EQUITY

How Companies Address the Climate Challenge

March 21, 2019

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As more vital signs of the impact of climate change become evident, Templeton Global Equity Group's Maarten Bloemen argues the solution requires much more than simply reducing carbon emissions. He thinks asset owners and managers have a much bigger role to play in addressing the climate change challenge. Here, he suggests a few ideas for those interested in investing in a sustainable future to consider.

Amid a rise in global temperatures and extreme weather events, there has been more acceptance of the challenges the planet faces. Governments, companies, investors and citizens around the globe have begun to take action.

Last year was the fourth-hottest year on record.[1] As the planet heats up, so does the race to mitigate the consequences of rising temperatures that have brought floods, heatwaves, wildfires, drying vegetation and drought.

We believe investors hold one of the keys to tackling climate change, and we think any solution will require more than just reducing carbon emissions.

As asset owners and managers, we have an opportunity to play our part in directing capital in ways that encourage companies to be more responsible. Our aim is to invest in companies that think about the success of their business over several decades, rather than the next quarter.

Here are some considerations that we think can help foster that thinking:

Sustainability

In our view, focusing on sustainability isn't just about reducing carbon emissions. We engage with companies to assess whether management has a credible strategy for managing climate change risks and opportunities. In our experience, even large companies are starting to think longer term about the biodiversity implications of their operations.

One good example can be seen in the actions of a major Swedish packaging solutions company. It switched to using sustainable virgin fibre packaging, produced using energy from burning waste wood.

The company felt this was more sustainable than using recycled material which requires more electricity and fossil-fuel sourced energy to produce. We've seen an increasing number of companies create innovative solutions for a growing and environmentally conscious market.

DATA POINTS HELP MEET GOALS

We use a mix of external data and proprietary analysis as we survey the investment universe for climate-change-related opportunities.

In another example we've come across, a company in water and waste management has taken active steps to improve the cleanliness of the discharge from its industrial projects. This company also takes ownership of the biodiversity in the wetlands around its facilities, turning the surrounding area into a wildlife park popular with bird watchers.

In our view, rising awareness of the impact of climate change is likely to shift investor focus to companies that are taking action now to keep in line with industry standards.

One data point we've found helpful has been the Science-Based Targets initiative (SBTi). The initiative was created to assess whether companies were doing enough to limit global temperature increases to 2°C above pre-industrial levels, the Paris Agreement's long-term goal.

Only 169 companies globally qualify today, but the SBTi focus on both internal operations and the environmental impact of a company's products provides a way for us to assess whether a company is doing enough to support the Paris Agreement's goal.

Old to New Energy

When we're looking for investment opportunities, we look more favourably on companies that have gone through significant structural changes in recent years to position their businesses for a more sustainable future.

For example, one Danish energy company on our radar has switched almost entirely out of oil and natural gas and coal derived from thermal energy to become one of its country's leading offshore windfarm operators.

Today the company is almost entirely focused on renewable energy. It finds and develops suitable sites, manages and maintains facilities and sells energy into the power grid. In our view, companies are increasingly switching to renewable energy at scale, and investors seem to be waking up to the huge potential in this industry.

War on Plastic

While a company's climate impact is our primary focus, we still look at several other environmental responsibilities. We have had direct discussions with large companies about ways in which they can—and in our eyes should—reduce plastic usage.

We've observed that the economics of plastic use is also changing. Manufacturing plastic is extremely energy-intensive, but we think it's likely that effective carbon pricing could increase cost pressures and dissuade companies from manufacturing as much plastic.

Addressing Climate Change Is a Long-Term Endeavour

One of the key challenges we have is determining which companies truly believe in creating meaningful change through their products and operations.

With increasing focus on companies' environmental credentials, there may be a temptation for some companies to exaggerate their commitment to sustainability. For us, understanding whether sustainability is really in a company's DNA is crucial.

To overcome this challenge, our approach is to meet not just with management, but with people at all levels of the organisation. We go out on site visits and speak to regional managers or workers on the shop floor. As such, we as asset owners and managers can collaborate our efforts in encouraging companies to be more responsible when it comes to a sustainable future.

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What Are the Risks?

All investments involve risks, including potential loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. To the extent a portfolio focuses on particular countries, regions, industries, sectors or types of investment from time to time, it may be subject to greater risks of adverse developments in such areas of focus than a portfolio that invests in a wider variety of countries, regions, industries, sectors or investments. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments; investments in emerging markets involve heightened risks related to the same factors.

1. Source: National Oceanic and Atmospheric Administration (NOAA), February 2019.