

THE SECULAR SUSTAINABILITY SHIFT

By James Rich, Chairperson of the Sustainable Investment Committee

Key takeaways

- A secular shift toward sustainability is underway, bringing with it an evolution of business practices, products and services.
- The growing shift by companies to adopt sustainable business practices presents compelling investment opportunities.
- We believe aligning fixed income portfolios with long-term sustainability megatrends may provide the dual-benefit of generating better returns while contributing to a more sustainable world.

The sustainability imperative

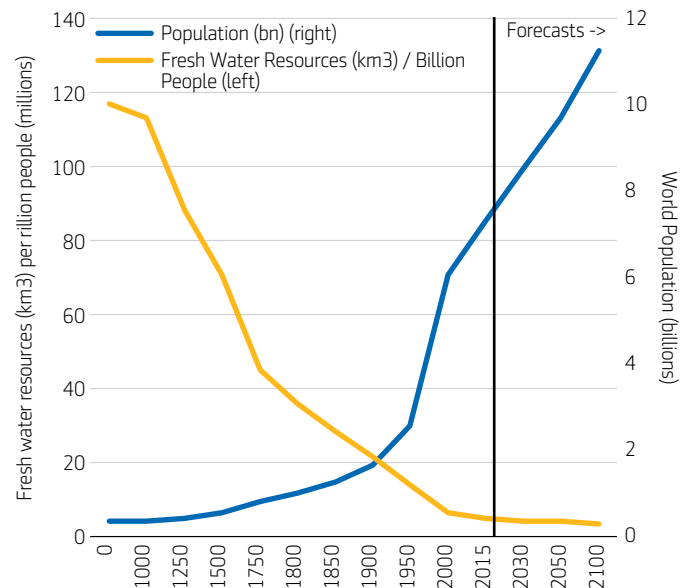
A secular shift toward sustainability is underway. Companies and countries continue to dedicate more resources to sustainable initiatives as environmental or social issues threaten business models, balance sheets and corporate survival. Moreover, consumers and investors are keenly interested in contributing to a more sustainable world. Sustainability is no longer a nice-to-have but rather an imperative.

First, let's define sustainability. To us, sustainability is a global economic state that meets the needs and aspirations of people today and in the future, while simultaneously maintaining or improving our environment and preserving a harmonious society.

For the first 300,000 years of humans' existence¹, achieving sustainability wasn't that difficult, primarily because there weren't that many of us; the world's population didn't reach one billion people until 1804². The resources required to support humankind during these times were small in absolute terms. Today, we face far more significant challenges to achieving global sustainability. A cascade of health and safety breakthroughs in the 19th and 20th centuries caused global life expectancy rates to climb from 31 years in 1900 to 65 years by 2005³. As a result, the world's population has exploded to over seven billion people today and is expected to reach over eleven billion by 2100⁴.

On the other hand, the resources available to meet our needs and aspirations are fixed or, in the case of minerals, depleting. That is, the amount of arable and inhabitable land, fresh water, clean air and useable minerals available to satisfy eleven billion people in 2100 will be the same or less than today. That means we have to do more with less, all while maintaining or improving the absolute impact on our environment and preserving a harmonious society.

Exhibit 1: An increasing global population continues to strain fresh water resources



Source: Historical population data sourced from Department of Economic and Social Affairs. Forecasted population data sourced from the United Nations. Fresh water data sources from Igor Shiklomanov's chapter "World fresh water resources" in Peter H. Gleick (editor), 1993, *Water in Crisis: A Guide to the World's Fresh Water Resources* (Oxford University Press, New York).

Of course, industrialists in the 20th century understood the "more with less" part, but failed to appreciate the full effects on our environment and society. Industrialists built 1,000 megawatt, coal-fired power plants capable of powering thousands of homes and businesses, but did not consider the effect on our climate. They developed large-scale farms capable of feeding thousands of people, but were unaware of the effect on our water and soil quality. They constructed manufacturing facilities capable of meeting growing demands for consumer goods, but did not take into account the amount of energy required to run them. None of this was sustainable.

To achieve true sustainability, we must rethink and rebuild almost every piece of our global economy. Manufacturing companies must utilize greater amounts of recycled inputs. Power companies must produce power with little or no effect on our climate. Transportation companies must move people and goods around the globe using less traditional fuels. And it's not just all about the impact on our environment, we also have to preserve a harmonious society. That means making high-quality housing, education and healthcare available to everyone at an affordable price, ensuring the equality of all citizens, and producing food that's plentiful and healthful.

¹Source: Smithsonian Institute. <http://humanorigins.si.edu/evidence/human-fossils/species/homo-sapiens>

²Source: United Nations Population Division. <http://mysite.du.edu/~rkuhn/ints4465/world-at-six-billion.pdf>, page 8.

³Source: World Health Organization. https://www.who.int/global_health_histories/seminars/presentation07.pdf, page 7.

⁴Source: United Nations Population Division. <http://www.un.org/en/sections/issues-depth/population/>

A blueprint for defining sustainable objectives

The United Nations' Sustainable Development Goals (SDGs) provide a good starting point for defining what must happen. They are a commonly agreed upon, broadly recognized set of objectives that help form a common language to discuss sustainability. These 17 goals were agreed to in 2015 by all 193 members of the UN, with a scheduled achievement of all 169 underlying targets by 2030. From ending global hunger and poverty to ensuring clean water and sanitation for all to taking immediate action on climate change, the Goals set forth a broad array of actions that must be urgently addressed to achieve global sustainability.

Drivers of the secular sustainability shift

Regardless of whether or not you believe in the need for sustainability, a secular shift toward sustainability is underway. According to Nielsen, 66% of global consumers are willing to pay more for sustainable goods⁵. Millennials, who represent the largest segment of the global population and an increasing portion of global spending and investing power, are demanding an even greater focus on sustainability. More than 70% of global millennials are willing to pay more for sustainable goods⁶. OEKO-TEX found that 40% of millennials list climate change as one of the top five things that worry them, tied with their personal finances and health at 40%⁷. And it's not just the wealthy: Nielsen also found that people earning less than \$20,000 are actually 5% more willing than those earning more than \$50,000 to pay more for products and services that come from companies who are committed to positive social and environmental efforts⁸.

Interest in sustainability extends to investing too. According to Morgan Stanley, over 80% of millennials are interested in ESG investing (compared to only about 40% of their financial advisors)⁹. Bank of America and US Trust found that 85% of millennials currently own or are considering impact investments⁹. And millennials aren't just those kids who know more about restaurants and technology: CNBC estimates that millennials will inherit or take control of \$30 trillion of assets in the coming decades¹⁰, suggesting they are a critically important investor base to consider.

Given this interest, one could argue that developing sustainable products, services and business practices may be essential to corporate survival over the long term. Consumers are demanding sustainable products and services and investors are prioritizing asset allocation to sustainable companies. As a result, sustainability, once more of a burden for some industries imposed by government regulations, appears to have become a competitive advantage for other companies.

Exhibit 2: United Nations' Sustainable Development Goals



⁵Source: 2015 Nielsen Global Corporate Sustainability Report. <https://www.nielsen.com/us/en/press-room/2015/consumer-goods-brands-that-demonstrate-commitment-to-sustainability-outperform.html>

⁶Source: 2015 Nielsen Global Corporate Sustainability Report. <https://www.nielsen.com/us/en/press-room/2015/consumer-goods-brands-that-demonstrate-commitment-to-sustainability-outperform.html>

⁷Source: "The Key To Confidence: Consumers and Textile Sustainability", OEKO-TEX® global consumer study. <https://sourcingjournal.com/topics/sustainability/millennial-consumers-really-care-sustainability-80072/>

⁸Source: Morgan Stanley Institute for Sustainable Investing, Cerulli Associates.

⁹Source: Bank of America, U.S. Trust investor survey.

¹⁰Source: CNBC. <https://www.cnbc.com/2018/06/28/wealth-transfer-baby-boomers-estate-heir-inheritance.html>

Sustainability initiatives present compelling opportunities for investors

As investors, this shift toward sustainability presents [compelling investment opportunities](#) that are hard to ignore. Al Gore, Chairman of Generation Investment Management and former US Vice President, refers to sustainability as the “single largest investment opportunity in history.” A study released by the UN indicates that nearly \$4 trillion of private investment is needed annually to achieve the SDGs by 2030. However, only \$1.4 trillion is currently being invested, suggesting an additional \$2.5 trillion of investment is needed annually (Exhibit 3).

The opportunity is indeed massive, and we believe there's value in aligning portfolios with this megatrend by investing in sustainable issuers in an effort to generate competitive returns while contributing to a more sustainable world. Supporting sustainability will likely benefit issuers as well. Companies or countries that pursue sustainable products, services or practices may have an advantage over competitors that forego sustainable efforts, offering issuers a better chance at long-term success. Overall, we believe the secular shift toward sustainable business practices, products and services will create interesting sustainable investment opportunities that should not be ignored.

Related literature

[Sustainable Investment Opportunities within Fixed Income](#)
[Enhancing ESG Integration: The Value of an Independent Research Assessment](#)
[Three Reasons to Invest Responsibly](#)
[Electric Power Sector to Drive Success of Electric Vehicles](#)
[Global Emissions Standards Driving Hybrid and Electric Vehicle Growth](#)
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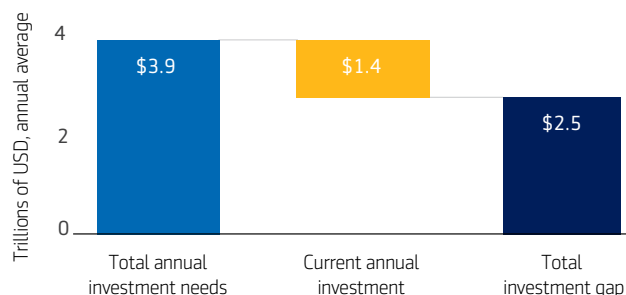
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Exhibit 3: Estimated annual investment gap in key UN SDGs



Source: United Nations Financing for SDGs - Breaking the Bottlenecks of Investment from Policy to Impact report as of June 2018.

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