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Sustainable Investment

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Maintaining the pressure on companies to decarbonise

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The need for companies to decarbonise has never been so clear if we are to achieve the increasingly unlikely target of keeping global warming to a maximum increase of 1.5c as agreed in the Paris Climate Agreement of 2015.

Despite ratification of the above agreement by almost every country in the world, new data shows March of this year was the hottest on record and the 10th month in a row of record high temperatures. Meanwhile the World Meteorological Society (WMO) confirmed that 2023 was the warmest year on record, with the surface temperature averaging 1.45C (+/-0.12C) above pre-industrial levels.

"*The WMO community is sounding a red alert to the world,*" said Celeste Saulo, WMO secretary general.[1] Among many unwelcome records, the warming of oceans stood out for shattering the previous record. The warming is the direct result of the increase in greenhouse gases, with CO2 concentrations now 50% higher than they were in the pre-industrial era.

There is no doubt we are changing the climate of our only planet. The consequences are predicted to be severely negative – with the added possibility of tipping points taking us into a completely new state of climate.[2]

[1] Climate change indicators reached record levels in 2023: WMO; https://wmo.int/news/media-centre/climate-change-indicators-reached-record-levels-2023-wmo

[2] Explainer: Nine 'tipping points' that could be triggered by climate change - Carbon Brief; https://www.carbonbrief.org/explainer-nine-tipping-points-that-could-be-triggered-by-climate-change/

What can we as investors do to reverse these alarming trends?

1. Invest in companies which are helping to reduce our dependence on fossil fuels – through energy efficiency and renewable energy solutions

Businesses can help to develop and distribute innovative products. The profit motive is a critical incentive to doing this rapidly. We have seen the fruits of this in the fantastic reduction in the price of renewable energies, allowing countries such as the UK to adopt wind and solar for over 35% of electricity generation in 2023. This would not have happened without the scaling up of production by profit-generating, competing industries. We back businesses such as Vestas, a leading manufacturer of wind turbines' and TopBuild, a distributor of thermal insulation for buildings across the US.

2. Avoid investing in those companies extracting fossil fuels or which depend on the growth of this type of energy system for their success.

Fundamentally it is essential there is a reduction in greenhouse gas emissions from human activities. We then need to move to bring the concentration of these in the atmosphere back down. To put it simply, we have to stop burning fuel to produce energy and associated services – heat, light, mobility etc and replace the 80% of our primary energy system which is linked to fossil fuels. Given this need, the longer-term picture for coal, oil and gas companies is challenging and they are likely to deliver poor long-term returns.

However, many commentators and leaders of these companies do not share our view. For while they talk about 'transition', the industry continues to invest for growth in oil production in the decades to come. Take for instance the speech by Amin Nasser, the CEO of the major oil company Aramco, which stated that: '*We should abandon the fantasy of phasing out oil and gas, and instead invest in them adequately, reflecting realistic demand assumptions.*'

We believe oil companies underestimate the change underway and ignore historical precedents of how rapidly one era replaces the next. For this reason, in the Sustainable Future funds we do not invest in any oil and gas companies, however much they talk about transitioning to renewables.

3. Encourage the companies we invest in to reduce their own greenhouse gas emissions

Over the 23 years of the Sustainable Future funds, we have consistently engaged with businesses that we invest in, or are likely to invest in, to encourage them to decarbonise and reduce other greenhouse gas emissions.

Most recently this was encapsulated in our *1.5C Transition Challenge* launched in 2020, for which we asked companies to develop plans for absolute emissions reduction and to develop strategies for full decarbonisation. We target the top 10 emitters for each SF strategy and have engaged with 86 companies as part of the 1.5 degree challenge.

The results have been revealing. Of the companies responsible for over 85% of the emissions in our portfolios, 60% have made meaningful, timely commitments to reduce emissions in line with the science and, of these, 53% were already involved with the Science Based Targets Initiative. And 36% had a commitment to a 1.5C pathway by 2030.

But we understand how vital it is that we keep up the pressure. So, four years later, we are continuing with this engagement initiative to assess the plans and performance of our companies, highlighting examples of leadership and also encouraging those that need to do more. We will report on progress later in the year.

While we can't claim this positive change is solely down to our engagement (many others are pushing for decarbonisation), we have seen some examples of meaningful progress. For example, Smurfit Kappa (a natural fibre packaging company) has increased its ambition from intensity targets (CO_2e per unit of sales or profit) to a more stringent absolute emissions target. We also were pleased to see that Compass Group PLC (a proactively managed business providing meals) increased the scope of its decarbonisation from only the UK to include the business as a whole.

We believe that funding the transition is a major challenge and that around 70% or more of the capital required will come from the private sector.[3] Within this, we believe that the most proactive banks (not just any bank) will play a key role. We continue to engage with the banks we own on their decarbonisation targets – especially of their loan books and the quantum of funding they provide to climate solutions – while also aiming to align their clients with the transition and a credible decarbonisation pathway. This is discussed by our team in more detail at our conference and can be viewed here.

Conclusion

Humanity faces an enormous challenge to stabilise the climate. While we will almost certainly exceed 1.5C in warming in the coming years, every 0.1C of warming we can avoid is critical. Sustainable investing is one point of influence that people can use to accelerate the change. On the Sustainable Future team, we continue to work on behalf of our clients to speed the transition by backing those businesses that will be successful as we move to a world where we no longer get our energy from burning fuel.

Peter Michaelis, Head of Sustainable Investment

[3] Source: International Energy Agency, 2021 report – Executive summary – Financing Clean Energy Transitions in Emerging and Developing Economies – Analysis - IEA

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

The Funds managed by the Sustainable Future Team:

Are expected to conform to our social and environmental criteria.

May hold overseas investments that may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of a Fund.

May hold Bonds. Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result; The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

May encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.

May invest in companies listed on the Alternative Investment Market (AIM) which is primarily for emerging or smaller companies. The rules are less demanding than those of the official List of the London Stock Exchange and therefore companies listed on AIM may carry a greater risk than a company with a full listing.

May invest in smaller companies and may invest a small proportion (less than 10%) of the Fund in unlisted securities. There may be liquidity constraints in these securities from time to time, i.e. in certain circumstances, the fund may not be able to sell a position for full value or at all in the short term. This may affect performance and could cause the fund to defer or suspend redemptions of its shares.

May, under certain circumstances, invest in derivatives, but it is not intended that their use will materially affect volatility. Derivatives are used to protect against currencies, credit and interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The use of derivatives may create leverage or gearing resulting in potentially greater volatility or fluctuations in the net asset value of the Fund. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of a fund than if the underlying investment was held instead. The use of derivative contracts may help us to control Fund volatility in both up and down markets by hedging against the general market.

The use of derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short-dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

Outside of normal conditions, may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

May be exposed to Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

Do not guarantee a level of income.

The risks detailed above are reflective of the full range of Funds managed by the Sustainable Future Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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