



2021: the year of climate commitments

2021 was a landmark year for both climate change policy and increasing awareness about the interaction between human activity and changes to the natural world. The way was paved by significant momentum in 2020; we saw China commit to climate neutrality, the biggest ever issuance of green bonds and the European Green New Deal. Despite the enormous progress made throughout 2020, 2021 saw issues around climate and the environment shift to centre-stage. We review some of the main events that have hit headlines over the year.

The scientists have spoken

In August, the publication of the Intergovernmental Panel on Climate Change report made waves. The largest ever report of its type, it is the culmination of over eight years of work and more than 12,000 scientific papers. This damning indictment of our climate's future was released in the run-up to COP26 and successfully focused the attention of world leaders.

The report found a near linear relationship between global warming and CO2 emissions caused by human activity. Although this had been widely acknowledged by many for some time, the science and technology now sitting behind this statement is irrefutable. It does not feel so long ago that we had a President in the White House denying the existence of climate change, so the fact that the science is no longer up for debate on the global stage has to be seen as progress.

Limiting human-induced emissions and getting to net-zero is essential if we are to limit temperature rises any further. This will be a long-term process that we can slow down, with immediate reductions in emissions leading to noticeable improvements in air quality, especially in urban areas, where time is even more of the essence.

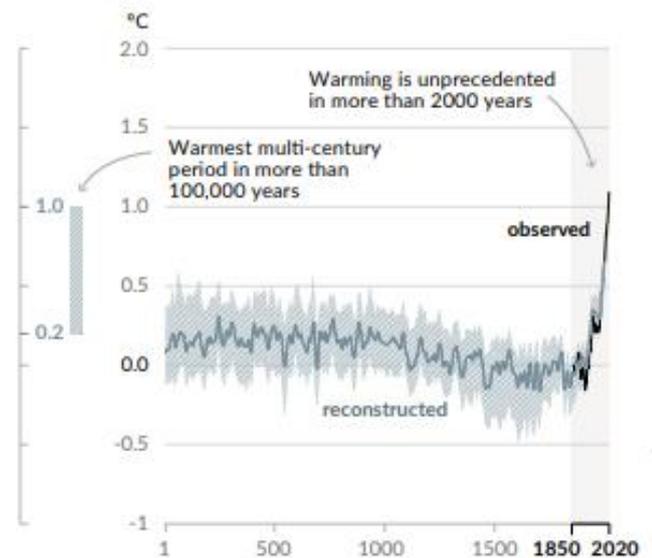
COP26

The 26th United Nations Climate Change Conference of the Parties (COP26) was hosted by the UK in Glasgow this year. The central goal of the conference was to bring together leaders from across the world to accelerate action towards the Paris Agreement, developed at COP21. Never before has a UN Climate Change Conference attracted so much attention from the world's media.

2021's COP put climate science well and truly on the map for everyday people. In the approach to COP and during the conference itself, governments from across the world released climate policies in response to growing pressure.

COP26 was the first at which the presence of business and finance dominated proceedings. The lobbying by the fossil fuel industry drew considerable criticism, but elsewhere there was an important recognition of the bi-lateral coordination between businesses and governments in getting to net-zero. This is seen clearly in the 'Glasgow Breakthroughs' that we saw published during the conference, demonstrating a number of clear commitments by governments to progress the use of clean technology across the most polluting sectors. We have been investing in these net-zero 'enabler' sectors for some time and believe they continue to be very well-placed given the announcements made at COP.

Change in global surface temperature:
reconstructed 1 – 2000 and observed 1850 - 2020



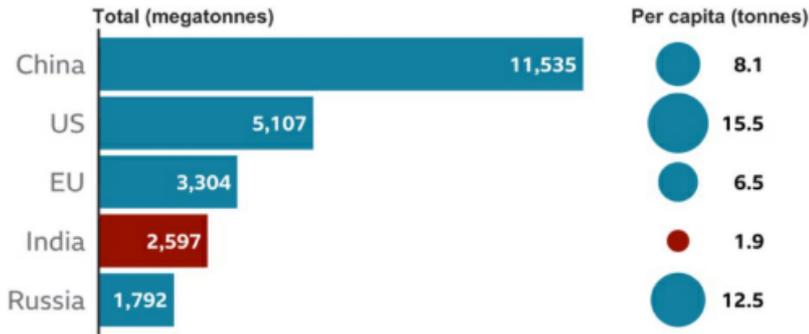
Source: IPCC

India commits to net-zero

One of the standout surprise commitments made at COP26 was from the world’s third largest emitter, India. The pledge by India to reach net-zero by 2070 is an important and extremely ambitious goal for the developing nation. In order to deliver on the country’s climate promises, India’s Prime Minister, Narendra Modi, has committed to expand India’s renewable, hydro and nuclear power capacity over the next decade to help reduce the reliance on fossil fuels. This announcement was largely unexpected and is of great importance to both India and the rest of the world. The commitments by India to accelerating investments into clean technologies will provide significant support for many of the companies held in the sustainable portfolios, both through our domestic Indian exposure and other companies based elsewhere in the world.

The nation will need to significantly increase investment into the green transition, whilst still battling high levels of poverty and social inequality in the country. Creating a national strategy to tackle both issues in a country of 1.38 billion people will be challenging.

Total and per capita emissions of CO2 per year

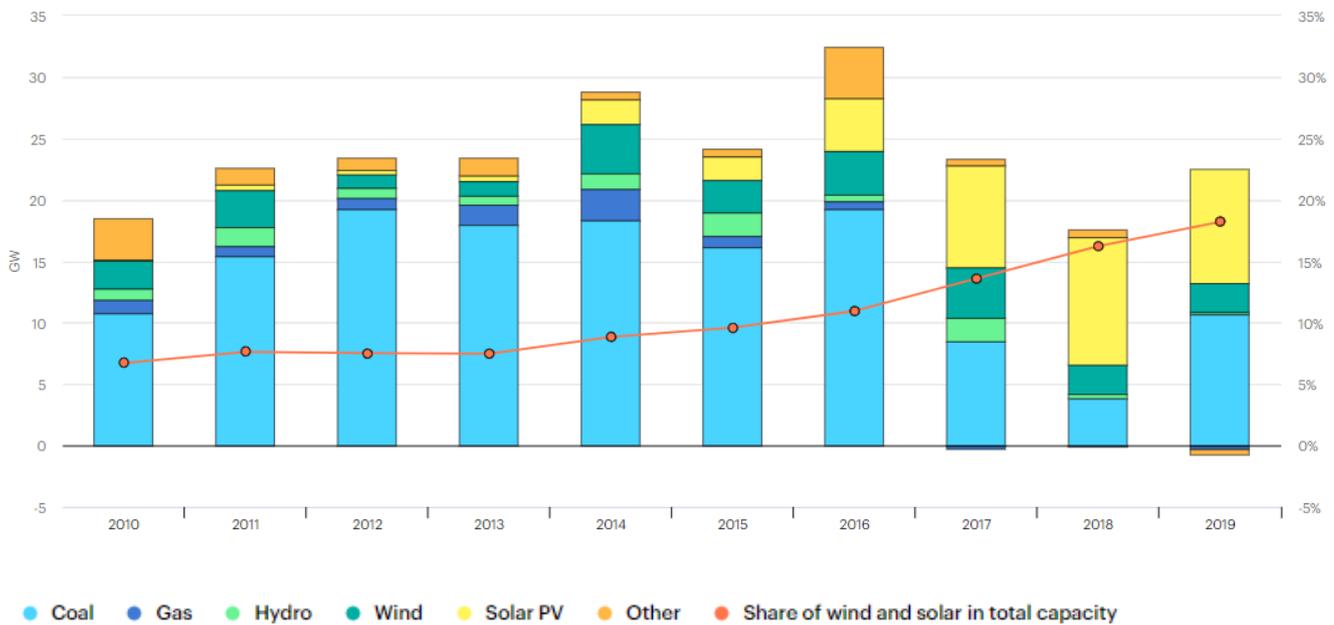


2019 data, EU includes UK
One megatonne = 1,000,000 tonnes

Source: EC, Emissions Database for Global Atmospheric Research, BBC

However, India is not starting from scratch. The below graph shows that India’s investment into renewable energy capacity and the rate of capacity growth has been outpacing that of fossil fuel power since 2017.

Annual power sector capacity additions, India, 2010 – 2019



Source: International Energy Agency

Nature-based solutions

At COP, we saw 100 world leaders from countries responsible for around 85% of the world’s forests commit to end and reverse deforestation by 2030. This landmark deal will see pledges of around £14 billion go towards protecting and restoring natural habitats and carbon sinks around the world. Of the signatories, 28 have also committed to removing deforestation from the global trade of food and other agricultural products such as palm oil and cocoa.

Our forests act as natural lungs to sequester carbon dioxide that is emitted. With deforestation comes greater environmental instability, leading to more volatile and extreme weather events which can wreak destruction and cause huge economic impacts, as we saw with the wildfires in the Amazon and Australia. Therefore, ensuring that our natural habitats are protected and restored will be vitally important in both limiting climate change and protecting our wildlife and ecosystems. It is very positive to see the rhetoric around tackling climate change become more inclusive and encompass nature-based solutions. We hope to see more focus on biodiversity by the finance industry next year.

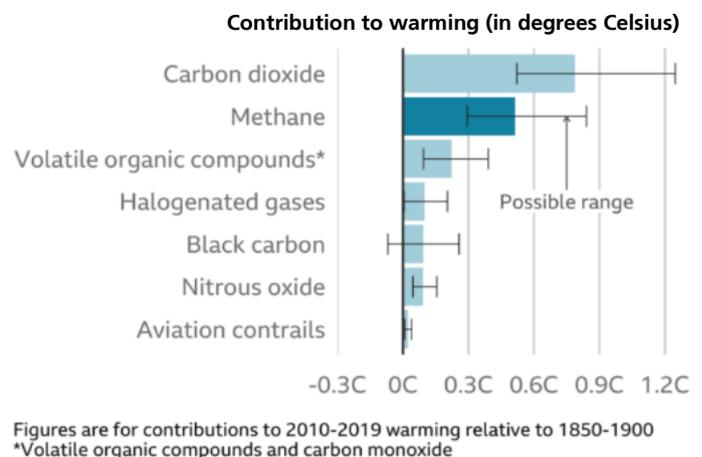
Net-zero is more than just carbon...

A proposal first posed by the EU and US has now been signed by more than 100 countries to cut methane emissions by 2030. The aim is to limit methane emissions by 30% compared with 2020 levels. These commitments cover over 70% of global GDP.

Methane has a much bigger warming effect than carbon dioxide and is currently responsible for around one third of current warming from human activities. Over a 20-year period, methane is up to 80 times more potent at warming than carbon dioxide. Although carbon reduction remains a big focus, cutting methane emissions could provide great nearer term environmental benefits. The technologies for limiting methane are viable today.

The source of methane is broadly concentrated in a few sectors – mainly agriculture and traditional energy. Agriculture is estimated to account for one quarter of all methane emissions, with cattle farming being one of the biggest sources. In terms of how we can invest in solutions to agricultural methane production, we can look to companies such as Royal DSM, which produces a product that is mixed with cattle feed. The company’s product vastly reduces the amount of cattle methane emissions when digested.

Further to this, renewable energy is a key investment theme within the sustainable portfolios, and we see it as a core and exciting investment opportunity in reducing carbon dioxide and methane emissions.



Source: IPCC Sixth Assessment Report 2021

Sovereign debt goes green

In 2021, the UK issued two green gilts with a combined value of £16 billion, making it the largest green bond issuance by a government to date. The proceeds will be used to invest in zero-emission buses, offshore wind and other schemes to decarbonise homes and buildings. Whilst we do not hold the green bonds directly in the sustainable portfolios that we run for clients, these gilts are held in several of the active bond funds in sustainable portfolios.

The UK and Europe have been at the forefront of developing robust net-zero ambitions, with green sovereign bonds being a key enabler of these ambitions. As more governments issue green bonds, it opens up a great investment opportunity to invest in bonds issued by G7 countries, whilst having the visibility that investing in a green bond provides.

Despite the positive moves that we have seen in terms of mobilising green capital, much of it has occurred in wealthier nations due to their ability to do so. To this end, it was very positive to see the US and other wealthy nations support a financing mechanism that looks to direct over \$500 million a year to support developing nations in the move away from coal-based energy and towards wind, solar and other low- and zero-carbon energy sources. This climate-directed financing will act as a crucial mechanism in supporting developing nations reduce their reliance on non-renewable energy sources.

The US commits to building back better

During 2021 we saw the ground-breaking achievement of the passing of the Build Back Better Act. This represents \$1.7 trillion, of which \$555 billion has been set aside to help fight climate change. It was not long ago, under the Trump administration, that the outlook for climate policy and addressing climate change in the US looked entirely bleak. The turnaround achieved by the Biden administration in such a small period of time is as crucial as it is encouraging.

The majority of funds allocated will go towards clean energy spending (\$320 billion) and will come in the form of tax credits for companies and consumers that install solar panels, improve the energy efficiency of buildings and purchase electric vehicles. It is estimated that these tax credits could reduce the cost of installing rooftop solar panels by as much as 30%.

There will also be financial incentives for homegrown manufacturing of clean energy technologies with the goal for more wind turbines and solar panels to be made domestically. Spending will also go towards the creation of around 300,000 jobs to restore forests and wetlands and guard against global warming.

The US is not only the world's biggest economy, but we also believe it is home to some of the highest quality businesses in the world with an abundance of opportunities across sustainable investment themes. Although many sustainable companies, and indeed the sustainable portfolios, have delivered strong returns to date, we continue to see significant runways for growth and when accounting for this future growth believe that valuations look compelling.

Focusing on the future

Despite 2021 being a watershed year of developments around climate change, a great deal needs to be done if we are to even nearly achieve the goals set within the Paris Agreement. In light of this, we believe climate change and the green transition will continue to receive ever-increasing traction and will become further entrenched into corporate and government strategies. As a result, the opportunities to invest in companies that are helping to facilitate a more climate-friendly economy continue to expand and have the capacity to offer compelling returns for investors.

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