The future of sustainable investment

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Since we launched our Sustainable Future funds back in 2001, our proposition to clients has been to deliver superior returns by investing in sustainable companies that are making our world cleaner, healthier and safer. We believe these businesses have better growth and greater resilience than the market understands so we can use this underappreciated advantage to deliver outperformance.

In addition, by allocating capital to these businesses and engaging with management, we can accelerate environmental and societal improvements.

With 2021 and so far in 2022 a more challenging backdrop for our SF investment process, it is worth reiterating exactly what we mean by a sustainable company and why we continue to believe there is alignment between doing good things and business success.

If you examine how change happens, there tend to be three actors at work: first, an understanding is developed of the issue and likely ways to resolve it discovered (air pollution is harmful to health, for example), then society/government lay the groundwork for action – via new regulations, taxes and other incentives – and finally companies take advantage of the opportunity to develop, commercialise and distribute solutions. This moves the dial of the possible and accelerates the process.

What is interesting from an investment point of view is that the businesses involved in this triangle tend to experience strong and persistent demand growth and face less competition due the novelty of the product or service they are delivering.

We continue to believe human ingenuity, cooperation and desire to improve our lives leads to solutions and that profit-making companies backed by capital from investment managers have a big part to play. It is reasonable, though, to ask whether this model will work for such enormous challenges as climate change, biodiversity collapse or increasing inequality. On climate change, for example, we have been aware of the issue for over 30 years, and yet the latest IPCC (Intergovernmental Panel on Climate Change) report, issued in February 2022, shows greenhouse gases at record levels and that we are already experiencing some of the predicted extreme weather-related impacts.

With over 80% of global energy still coming from fossil fuels, is this not a challenge too far for the system outlined? We believe not. Change is rarely linear and when a cheaper, better solution is developed, it can displace the old at an exponential rate. Progress has been slow but we are confident the rapid growth in renewables and adoption of electric vehicles is exactly one of these exponential transitions.

For years, renewables plodded along supported by regulation and subsidies, then there was a tipping point where, in region after region, it became the cheapest form of new energy generation. Solar since 2010 has fallen by 90% in price and onshore wind by 60% – and this cost deflation continues. The consequence of such growth is the picking off of fossil fuel generation, starting with coal. Since 2008, regardless of the US president in power, coal power has fallen 61%.

We are often asked whether we invest in turnaround situations, such as oil companies pivoting to renewables, for example. This sounds like a potentially attractive strategy but we avoid it for two reasons – first, it is rare for companies to successfully execute such a pivot (think Kodak and the digital camera, or Nokia and the smartphone) and second, we like to stick to a strategy we know well and that has demonstrated long-term success. We therefore continue with our thematic approach to select winners and avoid those losing due to inevitable change.

Over the last two decades, we feel we have made good on that initial aim of delivering superior returns by investing in sustainable companies. Along the way there have been periods of underperformance and 2021 has been one of those, but the longer-term picture backs up our view that sustainable companies can deliver superior returns. Looking to the future, we see no reason why the powerful trends in which we have invested should not persist, and so look forward to the next two decades with confidence.

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