Insights into responsible investing

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ESG TRENDS FOR 2022

The Russia-Ukraine war and its impact on responsible investing

Russia's invasion of Ukraine in late February 2022 has impacted many, with extensive conflicts and resulting humanitarian crises. The invasion of Ukraine highlighted Europe's reliance on energy imports from Russia, and the European Union (EU) recognizes the importance of becoming independent from Russian oil, coal and gas. Russia's invasion made both the energy transition and energy security hot topics among the financial markets, and intensified the case for a just and orderly clean energy transition.

European Union's plan

On March 8, 2022, the EU has brought forward plans for decarbonization. The European Commission published REPowerEU, its plan to achieve more affordable, secure and sustainable energy and phase out its dependence of Russian fossil fuels before 2030. Over the next year, the EU aims to cut reliance on Russian gas imports by two-thirds through gas storage and a faster shift to renewable energy sources, according to the Washington State Journal. The European Commission revealed that the EU intends to have renewables account for 40% of its energy supply by 2030 to address the climate crisis. Diversification of energy supplies, accelerating the roll out of green energy technologies, and reducing demand of energy should help the EU reach energy independence.

Asset managers

Asset managers have joined a global effort to isolate Russia from the capital markets, severing financial, business and operational ties. Globally, governments have imposed sanctions, multiple companies have suspended operations in Russia, and companies and governments have re-evaluated their dependencies. From an ESG perspective, multiple factors have become more prominent due to the armed conflict, including energy policy, human rights, defense, corruption and global governance. The effect on energy is of particular concern to the ESG investor, as they typically have structural underweights to traditional energy and over weights to alternative energy.

In the near term, reducing dependence on imported natural gas will likely require the utilization of all available energy sources. However, as countries scramble to find new sources of energy, it may lead to increased consumption of coal, oil and gas for many countries, slowing down the global progress toward net zero in the short-term. Crude oil hit an all-time high during the month of March, and nickel, a key metal of stainless steel and EV batteries, spiked in price following Russia's invasion. According to Bloomberg, Russia is the world's third-largest producer of nickel and largest exporter of refined nickel metal.

The energy transition is representing a security issue, not just an environmental one. Accelerating the green transition would help reduce emissions and dependency on imported fossil fuels, while protecting against price hikes. Higher commodity and energy prices are disrupting the economy, and may result in increased oil production and drilling over the next few years as the transition unfolds. The Wall Street Journal reports that many western nations are planning to release oil from reserves in a bid to tame prices and meet demand. Over the next few years, increased production of oil will likely be needed to replace reserves and serve industries that continue to heavily rely on fossil fuels.

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Due to an already fragile supply-chain from the COVID-19 pandemic, multiple industries have been impacted and it will take time and resources to diversify sources and become energy independent. Short-term tensions may slow the pace of the climate transition, but the shift toward cleaner sources of energy remains strong for market stakeholders over the medium and longer term perspective.

Companies at the forefront of developing technology solutions to sustainability issues may offer compelling long-term opportunities. Certain companies investing in GreenTech (Green technologies) will likely benefit from the energy transition, including industries within renewables, energy storage, green hydrogen projects, transmission and distribution of electricity, and electric vehicle manufactures and charging infrastructure. Rising gas prices have led some consumers to seriously consider hybrid car models and electric vehicles (EVs) as an alternative.

Conclusion

Despite short-term volatility and tension, in the long-term, it's likely that initiatives toward the clean energy transition will represent important investment opportunities. Driven by innovation and technology, sustainability through technology (SusTech) will play a critical role in creating solutions to make a more sustainable global economy. We are seeing a transformative shift to a clean energy world as companies develop environmentally friendly technologies that present long-term GreenTech opportunities, and the next normal. While it won't be a quick or easy, the transition to net zero can make a meaningful difference in the years to come for companies and investors alike.

Proxy and engagement season is underway

When you buy equities, you become a partial business owner. As an investor in that company, you have a say in how it is governed through proxy voting. Proxy voting is occurring now during publicly traded companies' 2022 annual meetings, and voting is one of the most significant opportunities many investors have for influence.

Equity owners can engage with companies through proposing resolutions and formally asking companies to address certain issues to improve shareholder value. Proxy votes give investors and business owners the right and responsibility to have a say and communicate their views about the future of the company. Voting strengthens engagement, where investors communicate with companies about their priorities. This can lead from ambition to action. For example, the election of directors of a board's composition can change the structure of management.

What to expect for 2022 proxy season?

The 2022 proxy season is shaping up to be heavy on environmental, social and governance (ESG) matters. It is likely that more proposals will target climate change, diversity and inclusion and other social issues. Investors focus on making sure the companies they invest in are addressing concerns about material ESG factors. According to RBC Capital Markets latest ESG Scoop report, "E" and "S" topics are in focus for proposals on the ballet for 2022 with key issues across sectors, including: Political activities, lobbying, climate governance strategies and targets, and workforce diversity, equity and inclusion. This season looks to portray a number of "E" and "S" proposals on topics such as diversity, gender and racial pay gaps, and corporate purpose. CEOs and director boards can move ahead of the curve on shareholder concerns by clarifying their role and stating leadership commitments. According to Morningstar's research, more companies are adopting proposals before they make it to the proxy statement.

Ernst & Young lists three themes investors should expect in its What investors expect from the 2022 proxy season report. They include 1) board ESG competence and oversight 2) investors wanting companies to walk the talk on climate and diversity, and 3) investors seeking more candor and active listening.

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Additional issues to expect this proxy season include climate change at the top of the lists, along with evolving expectations around human capital, a shifting landscape of shareholder activism, and new trends in retail and institutional shareholder voting, according to PricewaterhouseCoopers.

Proxy activity

Compared to previous years, shareholders are more active. Investors are using their votes to direct companies to address stakeholder concerns and boards of directors are taking them seriously.

According to the Interfaith Center on Corporate Responsibility (ICCR), members are also more active. In ICCR's 2022 report, members filed a record-breaking 436 shareholder resolutions in 2022, compared to 244 during proxy season 2021. The ICCR reported that 2021 proxy season had 23 proposals that won majority support. This year's proxy season looks to be even more challenging for corporations as almost half of these resolutions address racial justice, the climate crisis, and diversity, equity and inclusion topics. Technology companies and other businesses face proposals related to data privacy and security.

Investors can expect 2022 shareholder ballots to include climate, lobbying transparency, gender and racial pay equity, diversity, and support for animal rights, according to Morningstar. More active participation is expected from both investors and index fund providers this year.

What will life be like in 2050?

We reflect on Earth Day 2022

Earth Day often reminds us to better preserve and protect our health, families, livelihood—and the planet. This Earth Day—April 22, 2022—we reflected upon Net zero: What will life be like in 2050?

Across the globe, life in 2050 will probably be very different from what we know today, much in the way that today's hyper-connected society is worlds apart from the pre-internet days of 30 years ago. You may notice the current environment shifting as the world prepares to achieve net-zero by 2050. Many countries and regional blocs, including the U.S., UK, and the European Union (EU) have committed to reach net zero by 2050; China targets 2060. Some nations have made the commitment legally binding. Meanwhile, many businesses have declared their intentions to meet this goal by 2050.

A different world

Today's younger generations will live in a world that's very different than today, with wholesale changes in their homes, modes of transport, and the landscape that surrounds them.

- **Decarbonized homes** — Homes will likely receive 95% of electricity from wind and solar power, compared to only 40% in 2020. Most fossil fuel-powered furnaces and boilers will likely be replaced with heat pumps. Innovation is needed to reduce the size of the units, while also offering heating and cooling options. Policy support will also be needed to speed up adoption and scaling of the technology. Several emerging technologies could yield significant emission reductions in the medium term.
- **Transformed transport** — It is expected that electric vehicles will be ubiquitous, but their capabilities will likely be far more efficient than current models. Charging technology will continue to evolve with the possibilities of wireless capabilities and charging while the vehicle is being driven. Additionally, electric trains powered by hydrogen are expected to roll out more widely.
- **Reshaped landscape** — The landscape of 2050 will be different beyond simply the further proliferation of wind turbines and solar panels, which have already become prevalent over the years. Travelers may see tram-style overhead power cables hovering above a truck lane on the highway—turning it into an electric motorway.

  In addition, direct air capture (DAC) facilities, which extract carbon dioxide directly from the air will likely be built on the edge of urban areas. A cheaper option to removing carbon dioxide is planting trees, which can help store atmospheric carbon. Tree planting may be cost-effective, but it may not be the most efficient method to pull carbon dioxide from the air. Moreover, trees can burn in wildfires or be cut down, causing much of the stored carbon to be released. Simply, reforestation cannot reduce emissions on its own.
- **Industries in pursuit of greening of the economy** — Some industries set to benefit from the energy transition. See chart:

Some industries to potentially benefit from the energy transition

A wide range of industries are working toward achieving the greening of the economy.

Transformation	Industry
Renewables	• Independent wind farm operators • Wind turbines • Utility companies with expertise in renewable power • Solar panel equipment manufacturers • Semiconductor manufacturers • Software • Monitoring systems
Energy storage	• Battery systems operators • Battery manufacturers
Transmission/distribution	• Transmission systems managers • Electric cable manufacturers • Power equipment manufacturers (e.g., subsgtations, transformers) •Electricity distribution companies
Electric vehicles	• Manufacturers and operators of charging infrastructure • Parts manufacturers
Hydrogen	• Industrial gases companies
Heat pumps/eHighways	• Industrial conglomerates
Engineered timber frames	• Building materials companies • Wood products companies

Source: RBC Wealth Management

Achieving net zero is a huge task with enormous challenges. One of these is the hefty price tag spread over 30 years. Certainly, the cost of inaction could very well be higher than the investment needed.

It is an encouraging sign that at the recent UN climate summit COP26, not only did nations pledge to meet net-zero targets by 2050, but so did more than 5,000 businesses. Net-zero represents both risks and opportunities for investors and companies. High emissions companies that do not adapt are likely to incur difficulties. Those that adapt or develop new technologies—if given support to reach commercialization—will likely find themselves in a position to benefit from this transformation.

Interest in ESG is not going away anytime soon

ESG investment is more than a fad, according to three survey results conducted in the last year. While approaches and definitions vary around the world, not only are investing opportunities growing year to year, but so is investor demand.

Results from new surveys conducted by RBC Wealth Management and RBC Global Asset Management showcase how much investors can anticipate the ESG investment world to continue growing in the near future. Three surveys highlight that demand for ESG knowledge and information continues to be a big topic of interest for investors in 2022.

For example, the RBC Global Asset Management ESG in a Pandemic World 2021 Report found that 72% of global investors integrate ESG principles in their investment approach and decision-making. Investors in Europe lead the practice with 96% of respondents saying they use ESG in decision-making. Canada-based respondents dropped eight points in the last year to 81%, and U.S. respondents have plateaued between 64% and 66% for the past three years.

Correspondingly, 83% of global investors think ESG-integrated portfolios are likely to do as well or better than non-ESG-integrated portfolios. But that viewpoint drops in the U.S., with only three-quarters of investors, according to the Global Asset Management report. According to the RBC U.S. Wealth Management 2022 ESG Survey conducted with clients, half the respondents said financial performance and Return on Investment (ROI) were higher priorities compared to ESG impact. However, millennials in the U.S. have a slightly different point of view. Millennials who responded to the High-Net-Worth Millennial Survey by RBC Wealth Management were not afraid to incorporate ESG investing into their portfolios, even at the risk of immediate financial gain. In fact, 80% reported that ESG guides all or most of their investment decisions. With their long-term approach to investing, 85% of the millennials expected that over the long term, ESG-rated investments will outperform the market.

For U.S. respondents to the ESG survey, governance, corporate ethics and regulatory compliance, and transparency were the top ESG elements focused on when planning their ESG investments. Females also rated human rights and climate change as top elements. At a global level, respondents to the Global Asset Management report listed anti-corruption, cyber security and climate change as the top three elements.

These survey results highlight that the ESG trend appears to be less of a bubble and more of a long-term investment strategy for many investors around the globe. Plus, they help explain why ESG investing opportunities are growing year after year—assets are expected to reach $50 trillion by 2025, according to Bloomberg Intelligence, as well as why ESG reporting metrics are becoming a global concern, as determined by the 2021 COP26 United Nations Climate Change Conference in Glasgow.

To keep up with the demand for more knowledge about ESG investment, RBC Wealth Management advisors stay equipped with the ESG knowledge, experience and tools to support clients' goals and connect them with appropriate goal-related investment opportunities.

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