Insights into responsible investing

CREATE A POSITIVE IMPACT

Wealth Management

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ESG TRENDS FOR 2021

What did and didn't happen at COP26

There was much speculation about what would happen during the COP26 meeting in Glasgow last month. Nations around the globe discussed action on climate change and more than 200 signed the new Glasgow Climate Pact, which renewed their commitment to fighting climate change. Here's a summary of what did—and didn't—happen so savvy investors can monitor commitments and understand what may impact the long-term performance of their responsible investing portfolios.

What did happen

- The International Finance Reporting Standards (IFRS) board announced a new International Sustainability Standards Board[1], which will develop accounting standards for companies around the globe when announcing ESG disclosures—specifically, what data needs to be disclosed and what the measurements will be. This is a huge step toward much-needed consensus around ESG data.
- Financial institutions (banks, insurers and investors) representing US$130 trillion in capital pledged to transform the economy to net-zero
- An agreement was made on Article 6 of the Paris Agreement, eliminating double counting on carbon credits. This eliminates a country undergoing a project that reduces its emissions (counting as one credit), but then also turning around and selling said credit on the market (counting as one credit by a second country). Now the UN will authorize a country's voluntary emissions reductions. This makes the responsible investing market more transparent.[2]

What didn't happen

- Coal survived. There was speculation there would be an agreement to completely phase out coal, but the final language was changed to "phase down" coal. China and India fought the phase-out language because they both have substantial coal reserves and very little alternative without significant aid from developed worlds.[3]
- Developed nations failed to live up to their 12-year pledge of a US$100 billion fund to aid developing nations.[4] As of the start of this year's conference, only US$80 billion had been put into the fund. The U.S. in particular is lagging in its contribution. Even further, the UN estimates that developing nations will need cumulatively US$70 billion a year to finance adaptions to climate change, with the number doubling by 2030.[5]

What's in it for investors

The responsible investing world will keep an eye on if the development of alternative fuel technology industries moves at pace with, faster than or slower than the COP26 projected phase down of coal. In its October SusTech series, the RBC Global Portfolio Advisory Committee reported GreenTech stocks had strong gains in 2020, but experienced volatility in early 2021, potentially providing investors a good opportunity to build exposure to GreenTech for a long-term investment.

We also think the IRFS' International Sustainability Standards Board addresses one of the ESG data reporting issues investors were facing. As this standards board gets established, we think investors will have an easier time evaluating both their investments and the impact those investments are making.

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In addition, the increased transparency for carbon credits should make it easier for countries and companies to achieve net zero commitments. For more background information about putting a price on carbon emissions, read the [November Global Insight] published by the RBC Global Portfolio Advisory Committee.

In summary, the ESG investing world was rapidly changing prior to the COP26 conference, and it doesn't show any signs of slowing down in changing for investors in the near future.

How to incorporate ESG into year-end planning

This is the time of year when investors traditionally undergo a thorough portfolio review. As you look at rebalancing your portfolio, also take the time to investigate if you can implement ESG investing into it.

Before you get started, check out [A workbook for the values-driven investor: ESG and responsible investing]. This workbook was produced by RBC Wealth Management as a resource to help investors align their portfolios with their personal values. It can help you determine your ESG investing path, providing you with a foundation for when you meet with your financial advisor for your annual investments review. You can also use the workbook to help your family have a conversation about defining the family legacy intentions.

As you meet with your financial advisor, consider these three questions to discuss:

1. How can I align my current investment portfolio with my values?

Your values and goals are unique to you. You'll want to sit down and discuss these with your financial advisor before you start putting your values into practice. There are a couple of different ways to approach this. One is through a negative screen where you identify companies that don't align with your values and remove them from your portfolio. Another is a positive screen, where you actively invest in companies that align with your goals and values.

The most popular way to reflect your values in an investment portfolio is to identify the right sustainable or ESG funds for you. A fund can reduce the need to analyze individual stocks and spread out risk by holding a large basket of equities. Funds that integrate ESG into their decision-making process allow you to hold a diversified portfolio of companies that have more attractive environmental or social practices than their peers.

2. How can my new ESG-focused portfolio meet both my values-based goals and my investing goals?

The growth of ESG investing opportunities in the last few years makes it easier than ever for investors to blend their values into their investing goals. ESG investing is all about recognizing the real risks that are present in your portfolio and making a personal judgment about whether you're comfortable with those risks or not for both supporting your values, and supporting your financial goals.

Beyond that, there is growing evidence that you do not have to sacrifice returns in order to integrate your ESG into your portfolio. One study conducted by a large asset manager studied the returns of 11,000 funds between 2004 and 2018. They segmented the returns of ESG funds and traditional funds and compared the results. They found that ESG funds performed at least as well as traditional funds and offered 20% less downside risk than their traditional peers.

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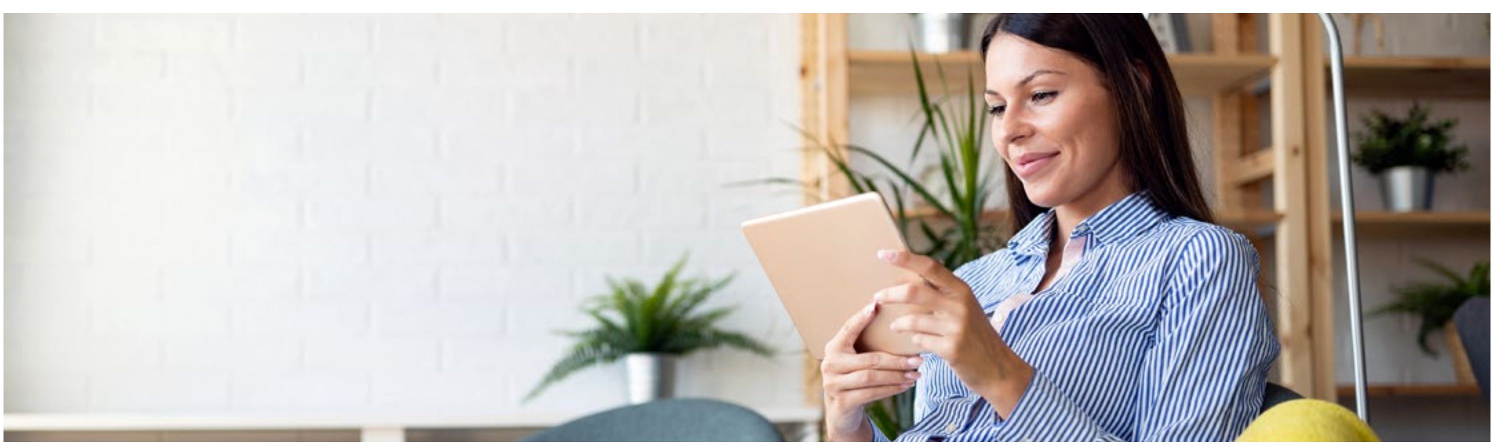

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3. How can I measure the success of my ESG investing goals?

One answer to this question you'll discuss with your financial advisor would be identical to how you measure the success of your investing goals. Together, you can set up portfolio performance desires and expectations.

ESG investing has shown to not hamper investing returns. In a recent report, research firm Morningstar explains, "Sustainable funds outperformed their conventional fund peers in 2020," with three- and five-year results looking similarly powerful. The report also showed this past year, three-quarters of sustainable funds finished in the top half of their categories.

ESG investing, however, does take a third-dimension approach to measuring investments. You'll want to discuss with your financial advisor how you measure the impact your investments are making to support your values.

As you meet with your financial advisor and discuss incorporating ESG into your portfolio, just know that whatever investment route you choose, you're essentially authoring the "story" of your own portfolio, which can lead to a positive impact for both you and the planet.

ESG investing: Don't let perfect get in the way of good enough

Many investors are watching the trend of growth in responsible investing with great interest. They like the idea of putting their money to work with companies that have good environmental, social and governance (ESG) practices, but fear of not doing it just right prevents them from taking the first step.

Our advice? Don't let perfect get in the way of good enough!

Where to start

In many cases, responsible investing is about aligning your individual values with your investments. Those values vary investor to investor.

Working with your financial advisor, you can dig into those values—whether it's addressing climate change, closing the racial wealth gap by investing in BIPOC communities, or funding companies that exhibit good governance—and make targeted investments into companies that exhibit those same values or in funds that score companies based on those principles.

Greenwashing

Even though there are ready-made funds to choose from, investors are wise to ask tough questions about the make-up of those funds.

One question we often hear from clients is "How do I know that the fund I own is truly integrating ESG into its decision-making process?"

In the third quarter of 2021, Morningstar reported that 270 new sustainable funds launched globally. During that same time period, asset managers also repurposed 346 funds to claim sustainability. That means there were 578 new "sustainable" funds in the third quarter alone.

We at RBC Wealth Management do think that there has been an increase in greenwashing over the past few years because the Morningstar report shows a significant increase in new products, while funds on the select list have not increased at the same rate. However, the notion that all portfolios claiming ESG integration are greenwashing is overly pessimistic and simply not true.

Our firm spends a lot of time vetting ESG solutions in every market around the globe and we continue to add new solutions that we deem true to ESG. Earlier this year,

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our manager due diligence team launched their ESG "Spectrum" ratings that classify asset managers as ESG or not. This process has allowed us to segment managers we believe are genuinely considering ESG factors and then make those managers available to our clients.

Investors who work with wealth managers with these kinds of resources can more easily sift through the noise.

Competing priorities

There are also times when a single investor values things that create friction in their ESG portfolio. For example, an investor values both reducing fossil fuel emissions and social equity. They may want to invest in renewable energy technologies that promise to move society away from fossil fuels. However, the technology that is required to create fossil fuel-free power is expensive and therefore less available and less feasible in socio-economically disadvantaged areas of the world.

Depending on the views of the investor, a responsible investing portfolio may require some give and take.

Utilizing ESG integration is an excellent way to have a diversified portfolio that can look at the vital ESG factors for each company owned in the portfolio.

Engagement can drive change

Yes, there are hurdles, such as avoiding greenwashing and confirming the vehicles you are investing in truly represent your vision and get a solid return on your investment. Investors need to review the actions of their asset managers to make sure their actions reflect the values they hope to integrate.

But also consider we are still in the early innings of ESG integration. Even with the considerable growth in assets lately, ESG assets are still small relative to the broader investable market.

Just because ESG investing may not be perfect doesn't mean it isn't worth starting your journey toward more sustainable investments.

How to engage in a sustainable holiday season

It probably isn't a surprise that holiday seasonal consumption creates significant waste, resulting in unneeded carbon emissions. In fact, Americans create 25% more trash between Thanksgiving and New Year's Eve than they do the rest of the year, and in the United Kingdom, 6 million trees go to waste annually, as many residents dispose of artificial trees instead of reusing them, according to Esquire Magazine.

As an investor interested in making the world more sustainable, there are many ways to individually participate during the holiday season.

Investing options

In recent years, companies are doing a lot to turn the manufacturing process of their products green. This is partly due to public sentiment, global political pressure and investors. Proxy voting is one way investors have increased sustainability at companies, and the holiday shopping season is a second way.

Investors may also want to keep aware of programs like Greenpeace International, which invited clothing manufacturers around the world to join its Detox commitment—designed to eliminate hazardous chemical use in all stages of manufacturing. In November 2019, Greenpeace reported most of 11 priority chemical groups are no longer intentionally used by the Zero Discharge

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of Hazardous Chemicals community, and Greenpeace "paused" the campaign due to this success.

It's not just the apparel industry. One popular toy maker in the U.S. is spending up to $400 million over a three-year period to reduce the amount of petroleum used in developing and packaging its product.[6] Toy companies have reported their customers—children—are asking them to clean up their footprints, resulting in a lot of research for more sustainable product development and packaging.

Actions consumers can take

Keep it real — The oil and transportation investments in developing and selling a fake tree or decorative boughs are more significant than cutting down a small, fast-growing tree and pine branches. Real trees are also biodegradable and tree farms help remove carbon dioxide from the air. If the thought of single use makes you uncomfortable, consider purchasing a potted living tree for eventual planting in your yard.

Shop as you would invest — Certified Benefit Corporations (B-Corps) are verified for social and environmental performance, transparency and accountability. Most are not public companies, so you aren't able to invest in them, but by shopping through them, your dollars still can make a difference. In addition, pay attention to actions your favorite brand companies are taking to make toys, clothing and other gifts more sustainable. As companies achieve success in moving toward net zero greenhouse gasses produced or zero discharge of hazardous chemicals, consider spending more of your holiday shopping budget with them.

Measure your footprint — RBC is working on an app called Goodside. This app is designed to measure the carbon impacts of a person's transactions. The idea is, you can identify what your personal carbon footprint is, and take actions to reduce it. Sign up today to get early access to the app.

Investors have many opportunities to support their environmental values all year long. This holiday season, consider the additional ways you can support sustainability in your gift ideas and decoration practices.

1. IFRS: https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/, accessed November 22, 2021.
2. S&P Global Platts: https://www.spglobal.com/platts/en/market-insights/latest-news/energy-transition/111421-cop26-nations-strike-deal-on-international-carbon-markets-at-glasgow-summit, accessed November 22, 2021.
3. The Conversation Canada: https://theconversation.com/coal-why-china-and-india-arent-the-climate-villains-of-cop26-171879, accessed November 22, 2021.
4. Nature Portfolio: https://www.nature.com/articles/d41586-021-02846-3, accessed November 22, 2021
5. Council on Foreign Relations: https://www.cfr.org/in-brief/cop26-climate-outcomes-successes-failures-glasgow, accessed November 22, 2021.
6. https://www.lego.com/en-us/aboutus/news/2020/september/sustainability/. Accessed on December 3, 2021.

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