' numbers were strong and the weakness of the Swedish crown, a new aviation tax and a soft economy may have all played their part. Swedes also already fly about five times the global average. However, their "flight shame" movement has gained momentum. In Germany, flight movements are reported to have fallen by 2.9% in 2019. This writer was pleased that a recent flight booking with Cathay Pacific had the option of an immediate carbon offset opportunity through the airline's website at the time of booking. Every little contribution is going to matter. Companies and their shareholders should be looking over their shoulders. They could be overwhelmed by a global movement.

Looking at the issues facing the planet with a short-term perspective is, perhaps, "rational" for individual companies at the local level where they face off to profit-maximising shareholders on a quarterly basis. This may be another tragic example of how the mispricing of externalities is causing irreparable harm. Longer-term thinking may well lead to sounder outcomes. Another recent example of underinvestment leading to possible damage: shrinking investment and a lack of innovation in the development of new antibiotics is "undermining efforts to combat drug-resistant infections", the World Health Organisation warned just this Friday, citing two of its own reports. Does it matter? According to United Nations estimates, "resistant infections could kill 10 million people annually by 2050 and trigger an economic slowdown to rival the financial crisis of 2008." The recent and still ongoing outbreak of a new coronavirus in China, previously unknown and undetected, is a timely reminder of the risk. We do not know yet if this is a new strain or a resistant version of an older one, but the complacent view that modern medicine has disease under control, even in the developed world, is clearly misplaced. Failing to hedge that risk by underinvesting is foolish, short-termist and downright dangerous.

Privately, many investors still express a greater or lesser extent of scepticism about what some still view as the "ESG movement". Many investment firms have realised that it is important to have a capability in this area, but still lag the credible level of expertise or engagement to fully make a difference – the examples above make the point. Full engagement, especially within the Environmental aspect, of "ESG" will have to be at a completely different level. A superficial public relations campaign will surely backfire.

Sceptics rightly point out that many measures touted today will, on their own, have a negligible impact on the overall state of affairs. No argument there. But it misses an important point: the broader public, globally, has to be engaged in the project, and be persuaded of its necessity. Without grassroots support, the planet faces a catastrophe. So, even if it does not save every ocean species if everyone stops using straws, it mobilises opinion and makes possible the furthering of the overall agenda. It also creates a feeling of camaraderie: we are all in this together.

There are also very good investment management reasons to pay attention to ESG factors in building portfolios. In conservative equity portfolios and in almost any form of credit fixed income portfolio, environmental risk is a real issue that affects the solvency of firms. When firms go bankrupt, they trigger losses to the investor. The recent bankruptcy of PG&E illustrates the point. Through internal failures, the firm's negligence contributed to the California wildfires, leading to legal liabilities that bankrupted the firm.

Therefore, a rigorous adoption of ESG screening criteria has more than the purpose of trying to save the planet. It has something for the short-termists, also: the avoidance of avoidable losses. If that is not a persuasive enough argument for full adoption, nothing is.

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