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MID-YEAR **OUTLOOK**

16.06.2022

DPAM

DEGROOF PETERCAM **ASSET MANAGEMENT**

SUSTAINABLE
MID-YEAR OUTLOOK

Ophélie Mortier
Chief Sustainable Investment Officer DPAM

1 ESG OUTLOOK

ESG IDENTITY CRISIS IN A COMPLEX REGULATORY ENVIRONMENT

THE **FOUR MAIN DRIVERS** OF ESG

- Regulators
- Investors
- Consumers
- Corporates

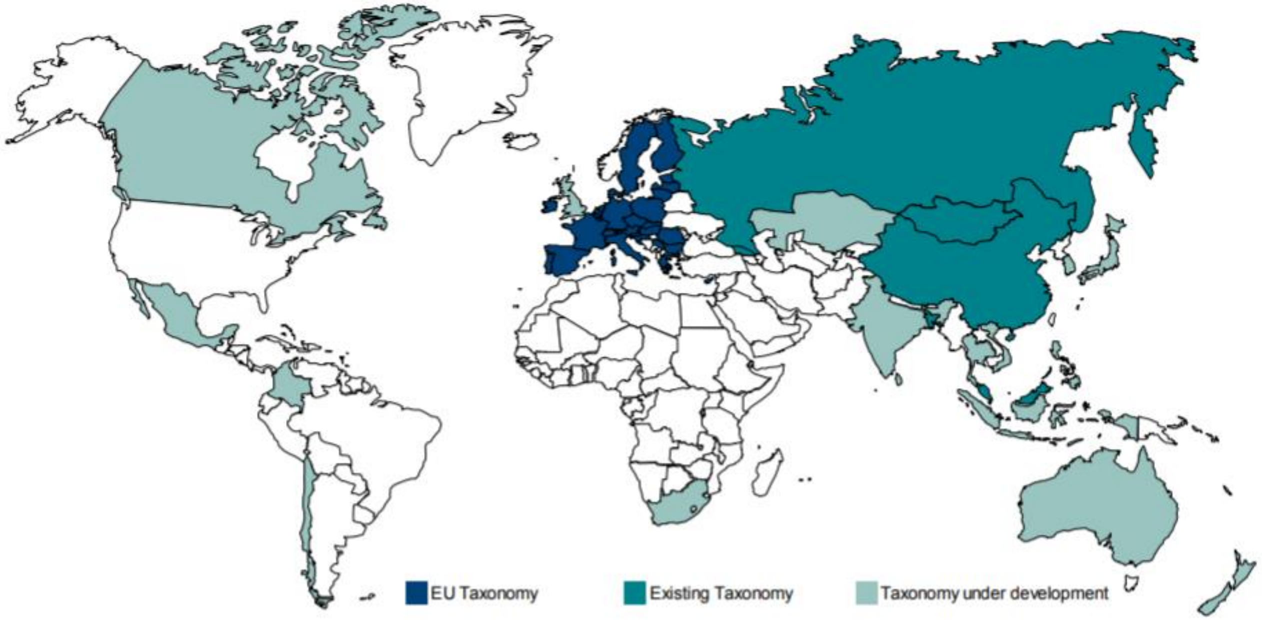
A **COMPLEX ENVIRONMENT**

- Regulatory pressure
- Energy nexus
- Ukraine/Russia crisis

UNDERSTANDING THE **COMPLEX ENVIRONMENT**

- Global **Taxonomies**
- Redirection of capital flows to **sustainable** & **inclusive** growth?

Global Taxonomies



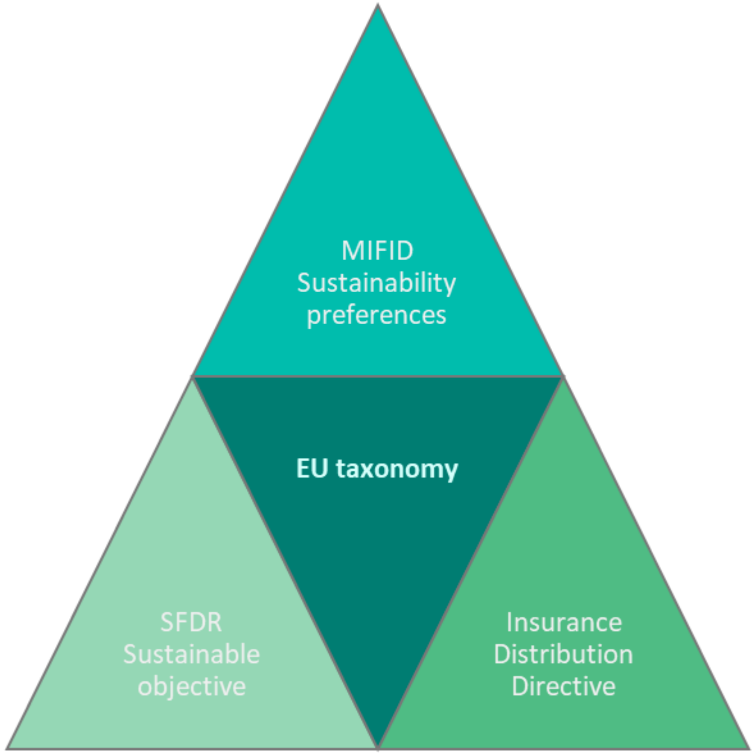
Source: Exane

UNDERSTANDING THE **COMPLEX ENVIRONMENT**

The minimum taxonomy alignment to commit in SFDR sustainable products is one of the three options for the MIFID client to express his sustainability preferences.

98 economic activities are currently covered by two pillars of the EU taxonomy: '*climate change mitigation*' & '*climate change adaptation*'.

Though these activities only involve 40% of listed companies, they still cover almost **80% of direct GHG emissions** in Europe.



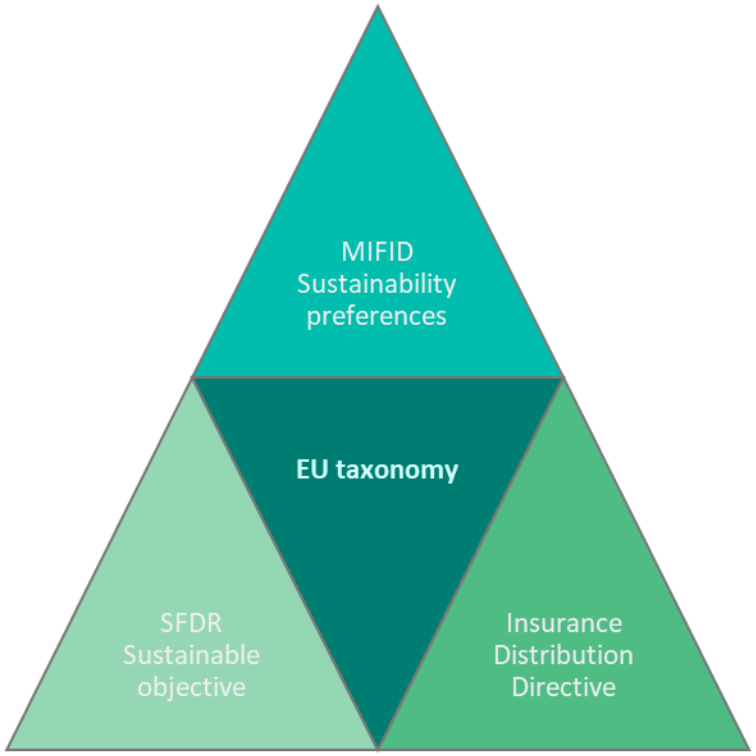
Source: DPAM

UNDERSTANDING THE **COMPLEX ENVIRONMENT**

Less than 10% of the market is currently aligned with the EU Taxonomy. This should increase with the adoption of the final part of the EU Taxonomy. Even then, it would only cover 2/3 of the EU economy. Sectors like education, financial institutions, etc. would remain uncovered.

Lack of conformity between SFDR & EU Taxonomy could create complexity for investors and lead to greenwashing.

Capex alignment is a potential forward-looking metric. It enables a shift away from fully 'green' companies and could include 'transitionary' firms.

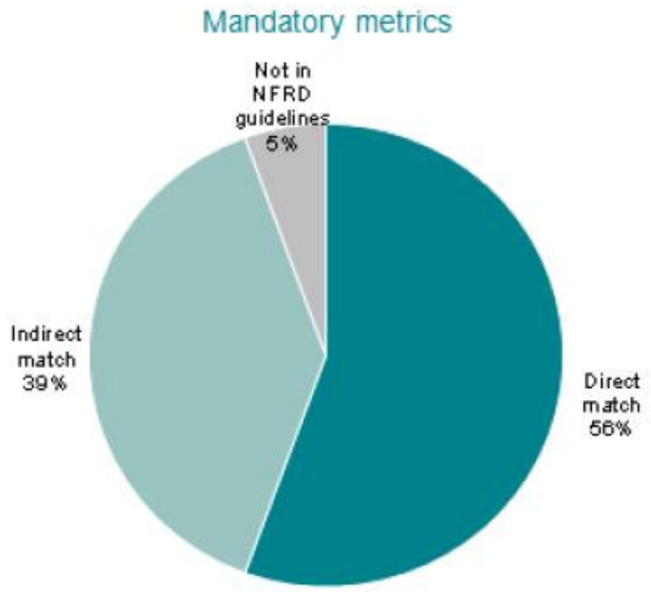


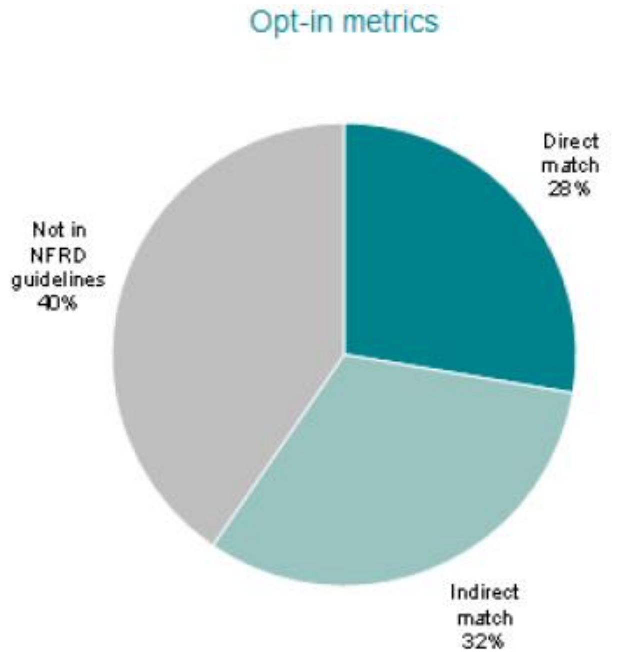
Source: DPAM

UNDERSTAND THE **COMPLEX ENVIRONMENT**

- **Data:** when the new Eldorado?
- NFRD to become CSRD will be a partial answer
- International Sustainability Standards Board (ISSB) from IFRS expected October 2022

Principal Adverse Impact indicators covered by NFRD





Source: Exane

ESG IDENTITY CRISIS IN A COMPLEX REGULATORY ENVIRONMENT

Fossil fuels exclusion – explicit or de facto – from ESG strategies (labels, Net Zero pledge, etc.) versus today's energy super cycle.

Engagement vs. **Exclusion** dilemma: 'the False Debate'

- There is environmental and moral pressure to divest to cut emissions. However, does this really move the needle?
- Fossil fuel companies are in the middle of a transition:
  - **Royal Dutch Shell:** The new, global electricity provider?
  - **TotalEnergies**: Not a simple brand name change

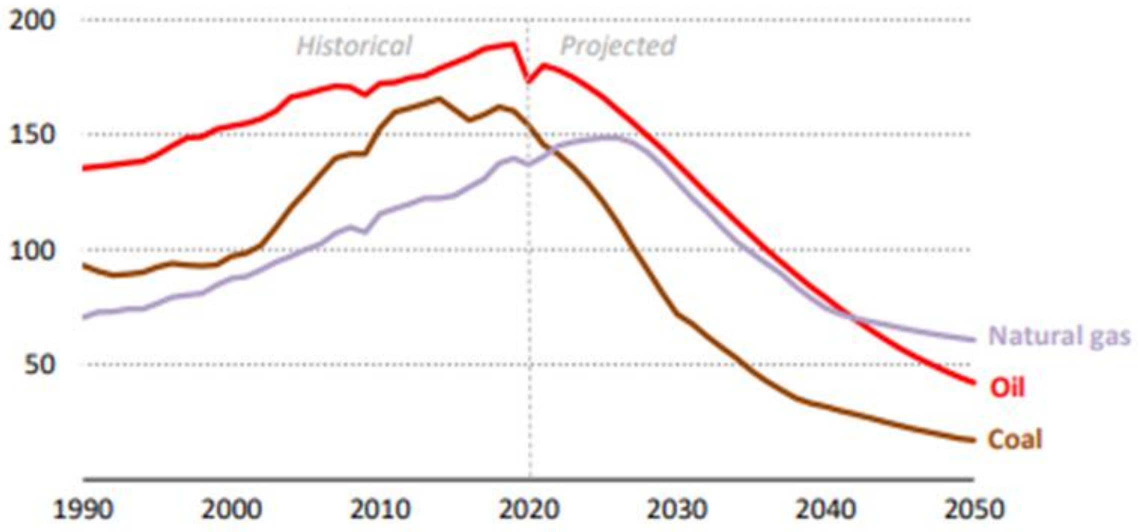
→ **Key question is: 'Who is really aligned with a 1.5° scenario?'** According to Transition Path Initiative (TPI), only Total, ENI & Occidental.

ESG IDENTITY CRISIS IN A COMPLEX REGULATORY ENVIRONMENT

- Between 2012-2021, the **S&P500 excluding fossil fuels** outperformed the **S&P500 including fossil fuels**.
- **Current energy super cycle**: Will demand for Oil & Gas be maintained even with the global commitment to Net Zero?

Between 2020 & 2050, demand for coal will fall by 90%, oil by 75% and natural gas by 55% according to the International Energy Agency (2021)

IEA net zero by 2050 scenario

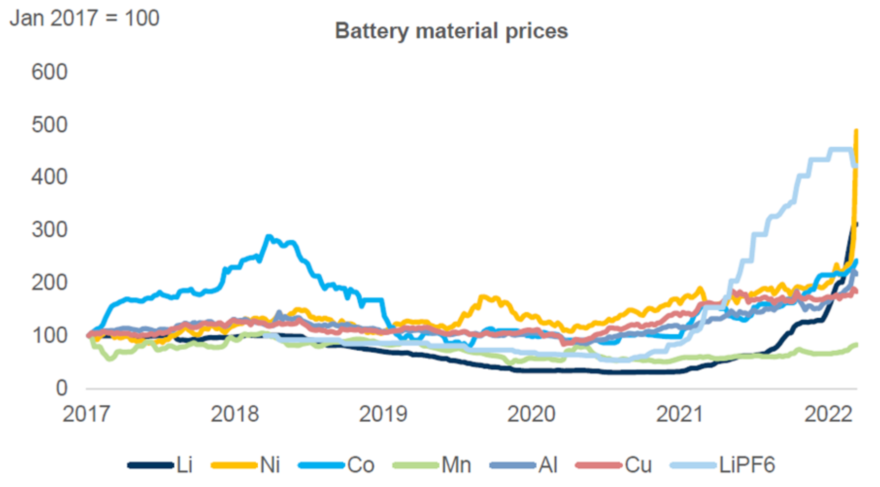


Source: JP Morgan

TRANSTION TO LOW CARBON ECONOMY =
A STRUCTURAL DRIVE FOR INFLATION?

- Example: raw materials for EV batteries

Exhibit 1: Battery raw materials have seen significant price inflation...

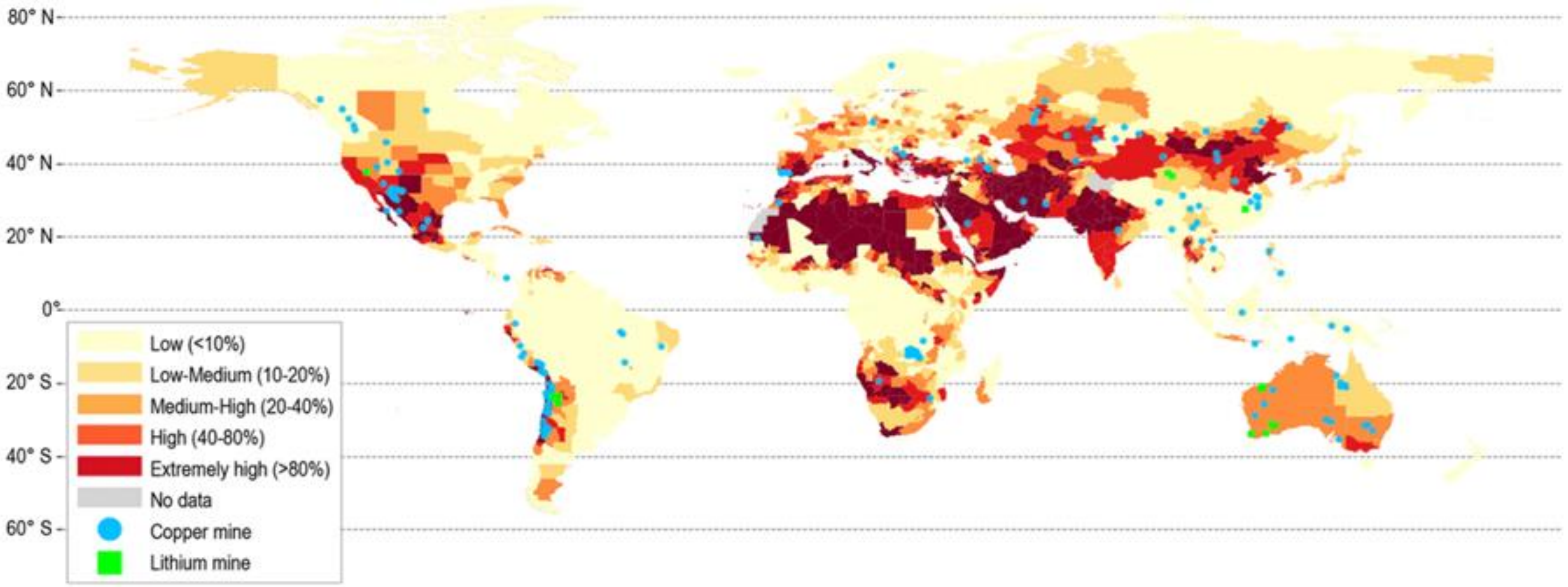


Source: Refinitiv, Wind, Goldman Sachs Global Investment Research

Source: Goldman Sachs Research

TRANSTION TO LOW CARBON ECONOMY =
A STRUCTURAL DRIVE FOR INFLATION?

- **Increasing demand for raw materials** for clean tech
  - Increasing demand for transition materials in countries with higher geopolitical risk & water stress



Source: JP Morgan, IEA

- Climate change and its disruptive **impact on food supply chains**

TRANSTION TO LOW CARBON ECONOMY =
A STRUCTURAL DRIVE FOR INFLATION?

COMING UP

- **Carbon price:** could increase costs of fossil fuels.
- **Potentially persisting underinvestment in fossil fuels.** However, this is still not the case today (if we consider the two Taxonomy objectives: Climate change mitigation & climate change adaptation).
- Low carbon tech still considered “**premium” products and more expensive in the short term.**

Carbon pricing is key for climate change policies – We need a minimum global carbon tax to incentivise renewables, and carbon storage & capture.

IS GLOBAL CARBON PRICING AN ILLUSION?

The formation of "**Climate Clubs**" (initiative of Nobel Award winner William Nordhaus in 2018):

- These are like-minded countries with similar carbon-pricing and ESG disclosure requirements.
- Such countries could allow for free trade among each other but agree on tariffs against firms from states with lower standards.

The **EU Carbon Border Adjustment Mechanism (CABM)** is comparable to the concept of Climate Clubs but faced significant difficulties in the EU Parliament.

- The tightening of the European Emissions Trading system (ETS) will likely lead to the acceleration of renewable power generation. However, it is not timed well: Industrial decarbonisation is mainly expected after 2030.

The **SEC proposal to disclose Scope 1, 2 & 3 Emissions** will also lead to a greater focus on companies' emissions.

IS GLOBAL CARBON PRICING AN ILLUSION?

- As of today, **global energy demand is greater than the total supply of renewables**.
- According to BCA Research, renewable energy growth will meet **90% of the growth in energy demand** between 2022 and 2024.
- Likely continued reliance on fossil fuels in the short term.

2 KEY MESSAGES

KEY **MESSAGES**

01

COMPLEX REGULATION

The different regulations are complex, and their timing is not harmonised.

Nevertheless, these regulations are all interconnected: The EU Taxonomy often acts as the common denominator.

The **data-challenge** is well known and should improve over time. We should not hurry the implementation of methodologies and approaches that only focus on quantitative metrics. Fundamental research (**combining qualitative analyses and engagement with issuers**) should help to avoid the side effects of this regulation.

The **evolution of the regulation**, particularly the broadening of the environmental objectives, will progressively reduce green premia.

KEY **MESSAGES**

02

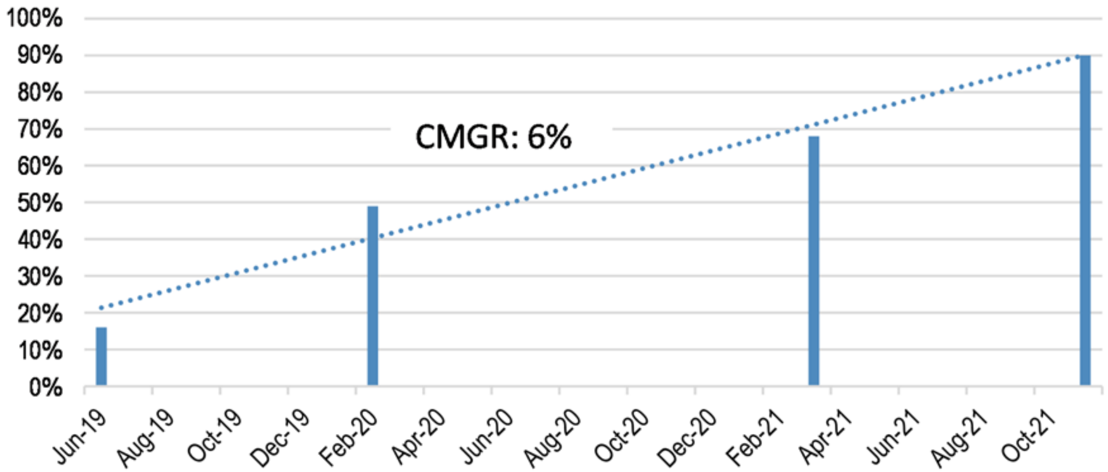
THE ENERGY SUPER CYCLE CANNOT LAST

Increasing Oil & Gas prices linked to cyclical events: More expensive fossil fuels favour the energy transition.

The search for 'double materiality' (i.e., reporting on financial matters & matters that impact the market, the environment and people) will support ESG inflows.

Net Zero Pledges are not compatible with the increasing demand for fossil fuels.

% of world GDP covered by Net Zero pledges



Source: JP Morgan, based on Net Zero Pledges

KEY **MESSAGES**

03

FOSSIL FUELS DIVESTMENT & ENGAGEMENT

The key question is the risk of stranded assets leading to:

- Climate-change risk litigation.
- Affected by the introduction of carbon pricing.
- Greater competition as clean tech becomes cheaper.

Engaging with issuers to understand their transition strategy and monitor their strategic goals is probably the best way to fulfill global net zero commitments.

KEY **MESSAGES**

04

GREEN PREMIUMS – HOW LONG WILL THEY LAST?

Green premiums for sustainable products could appear (but with nuances & not across all sectors).

- Highlights the importance of a qualitative fundamental approach with sustainable screenings and methodologies.

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Marketing Communication

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