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# Never waste a crisis: Lessons learned from COVID-19 for sustainable investment strategies

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## Introduction

Franklin Templeton and Green Templeton College, University of Oxford, recently launched a three-part series of virtual academic sessions and investor panels focusing on “The Way Forward: Navigating the COVID Challenge.” Academics from Green Templeton College will be sharing and debating their latest research with Franklin Templeton investment professionals, with the hope of delivering actionable insights. Here are some of the key takeaways from the second session on “Sustainable Investment Strategies Post-COVID” held on March 23, 2021.

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### Key takeaways

- Governments around the world responded quickly to the COVID-19 crisis in terms of providing much needed fiscal support—demonstrating signs of the political will to respond to global emergencies. The same type of response is necessary to address the climate crisis.
- The world’s problems are addressable through markets, from which profit seeking companies can create scalable solutions, while simultaneously doing good.
- Impact investing continues to create attractive long-term investment opportunities, particularly in sectors associated with renewable energy, organic food production and social infrastructure real estate.
- Real opportunities are in companies addressing the future, not those anchored in the past.
- Building back better will also involve the surface of the earth, in a literal sense. Mitigating carbon emissions will be landscape intensive, transforming the surface of the planet in tangible and visible ways.
- Tangible sustainability metrics are necessary to stress-testing investor’s portfolios against macroeconomic risks associated with the significant climate transition that lies ahead.
- All participants—governments, public institutions, the corporate sector, and consumers—have key parts to play in building sustainable economic growth.

In part two of the series, “Sustainable Investment Strategies Post-COVID,” panellists met virtually to discuss sustainable investments and the climate crisis, they assessed recent lessons learned by governments, the corporate sector, and the general public. The first session of the series focused on “Framing the COVID Challenge” and the final session will tackle “Measuring Progress towards a Better World.” This summary comes from the Franklin Templeton Investment Institute.

## The money is there...but is it where it needs to be?

If there is a positive to be taken from the global pandemic it is that the crisis was a dress rehearsal for other potential global emergencies. Broadly speaking, governments around the world were financially willing and able to respond relatively quickly to COVID-19. Local politics and the willingness of some to adhere to best-practice guidance from public health officials differed by country, but the fiscal response to the crisis was uniformly aggressive, and fast. For example, when the threat emerged in March 2020, the UK government was able to mobilize more than £200 billion (US\$275 billion) within a few months to combat the disease. This response was mirrored in other parts of the world. As of June 2020, stimulus packages globally totalled nearly US\$10 trillion.<sup>1</sup>

So, the good news is the money is there. The question is whether it is being spent in the best way to truly build economies back better. Is it being spent on green and sustainable economic

growth initiatives? Unfortunately, in many programs it is not. Roughly speaking, just one third of the USD \$10 trillion committed globally to pandemic response is associated with environmental issues such as sustainable agriculture or fossil fuel mitigation. In some areas, the spending may in fact be contributing negatively to sustainable economic growth. This is something that will need to be addressed as we look to manage climate crisis in the future.

## Corporations playing new roles

We are reminded of the economic notion of the “tragedy of the commons,” suggesting that only governments can be expected to do what is in the best interest of the common good in terms of consumption and conservation. The pandemic has thrown into question previous assumptions on the role of governments, corporations, and non-profits/non-government organizations (NGOs). Historically, companies have not been trusted to do well with

common goods. This dynamic is changing. There is an economic incentive to do so. We see companies developing business models that typically would have been left to governments or NGOs, and in doing so they are making attractive profits.

Indeed, we have seen a subset of corporates make a concerted effort to look after their stakeholders. For example, many corporations increased employee wages. Currently the US federal minimum wage is US\$7.25/hour, which does not provide a viable living income. Many corporations raised their wages independently to help constituents meet the challenges of the pandemic. In addition, many companies increased or extended health benefits, particularly around mental health. Companies also made commitments to limiting staff reduction, instead opting to reduce senior management compensation. The retail industry modified hours to facilitate early store access so that seniors could shop without crowds. Some broadband telecom companies committed to providing expanded cellular data at no charge, and to maintain internet data for all communities, especially lower-income demographics hardest hit by the pandemic. Ultimately, we saw corporations step up and provide a civic service.

Looking ahead, as it pertains to addressing the global climate crisis, the lessons of corporate institutions doing their part as they did during COVID-19 can be carried forward. Investors often imagine a false choice, that is focusing on profit versus seeking a greater good. The reality is the two are entirely compatible; indeed, the argument could be made they are inseparable for sustainability of growth. The world's problems are addressable through markets from which profit seeking companies can create scalable solutions, while simultaneously doing good.

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Mary Jane McQuillen

### Renew, recycle, real estate

We know real estate is a major contributor to climate change. The good news is we are seeing improvements in new construction practices to address green initiatives, such as carbon neutral buildings. The issue, however, is that 65% of the buildings that will exist in the year 2060 have already been built today.<sup>2</sup> So, we can’t adequately address the issue with new green construction alone. We must make improvements to the buildings that already exist. Improving existing facilities may not get the headlines that new green construction gets, but it is a critical step towards a sustainable future. We see many investment opportunities in this space. New technologies that can make older facilities more energy efficient, for example, providing financial incentives in terms of lowering utility costs.

Naturally, in renewable power there are many opportunities as well, including idiosyncratic downstream opportunities. For example, equipment manufacturers that make tracking units for solar panels. These devices autonomously track the path of the sun across the sky and move the panels accordingly, adjusting for date and time.

Waste is another area of opportunity. For example, plastic waste such as single use bottles. Tolerance for the use of plastics in packaging is at a generational low among consumers.

Companies addressing this include aluminium container manufacturers. While aluminium is not perfect from an environmental standpoint, it does present a solution to the overuse of single use plastic containers. It is infinitely recyclable and efficient in terms of energy use in the recycling process. Currently, countries like Brazil recycle 97% of aluminium containers, Europe 75%, and the United States 50%.<sup>3</sup>

While some of these companies may be deemed expensive near term, we see them as long-term plays, out to 2040 and beyond.

### Dismissing anchoring bias

We all have anchoring bias when making investment decisions, often experienced across asset classes. We are familiar with risks that have already happened, and so we seek to mitigate only those.

We are comfortable with business models that existed 10 or 20 years ago, where we can see an established track record that worked, and so we settle for similar investment opportunities. Instead, we should be considering the risks of the future. We should be looking to invest in companies being built to manage tomorrow’s problems—those addressing big risks including climate change and inequality. These are real opportunities.

In many ways, environmental, social and governance (ESG) investing gives a competitive advantage. If we consider the United Nation’s Sustainable Development Goals (SDGs), there are so many creative business models that could be developed to address them. Attractive opportunities to invest for a better planet.

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John Levy

## It's not just technology, its topography

The narrative on the street is that surviving the climate crisis will come down to the development of superior technology. Indeed, Bill Gates' recent book, *How to Avoid a Climate Disaster*, is a compendium of solutions that are technology based (not surprisingly). Fundamentally we agree that the pathways to success are technology related. Technology, and technology substitution, will play fundamental roles and represent large chunks of the resources allocated to the problem. But this is not the end of the story. The problem of building back better will also involve the surface of the earth, in a literal sense. Fundamentally, what we will need to do is transform the surface of the planet in tangible and visible ways. Mitigating carbon emissions will be landscape intensive. Wind turbines as far as the eye can see, concentrated solar power arrays covering vast swaths of land, large agricultural compounds growing biofuels, sustainable livestock and produce.

Implicitly this need for more space makes sense if we think about how we got here. In a way what we are doing is reverse engineering the efficiency of fossil fuels. Coal and oil, for example, effectively represent millions of years of sunlight concentrated and efficiently compacted deep underground. What we need to do is bring that concentration of energy to the surface, dilute it over large landscapes, and access it daily for use. Essentially, that is what technologies like wind power and solar do. In this way it is easy to recognize that developing these technologies to their full potential will have a significant impact on the landscape.

## The challenges of measuring real impact

A continuing challenge we see with ESG investments is the difficulty of quantifying in a meaningful way the real ecological impact we are making. For example, we can invest in programs designed to minimize deforestation, assuming that by protecting forests we will be absorbing more carbon from the atmosphere. But are we truly absorbing more carbon? That is what ultimately matters if we intend to change the trajectory of the planet.

So, we need to establish tangible sustainability metrics. This is a hard thing to do, but progress is being made, especially with technological developments. For example, satellites that can measure carbon stock and habitat conditions on a scale and precision unimaginable 10 years ago will help answer our carbon questions.

And, we are seeing it in some investment categories. In social infrastructure investments, for example, logic models can be used to measure outcomes and map quantifiable results to specific SDGs. The issue is defined, the strategy and tactics the investment will use to address the issue are determined, and tangible data is measured after to determine efficacy. This is how we transition from feel good investing to real good investing.

Ultimately, these metrics are necessary to stress-testing investor's portfolios against macroeconomic risks associated with the significant climate transition that lies ahead.

## Punched in the face

Mike Tyson purportedly said that "everybody has a plan until you get hit in the face." A perfect allegory for the pandemic. Governments and agencies had plans. Some worked and

some didn't. As investors we should take this experience into account. A very significant transition is ahead of us in terms of climate change, and it is impossible to consider all the risks. For example, a global mean temperature rise of 2°celcius by the end of the century could result in countries like Italy and Spain having a climate like Libya. Today, Italy is the second largest exporter of Durham wheat in the world. We doubt this will be possible in the future given these projections. In addition, significant investments in water infrastructure, energy, and agriculture will likely be necessary. These are only the most obvious of potential risks and unforeseen circumstances global warming will bring. The possibilities are endless.

The point is, ESG monitoring and activity needs to happen very quickly and become real. Sometimes it feels like conversations around the topic are rhetorical and not real. The planet is changing. It will change and in very dramatic ways. Developing countries may not have the resources to confront these changes.

## All together now...

Perhaps the biggest consensus take-away from the discussion was the need for unity. In order to achieve scalable, sustainable strategies for the long term, consumers must demand, companies must provide, and governments must facilitate transition. Just like we needed a unified response to COVID-19, we need a unified response to climate crisis.

The biggest driver of government action is citizen engagement. Citizens around the world are perhaps more uniformly engaged on climate change than on any issue in a generation or more. This is a good thing.

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Kim Catechis

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Action from citizens and the corporate sector is not sufficient. The COVID-19 pandemic and the broader

environmental crisis have shown that the state must intervene and make tough choices. The good news is we've already made progress on this front in some areas. Consider the European Union's (EU) green deal. The EU represents the biggest consumer market in the world, some 500 million people. This could potentially create a domino effect, where trade partners to the EU will have to adopt green programs as well. For example, if a

business in a third country wants to export to the EU, they will have to pay attention to carbon tax, and so on.

If we can hold this course—we humanity and we investors are part of this—then we can be optimistic about what the next generation will find. Starting now, not in the future, we need all actors on the same page and singing from the same song book.

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The mission of the Investment Institute is to deliver research-driven insights, expert views and industry-leading events for clients and investors globally through the diverse expertise of our autonomous investment groups, select academic partners and our unique global footprint.

## Endnotes

1. Source: McKinsey & Company. "Total stimulus for the COVID-19 crisis already triple that for the entire 2008-09 recession," *Featured Insights*. June 11, 2020.
2. Source: UN Environment and International Energy Agency. 2017. *Towards a zero-emission, efficient, and resilient buildings and construction sector. Global Status Report 2017*. Nairobi: United Nations Environment Programme.
3. Source: International Aluminum Institute. 2009. *Global Aluminum Recycling: A Cornerstone of Sustainable Development*. London: IAI.

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