Insights into responsible investing

CREATE A POSITIVE IMPACT

Wealth Management

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ESG TRENDS FOR 2021

New unique ESG investing opportunities

The ESG investing market is hot in terms of money invested globally in equity funds with a strong focus on sustainable investing practices[1]. For example, since 2018, investments grew from $282 billion (measured in U.S. dollars) to $829 million, according to a Morningstar report.[2]

With this growth of interest comes maturity in the market. And with maturity comes more unique investing opportunities—benefitting investors. For example, to date, the largest U.S. ETF launch focusing on clean energy investing was in April. The fund is a thematic fund, focusing on companies that are considered most likely to show success as the U.S. government—and other countries participating in the Paris Agreement—establishes new low-carbon initiatives.

The impact investing category of responsible investing is also growing, especially as regulations improve fund reporting measures and investors take a greater interest in supporting issues.

Another unique opportunity comes in the form of companies embracing sustainable technology, which we feel potentially offers compelling long-term investment opportunities.

As you sit down with your financial advisor to discuss your portfolio and changing your responsible investing strategies, consider these questions to ask:

What is the anticipated timing for new ESG investing opportunities?

Time and patience are very important when it comes to new and unique investing opportunities. For example, the new ETF fund mentioned earlier that was released in April isn't yet available at RBC Wealth Management. We have a practice of carefully vetting and evaluating fund managers. This process takes time, and is designed to better inform investors about the investments they're choosing.

For investors wanting to implement ESG opportunities immediately into their portfolios, there are many vetted opportunities in existence, and an RBC Wealth Management financial advisor can help investors set that up.

What thematic opportunities are available?

Thematic investing is impact investing with a common denominator for the companies and funds investors choose. Themes may range from climate change to gender equity, and investors use portfolios with a thematic focus to invest in the future today. Ask how setting up a thematic investing portfolio can make an impact to support your goals and values.

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[1] RBC Capital Markets

[2] Data is as of February 28th, 2021; data is based on our dedicated sustainable equity fund universe, a global universe of Morningstar equity funds that have a clear & heavy emphasis on sustainable investing practices based on our review of fund names, benchmarks & investment strategies). Source: RBC US Equity Strategy, Morningstar

How will sustainable technology influence responsible investing?

We anticipate the SusTech field will grow quickly. Many opportunities already exist. From SusTech funds to ETFs to equities, different opportunities from green technologies to smart cities exist to help investors both support—and potentially benefit—companies at the forefront of developing solutions in those opportunities.

Stay informed

Changes are happening rapidly in the responsible investing field. Use this newsletter and communicate with your financial advisor to keep abreast of new investing opportunities as they become available.

ESG regulations becoming more pronounced

As ESG investing grows in popularity, governments worldwide are stepping up regulations to help investors know that when a fund manager says the fund is invested in ESG opportunities, the fund manager has to prove it.

The increasing number of government regulations are attempting to prevent "greenwashing" from continuing. Greenwashing is the act of presenting false information—or misleading investors—about how a company's products and services support environmental, social and governance practices. With greenwashing, a fund promoted as an environmental investment opportunity could, in fact, contain investments with companies regularly emitting carbon waste.

Regulations have been slow to develop, but this year the European Union's Sustainable Finance Disclosure Regulation (SFDR) requirements started in March. This regulation requires fund managers, insurers and banks that provide investing products to disclose how sustainable the products are. By the end of 2021, the EU requires existing and new funds to identify as one of the following:

1. Fully focused on sustainable initiatives with disclosure language both about how the sustainable initiatives are met and how the initiative will be measured against benchmark references.
2. Fully or partially focused on environmental, social or sustainability issues with disclosure language required.
3. Not at all focused on sustainability.

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In the United States, the Securities and Exchange Commission this year developed a task force designed to develop initiatives designed to identify ESG reporting greenwashing practices. The SEC also released in April a risk alert, reporting it had identified instances with "a lack of policies and procedures related to ESG investing; policies and procedures that did not appear to be reasonably designed to prevent violations of law, or that were not implemented; documentation of ESG-related investment decisions that was weak or unclear; and compliance programs that did not appear to be reasonably designed to guard against inaccurate ESG-related disclosures and marketing materials."

RBC Wealth Management due diligence

The good news is, global regulations are quickly coming into play. And, even better news is that RBC Wealth Management already has the RBC Global Manager Research (GMR) team in place with a due diligence guide for evaluating and rating ESG managers. This team reviews funds in the RBC Wealth Management Unified Portfolio to determine if the fund can be classified as ESG or not.

In addition to this rating, the ESG Select Portfolios specifically developed for investors interested in ESG investing are constructed using only managers for funds that were identified as ESG funds.

Spectrum of ESG integration					
	Unaware	**Aware**	**Integrated**	**Best-in-class**	**Targeted outcomes**
Key considerations:	• Little or no ESG integration	• Small ESG team • ESG is seen as a risk factor but not key to investment	• Well-resourced ESG team • ESG risks influence an investment's inclusion in portfolio • Engagement with companies held in portfolio is key to investment process	• Multiple investment professionals working on ESG integration • Portfolio avoids names with poor ESG factors or controversies • Engagement is key to investment process	• Entire team is dedicated to ESG integration • Portfolio seeks opportunistic ESG themes • Engagement is key to investment process; investments have the potential to produce measurable social and/or environmental impact
	Not considered ESG managers		ESG managers		

RBC Wealth Management's Global Manager Research team defines several investment strategies as ESG managers. Using the segmentation outlined above, the team delineates and rationalizes which managers are classified as ESG by RBC. Simply because a manager claims ESG integration does not mean RBC classifies them as an ESG manager.

Building a portfolio using ESG regulations

For investors developing an ESG investing portfolio, it's important to check how different funds are measured both in fund performance and the sustainable initiatives the fund is developed to support. Work with your financial advisor to review the GMR due diligence report, and keep watch on how the EU SFDR as well as the SEC task force grow with stronger regulations.

Governments (indirectly) supporting ESG investing

Governments around the world are discussing and implementing plans and regulations designed to promote better environmental business practices and more stable environments.

The 2021 United Nations Climate Change Conference—also known as COP26—is meeting in Glasgow in November. On the agenda is a reporting on action items governments have completed in the first five years of the Paris Agreement.

In the United States, infrastructure and carbon-reducing initiatives are proposed and being discussed. Also, in the United Kingdom, the Bank of England is adding a climate remit to monetary policy, a UK Infrastructure Bank is launching to partner with the private sector on green infrastructure investments and a working group is underway to position the UK and London as leading global markets for high-quality voluntary carbon offsets.

The American Jobs Plan

Investors interested in developing an ESG approach with their portfolios will want to watch how governments approve regulations that could affect different segments of industries. Of note, in the United States, the American Jobs Plan is proposing the following green opportunities, which will affect the overall economy:

- A plan to spend $174 billion to shift from gas-powered cars to electric vehicles
- $100 billion to update the country's electric grid. Part of this is to help alleviate disasters like the March winter storm that shut down much of Texas' electrical grid
- $35 billion earmarked for research and development to mitigate climate change
- A mandate that a proportion of all U.S. energy comes from clean sources

Another economic viewpoint to keep in mind is this proposal includes achieving funding by cutting tax credits and subsidies to fossil fuel producers.

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Behind the scenes policy changes

In addition to these infrastructure proposals, a change to the "social cost of carbon" is already underway in the United States. The new figure is $51 per ton of carbon dioxide, and is used to measure the damage that greenhouse gas pollution inflicts on society. There are reports this figure could jump as high as $125 per ton with further administration review.[3]

What this figure means is the federal government will evaluate the price of emissions for new policies, projects or regulations. Projects and policies would have to measure the amount of carbon dioxide that would be released as part of the proposal. The hope is to encourage governmental projects or policies to promote lower emissions by increasing the cost per one ton of carbon dioxide measurement.

Stay vigilant

Much of these proposed changes are just that—proposed. Time will tell how much of the initial proposals in many of these governments make it to approved laws and regulations. At RBC Wealth Management, we're taking note of how many governments have climate change and greening the economy under discussion, and how many companies are following suit.

For example, Dave McKay, President and CEO of Royal Bank of Canada, made this statement on April 8, 2021 in his address at the 152 Annual Meeting of Royal Bank of Canada.

"Here in Canada, we have a national climate strategy, and all levels of government and policymakers are actively balancing the needs of our country and its citizens. RBC is aligned with a strategy that the majority of our society has voted for. And consistent with this, we are firmly committed to accelerating the transition to net zero. ... When we do finance responsible energy projects, they must be approved within the laws, the regulations and the policies of the jurisdictions within which they operate. I would say they must also be evaluated against international standards and our own enhanced due diligence frameworks and our human rights statement."

Keep in touch with your financial advisor to get updated information on how responsible investing funds are performing in light of these governmental actions.

SusTech: Sustainability through technology

Sustainability in business isn't just about "doing good"—it's about good business sense. Technologies that mitigate the challenges of the 21st century are likely to see long-lasting waves of growth, creating long-term opportunities for companies and shareholders alike.

A number of technologies have emerged to help make the world we live in more sustainable. More are on the horizon. Many are the result of innovations and will likely enjoy secular growth, perhaps for decades.

Companies at the forefront of developing technology solutions to sustainability issues may offer compelling long-term investment opportunities.

Why sustainability as an investment theme?

Sustainability has become a key concern for companies and investors alike in recent years. It is understood that both can benefit if growth and profits are sustainable—not earned at the cost of the depletion of natural resources and the deterioration of human living conditions, nor at the expense of future generations.

For companies, sustainability has ramifications beyond their main business activities—it may also encompass the way offices and places of business are located or configured, or the manner in which products are distributed. A large majority of companies are now using their annual reports to speak to their progress on this front.

The KPMG Survey of Sustainability Reporting 2020 found that out of a survey sample of the largest 100 companies by revenues in 52 countries, 80% reported on sustainability. The U.S. leads with 98% of its 100 largest companies reporting on sustainability, compared to 92% in Canada, 85% in Western Europe and 84% in Asia-Pacific.

Investors approve. According to Morningstar, assets in sustainable funds hit a record high of $1.7 trillion at the end of 2020, up from just under $1 trillion a year earlier. The rapid growth was driven by a combination of record inflows, existing funds repurposed to make sustainability a major decision factor, and rising markets.

Making the world sustainable

The most preoccupying threats to sustainability being discussed are diminishing access to fresh water, the massive proliferation of waste from human activities and the lack of social progress.

Access to fresh water has diminished greatly over recent decades. Agriculture consumes more water than any other activity, while inefficient manufacturing processes,

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[3] The American Jobs Plan: www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan, accessed May 6, 2021

storage and transportation often result in waste. Climate change and industrialization have also played their part. According to the World Wildlife Fund, 1.1 billion people globally lack access to fresh water and as many as 2.7 billion experience water scarcity during at least one month of the year.

The huge amount of waste the world generates each year is another growing threat to sustainability and global prosperity. According to the World Bank, 2 billion tons of solid waste, was generated in 2016, the last year for which global figures are available. Of this, a mere 16% was recycled, with 46% disposed of in a manner which threatens the environment.

Rich countries burn their waste, releasing greenhouse gases, while others dump it in rivers and oceans. At the current rate, the World Economic Forum estimates that by 2050, plastics will outweigh fish.

Finally, there is a growing appreciation that a lack of social progress could also inhibit the global economy from realizing its growth potential.

A March 2021 study by Bloomberg economists suggests that global GDP could see a $20 trillion boost by 2050 if women were to enjoy the same levels of education and employment as men, relative to a baseline scenario of persistent gender inequality. Meanwhile, a Goldman Sachs study indicates that closing the 35% pay gap suffered by Black women in the U.S. could add $300 billion to U.S. GDP per year, or 1.3% of the country's $21.4 trillion economy.

Technology can help

Tackling these challenges requires the dual involvement of governments (via regulation, incentives, and funding) and the private sector. Innovation and technology will play critical roles in creating solutions to make a more sustainable global economy. Companies at the forefront of developing such solutions potentially offer compelling long-term investment opportunities. RBC Wealth Management has grouped these opportunities in five overarching themes:

- GreenTech (green technologies)
- AgriTech and FoodTech (agricultural technologies and food technologies)
- FinTech (financial technologies)
- HealthTech (health care technologies)
- Smart Cities

The table below shows how each can help tackle the threats outlined above.

SusTech technologies	Threats to sustainability			
	Climate change	Fresh water scarcity	Waste management	Lack of social progress
GreenTech	X		X	
AgriTech/FoodTech	X	X	X	X
FinTech				X
HealthTech				X
Smart Cities	X	X	X	X

Source: RBC Wealth Management

As technologies emerge that make the world more sustainable, companies at the forefront of developing technology solutions to sustainability issues may offer compelling long-term investment opportunities.

The companies and industries that revolve around innovations and new technologies can make for volatile investments. Implementing these themes can carry higher-than-average risk and should thus be viewed within the context of a well-diversified portfolio. For investors who can withstand such a higher level of risk, the secular opportunities that emerge out of these themes should contribute to portfolio performance in the long term.