Research @ Citi Podcast, Episode 12: The Evolution of Sustainable Investment

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Transcript:

Lucy Baldwin (00:02)

Welcome to the Research @ Citi Podcast. I'm Lucy Baldwin, Global Head of Research at Citi. In each podcast episode, we bring you our thought-leading views and analysis across asset classes, sectors, and economies from around the globe. Now, let me hand you over to our host today.

Elise Badoy (00:22)

Welcome to Episode 12 of our Research @ Citi Podcast Series. My name is Elise Badoy, I'm Head of Research at Citi for Europe, UK, the Middle East and Africa. I'm delighted to be joined today recording in London by Anita McBain. Anita leads our research for sustainable investment. She joined Citi in 2020. Very importantly, Anita joined us from a UK asset manager, and she does have experience across equities and fixed income integrating sustainable investing into an investment process. Anita also has specific expertise in biodiversity, and that's why the conversation with her today will be particularly interesting.

The topic for today is the evolution of sustainable investment. Now, what does this means for the unbundling of the acronym ESG? What do 2024 elections mean for the sustainability and the climate agenda? How has sustainable investment evolved over the last five years? All of these are questions that investors keep on asking us. They're also looking for market opportunities more than ever. What are expectations for sustainable investment beyond the US election into 2025, five years shy of the 2030 UN sustainable development goals? We're going to basically go through that landscape together with Anita. And so Anita, thanks very much for being with us. Before we get into the outlook for sustainability and the climate agenda, I think it's important that our listeners understand how your team is organized. What's your specific approach to integrating non-traditional climate-related disclosures into your research and outlook?

Anita McBain (02:02)

Thank you, Elise, and it is a pleasure to be here today, following on from recent podcasts on the “commodity trinity”, AI as a multiplier, and the digital transformation of the global economy — all themes that intersect with our podcast today. So we are a team of three independent research analysts, we're based in London, serving institutional investors. Our strength lies in being able to collaborate with Citi stock analysts, often with 25-plus years of deep sector expertise in global equity research, fixed income markets, quantitative analysis, and equity strategy. We're fortunate enough to get to discuss the implications of environmental governance and societal issues with our stock and sector experts across the research floor on a geographic asset class basis to understand where future risks and opportunities may exist. In one of our most-read reports this year, we constructed a model portfolio, we handed it over to our quant team to look at performance, we harnessed the expertise of our strategists to look at the defensiveness of this portfolio, and then we leveraged expertise of our equity and fixed income analysts. The research identified overlooked sectors that generated new ideas for our investor clients, seeking to identify companies that deliver financially substantive outcomes aligned to a long-term climate solution. Our research combines macro perspectives and micro research to maximize the likelihood of making research impactful for our clients.

Elise Badoy (03:38)

Thanks, Anita. I think that sort of sets the scene very well. Obviously, sometimes we hear around this a form of “ESG fatigue” and we've talked about the unbundling of the acronym, but sustainable investing is the reality. You and I get questions when we meet investors, when we tour the world trying to meet those investors. So I think it's important that we set the scene again now. Understanding the size of the investable market, what are we talking about in terms of assets under management, asset classes? Can you take us through that, Anita?

Anita McBain (04:07)

So there is an estimated $35 trillion in assets with a sustainable investment mandate. There are views that these assets will grow and exceed $50 trillion because of intergenerational wealth transfer as wealth passes down to the next generation. And future capital will seek to align with solutions, solutions that address resource scarcity linked to food and water, energy security, human security, terrestrial and marine pollution, and decarbonization, calling this the New Climate Economy. And we see this as being underpinned by regulation. Every year here at Citi Research, we also conduct a Sustainable Investment Survey to understand how this sector is evolving and what investor expectations are, where they expect to see capital flows, and what are the priority themes. And this very much informs how we write research. We also follow elections and regulation and publish views on how they impact the climate agenda, which has been very topical this year.

Elise Badoy (05:09)

And Anita, we're both based in London today, but we're making this podcast in the middle of New York Climate Week. And obviously, if I'm not mistaken, it's the first year I would say since before pandemic that we have seen such a focus around a New York–hosted Climate Week. I mean, almost — in terms of questions, in terms of interest from investors — it seems to me that it's rivaling what we normally see for a COP event. These issues aside, how do you as analysts look at these climate milestones, and how does it inform how you think and write research? Does it matter? We see some skepticism sometimes, but tell us about that.

Anita McBain (05:46)

Yes, thanks, Elise. So, indeed, it is exciting to be doing this podcast today on day two of New York Climate Week. But if we cast our minds back to 2015, when the gavel came down on the Paris Agreement and set off a series of events that positioned Europe as a first mover and leader on climate action, the UN Sustainable Development Goals were launched with a target year of 2030. So combined, these two events created momentum, set ambition, and galvanized investors and corporates into action, an evolution we continue to respond to. Recent climate negotiations — Glasgow in 2021, Sharm El-Sheikh in 2022, and Dubai in 2023 — have seen host nations like the UAE acknowledge the fact that the science is irrefutable — a really important statement. Fast forward to today, we have New York Climate Week, where we are watching high-level discussions on the impact of extreme heat on food and water systems, and how this is linked to human security. And COP29 in Azerbaijan later this year will be in November. So as analysts, it is our job to understand not just the first order level impact from these events — such as heat stress, or water scarcity or food insecurity, which may be related to a climate event or a conflict or cyber — but to help investors identify and navigate how their portfolio companies could be impacted, and are they positioned to weather the storm metaphorically and literally.

So it's our view that identifying companies, understanding these climate milestones and seeing where there is this awareness of these future risks, how these companies position themselves as better prepared to respond to a supply chain shock. And do they need to, for example, substitute a key commodity or a hardware component? And ultimately, are they delivering long-term business model resilience? Once again, it is our view that investors should not ignore these company disclosures, which directly impact operations. And investors should actively engage with their companies to understand these supply chain dislocations. If you just allow me for a moment to expand on that. What are these examples of supply chain dislocations or disruptions? We've seen them coming from the pandemic. We've seen conflict which displaces human populations and interrupts trade routes. For example, there was a container ship that obstructed the Suez Canal in 2021, and all of a sudden, we had 370 ships queuing to pass through the canal. But what we're also seeing today is flooding, flooding of rivers, and this is called fluvial floods, where excessive rainfall over an extended period of time, causes a river to exceed its capacity, such as the river Rhine.

And these examples come immediately to mind because they dislocate global supply chains and what might be a two-week event suddenly translates into a six-month delay. So we make the case that water is a vector through which we can view climate risk or put another way, water is a climate connector. If floods and droughts occur with growing frequency, then it is incumbent upon us as analysts to understand what this means for the food, energy, and water system. And how does this impact the sectors and the stocks that we here at Citi Research cover? And of course, the losses from these disasters remain largely uninsured, which is a conversation for another day. But they can result in hundreds of billions of dollars of damage to assets. This can lead to loss of human life. It can destroy livelihoods, and of course, there's the risk of spread of water-borne disease, which remains largely uninsured today.

Elise Badoy (09:34)

Our podcast is about evolution. So when it comes to investor evolution, something I heard you mention earlier, how do you see investors and corporate evolve their investment thesis to actually integrate, embrace, respond to the broader climate agenda? I'm conscious that within our listeners, we obviously have investors, but we also have obviously corporates, people working for companies, and they're asking themselves that question, how can they back the change? I know that you speak to CIOs, to senior investment managers, analysts and academics, to in the broader environment ecosystem. What are your views on future trends and what should we look at in the year ahead?

Anita McBain (10:10)

You know, we welcome the debate to better understand how investors are evolving their thinking across the investment spectrum. Today, it's our view that we're looking at an entirely different landscape, and we describe this as a period of complex implementation. And if you just allow me to unpick that for a moment, this refers to a new era within sustainable investment, where typically for us, myself, my team, when we are speaking to our investor community, our clients, we're seeing new skills arriving on desk. Not only has the world been through a pandemic and is dealing with conflict and parts of the world. We're also seeing disruptions now to our food systems, our energy systems, and our water systems. And delivering on this food energy and water security nexus is core to human security and ultimately national security, exacerbating inequalities between developed and developing nations and impacting human health. So for us as analysts and also for investors and for corporates, understanding this evolution, understanding these potential future disruptions to this food-energy-water nexus which may come from extreme weather events such as heat stress or water scarcity, or supply chain shocks, cyber or conflict, we have to take a more medium to long term view, which tends to align with how company boards and long-term investors are thinking as they seek to deliver resiliency in their business model, or if you're an investor, identify those companies that are thinking about these long-term resilience pieces and building that into their model.

And secondly, we also know from our analysis that the digital transformation that uses AI and machine learning to find these signals in the noise means that data is no longer an impediment to progress. For us as analysts, this helps us to understand where an environmental strategy intersects with value creation, or put more bluntly, is aligned to shareholders and bondholders. And companies that are able to articulate the financial materiality of their sustainability strategy, whether it is environmentally aligned or not, but using these financial metrics are better able to communicate long-term resilience to a more inquisitive, as I mentioned earlier, evolving sophisticated investor base in this period of complex implementation. And finally, just to make that point and to emphasize, we do like this word *resilience* when we're thinking about future business models. In a world that has to meet the future demands of a growing population, manage cyber threats, food insecurity, health system preparedness, resource scarcity, ecological loss, supply chain disruption, these issues will be key to their long-term business resilience. And when it comes to investors that we speak to, it will be a fair observation that the level of sophistication inside investment teams is both energizing and exciting.

Elise Badoy (13:12)

I mean obviously, Anita, I've mentioned before your expertise specifically around biodiversity, so tell us about — you know, this is a nice transition from what you just mentioned — tell us about biodiversity loss, food insecurity and water scarcity as priority themes. I know you've been publishing on that specifically. What are your thoughts as we head into the biodiversity COP16 in Colombia in October 2024?

Anita McBain (13:35)

We have been publishing on food, water, biodiversity since 2020 for several reasons. There is now a greater understanding of this inextricable link between a change in climate, biodiversity loss, food systems and water security, along with habitat loss, marine and terrestrial pollution, population growth, overfishing of our oceans — all drivers of biodiversity loss. Why is this important? Why should investors care? Well nature and the ecosystem services that it provides — such as clean air, water, pollination, food security, carbon sequestration, to name a few — underpin the functioning of a healthy economy and provide insights into key sectors dependent on this natural capital. So once again, it is incumbent upon us as analysts to ensure that we are staying close to the science, to academia and investor initiatives as we uncover topics such as biodiversity loss and why they're important.

And just to mention, we've also just finished a webinar series on biodiversity loss and we were intrigued to hear how the world of climate science overlaps with ecology and expectations for future technological advancements in AI, which will help with bio-acoustic monitoring in the oceans and on land, species identification, and ecosystem integrity. And when we speak to our colleagues across the floor, looking at the digitalization of the economy to understand how these technologies advance our effort to adapt to a change in climate and deliver solutions, we find that this era of increased transparency allows us to use satellite data to monitor fugitive methane emissions, illegal deforestation, shipping routes, and biodiversity loss, and then how this overlaps with supply chain management. So lots of interesting areas for us to look at in this world of environmental monitoring and this overlap with the digital transformation: AI as a multiplier, earth observation, just a few examples for you there, Elise.

Elise Badoy (15:29)

Well, so essentially, digitalization and AI, no surprise, could be part of the solution to tackling climate change and also I guess biodiversity loss. That sounds pretty exciting. You've mentioned, finally, one last thing I'd like to explore on this podcast is at the start of 2025, really it’s a milestone year. Can you give us your outlook and what to watch in 2025, your top priorities? You mentioned we're entering a critical moment for the climate. What are your expectations looking forward — or I guess, put another way, how are you interpreting some of the signals that you're seeing today from the investors and corporates that you speak to?

Anita McBain (16:08)

We see no slowing down in the interest from the investors — and the corporates, actually — that we speak to. We're always looking forward. We're always trying to understand the financial materiality of future trends for this part of the Citi Research franchise, across equities, fixed income, public and private markets, and developed and developing nations. We try and keep a close eye on the implications of these elections on the climate agenda and what this means for investors and markets, and how these investment strategies are aligned to the energy transition. Looking at key themes like decarbonization of the transport sector, grid infrastructure, water scarcity, biodiversity loss and food insecurity. And where possible, we attend events like London and New York Climate Week, the climate negotiations that were held here in Glasgow a few years at academic workshops.

So to your point, Elise, our expectations going forward, well next year we will see Brazil host COP30. This will mark the ten-year milestone of the Paris Agreement. Brazil is the largest, most influential economy in South America with an abundance of natural resource. So it’s our expectations, our views, that it's going to give tropical forests and biodiversity loss propulsion as they are thrust into this spotlight, bringing us into these conversations around climate, energy security, food security, and water scarcity. So 2025 is an important year for us, as it marks this critical climate milestone. We're on the other side of the 2024 election supercycle, and there's a whole host of regulation that will come into effect.

Elise Badoy (17:35)

Well, it's about time to wrap up. Today, we've obviously heard about the evolution of sustainable investment. There are expectations as a result of intergenerational wealth transfer, also future capital flows, that will seek to be more closely aligned with long-term sustainable outcomes. Investors today need to be prepared to manage these future trends and future fund flows across asset classes and geographies. I guess we know elections can influence how we think about the climate agenda. A typical long-term investment horizon extends really beyond presidential term. We are fast approaching the ten-year milestone on the Paris Agreement, taking us from Paris to Brazil, which will be the host nation in the climate negotiations next year. Stay tuned for more. Thanks for listening. Please like this podcast and also subscribe to our series Research @ Citi. Thank you very much.

Lucy Baldwin (18:31)

Thanks for joining today's episode of Research @ Citi. We at Citi Research provide the highest-quality products, services and content covering all major asset classes and economies around the world. If you enjoyed this podcast, you can follow us for regular episodes. And feel free to share, like, leave a comment, and subscribe. See you next time.

[Disclaimer] (18:56)