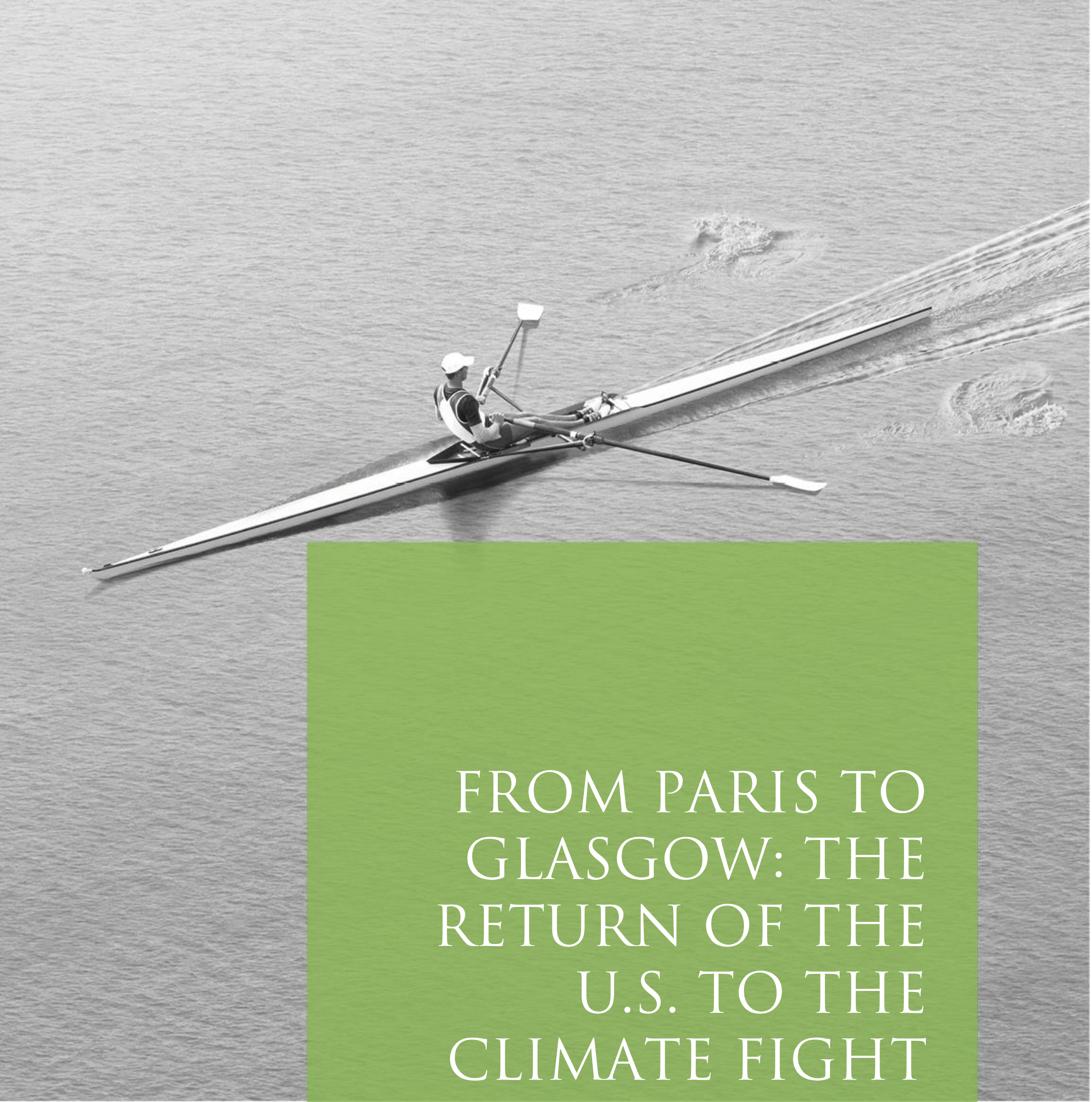


FROM PARIS TO GLASGOW: THE RETURN OF THE U.S. TO THE CLIMATE FIGHT

White Paper

Marketing communication

Wealth Management | January 2021

Union Bancaire Privée

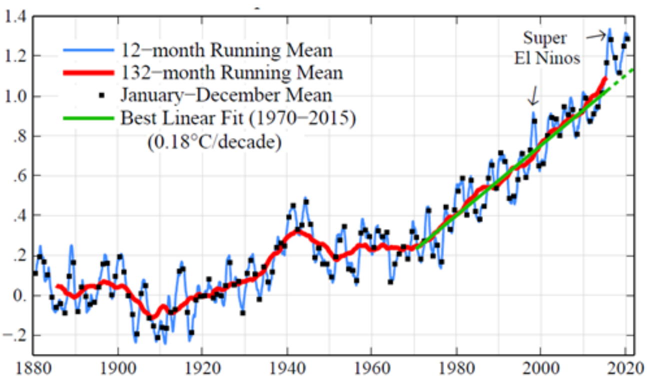
Key points

- *President Joe Biden will take the US back into the Paris Agreement framework.*
- *While time has been lost, CO_2 emissions are down over the last five years and the new US administration will push climate action up the agenda and build upon policies already enacted by corporates and at state and local levels.*
- *The world moved in the right direction in 2020. Green recovery plans will make sure that this becomes a trend, rather than a blip.*
- *The European Union's recovery plan and China's recent, but highly significant, commitment to carbon neutrality will contribute to that trend.*
- *We see ample investment opportunities available to benefit from these global, enduring and long-term trends.*

Make America Green Again

The 2016 Paris Agreement is at a critical juncture for at least two reasons. First, it recently celebrated its five-year anniversary. It is far too early to analyse the Agreement's "achievements", but that will not stop critics from trying. This scrutiny should be welcomed by those whose fear that not enough attention is being paid to rising temperatures' grave threat to mankind. After all, 2020 was the second-hottest year on record (after only 2016, the year when the Paris accord came into force). The world also witnessed weather extremes including fatal and devastating fires in California, Colorado and Australia, while a quarter of the world's wetlands burned in South America, as well as a record number of storms around the world and rising sea levels.

Figure 1. Global surface temperatures relative to 1880–1920



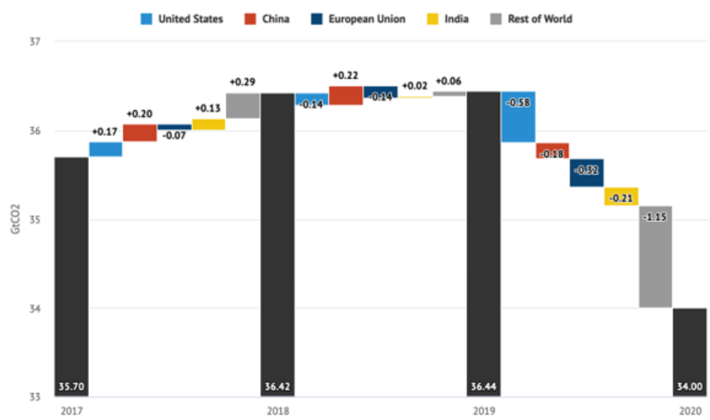
Source: Climate Science, Awareness and Solutions Program Earth Institute, Columbia University, 14 January 2021

Second, Joe Biden has been inaugurated as the President of the United States of America and he has already announced that one of his first executive orders is to rejoin the Paris treaty, something that will come as a great relief to many. This will happen three years and eight months after the previous administration expressed its desire to leave the Agreement. That said, the Agreement was structured in a way that made it difficult to leave in the first three years after being signed, and the country's exit only came into effect on 4 November 2020.

Joe Biden has signalled the importance of climate change on his agenda by appointing John Kerry as US Special Presidential Envoy for Climate, a newly created position on the National Security Council (NSC). This is the first time the issue of climate change has been elevated to the country's NSC, making the climate crisis part of the President's forum for national security and foreign policy. John Kerry was Secretary of State under President Barack Obama and was instrumental in developing the 2016 Paris climate accord. He has his work cut out for him, as President Trump continually undermined climate science and the Paris accord, and rolled back over 100 environmental rules and regulations. In recent conversations with John Kerry, he noted that despite having the best intentions, Paris did not go far enough, allowing for temperatures to rise by 3.7°C and heading toward 4.1–4.5°C, much higher than the 2°C that is needed to lower earth's rising oceans. Biden and Kerry will have an even bigger task ahead, namely convincing the world that the US cares (once again) about the perils of climate change and that the US wants to work with other nations to combat this critical issue.

Meanwhile, Biden proposed a USD 2 trillion climate plan during his campaign that calls for an emission-free electric grid within 15 years and includes a target of net-zero emissions across the entire economy by 2050. The plan expects to use clean energy in the transport, building and electricity sectors, while enhancing the nation's infrastructure and cutting fossil-fuel use. In another first, Biden has hired a White House "climate czar" who will push, coordinate, manage and synchronise climate actions at all US federal agencies and Congress towards achieving priority climate ambitions.

Figure 2. Change in global emissions by fossil fuels by country (2017–2020)



Source: Data from the Global Carbon Project; chart by Carbon Brief, 11 December 2020

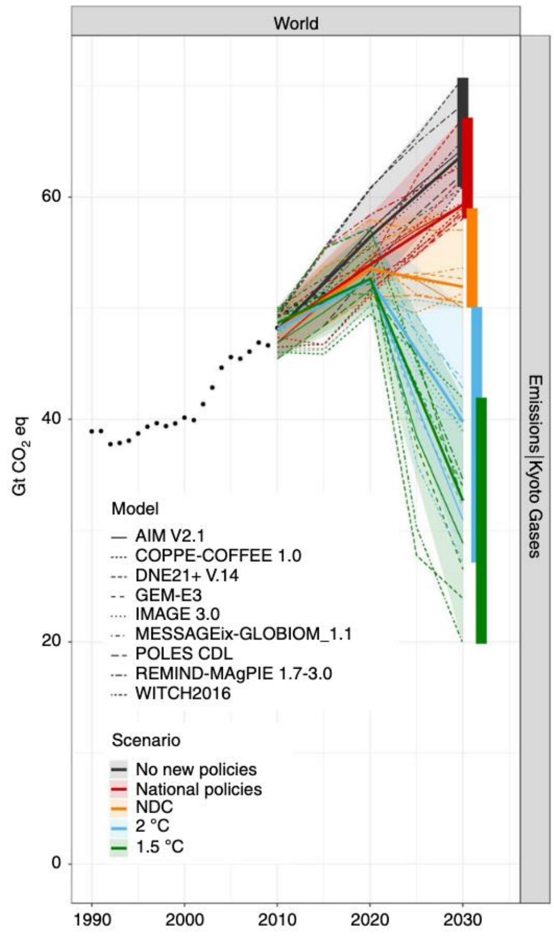
From Paris to Glasgow

With a strong team in place, President Biden may try to make an impression at the UN Climate Conference in Glasgow in November 2021, where world leaders will come together to take stock of the progress already made and adjust future targets. The consensus is that more needs to be done, as CO_2 emissions did not start falling until COVID-19 locked the world down and triggered a global decline in emissions of about 5%. To date, no green policy has been able to generate this type of decline, though most believe that these declines are only temporary, since lockdowns necessitated staying at home which placed limited demands on high-emitting sectors, such as air travel, road transport, energy and retail.

That said, it is likely that emissions will bounce back as soon as the economy picks back up, and the question is how fast this will happen. A new study in Nature Climate Change has looked at various scenarios: if 2020 is indeed just a blip (i.e. emissions fall but then increase on their previous path), the overall effect on global warming will be negligible. 5% fewer emissions in any given year are not commensurate with the target of cutting emissions to net zero by 2050. On the contrary: if policymakers manage to use the crisis to help economies decarbonise, the outcome could be a lot more encouraging.

As things stand, it is too early to lose hope, but the policies that have been put in place in the context of the Agreement (nationally determined contributions or "NDCs") are not enough to put us on a 2°C path. These contributions are estimated to be enough for emissions to peak, but the pace of decline is far too slow to stick to the initial objective (cf. Figure 3). This shortcoming has two aspects. First, there is an implementation gap, meaning that there is still a lot of work to do in order to deliver the current NDCs. Second, current NDCs are not sufficient and need to be improved. The good news is that the treaty allows countries to improve their commitments over time. This is why the Glasgow summit will be critical, as it will be the first significant opportunity for global leaders to raise their initial emissions reduction targets, as some countries have already announced. Further down the road, another summit will focus on the evaluation phase and assess whether or not those NDCs are likely to be delivered.

Figure 3. Greenhouse gas emissions for total greenhouse gases (in Gt CO_2 equivalent) and nine integrated assessment models between 2010 and 2030



NB: the coloured vertical bars indicate the range of estimates given by the various models under the different assumptions.

Source: Taking stock of national climate policies to evaluate implementation of the Paris Agreement, Mark Roelfsema et al., Nature Communications, 29 April 2020

Green Deals Everywhere

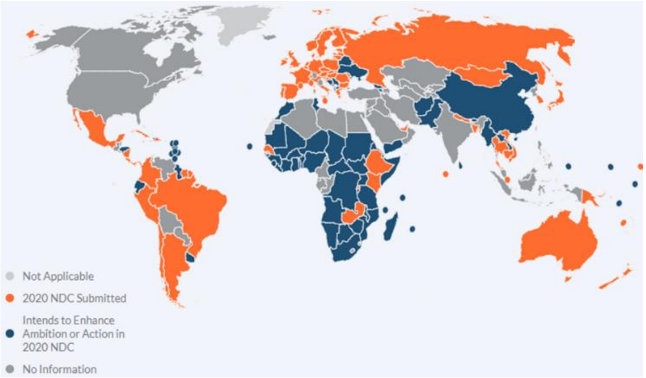
With the planet taking a deep breath and humanity pausing due to the global pandemic, 2020 was an impressive year for new green commitments, with positive momentum being seen in Europe, China, Japan and the US. Since well over 50% of the world's emissions come from these regions and countries, we count this as significant progress. Both corporations and local city/state governments entered the fray as well, announcing impressive climate targets.

While already on track to meet its 2020 objectives, the European Union extended its goal to further cut emissions by 55% by 2030. According to the European Climate Law, Europe's climate and society must be carbon neutral by 2050. The law aims for all sectors and society to contribute to this goal. This objective was also evident in the recovery plan that was decided by the EU following the COVID-19 crisis, with significant amounts of the EUR 750 billion plan earmarked for climate-friendly policies. The United Kingdom, despite leaving its transition period following its departure from the EU on 31 December 2020, went even further and is projecting a 68% reduction in its emissions compared with 1990 levels.

Most surprisingly, China stunned the world by committing itself in two important ways. First, Xi Jinping announced that Chinese emissions would peak, "well before 2030" – a clear improvement on the initial 2030 commitment that itself was considered an historic milestone for China watchers and made the China accord possible in the first place. But beyond that, China now sees itself becoming carbon neutral by 2060. Since then, announcements have followed about the country's five-year objectives in terms of renewable energy investments, and stocks linked to those investments have reacted very positively. The median return on the stocks we track in this area is well above 50% since Xi Jinping's announcement in September.

Japan, a country that did not make a strong commitment to the original agreement, made an unexpected shift at the end of October by committing itself to carbon neutrality by 2050. Criticised both domestically and internationally for its lack of detail, this new pledge demonstrates renewed ambition under new Prime Minister Yoshihide Suga, and certainly bodes well for the future. This change of heart is also an interesting case of peer pressure in action: clearly, China's commitment to its own carbon neutrality target a few weeks before was a key factor in establishing this new objective. One can hope that more world leaders suffer from carbon target envy in the months to come and start setting ever more ambitious objectives.

Figure 4. NDC tracker: countries updating or enhancing their national climate commitments in 2020 or in the run-up to COP26



Source: Climate Watch, 1 January 2021

Moreover, countries are not the only entities that have made environmental commitments recently. Whether it is through frustration of a lack of leadership, or a drive and commitment to make a big impact, it is happening increasingly at local level. According to the Sierra Club, over 170 cities, more than 10 counties and 8 states in the US have made resolutions to power their communities completely with clean, renewable energy, and the list of committed communities and geographies continues to grow.

Similarly, corporates have made remarkable inroads into sustainability pursuits. Impressively, Microsoft announced it plans to be carbon negative by 2030 and, "[…] by 2050 Microsoft will remove from the environment all the carbon the company has emitted either directly or by electrical consumption since it was founded in 1975." Unlike many of the announcements made by the countries mentioned above, Microsoft management outlined a highly detailed plan, both for its direct emissions as well as for its entire supply and value chain. Delta Airlines has also announced a plan to be entirely carbon neutral by 2030, and BP announced that it would pursue becoming net zero by 2050 while also cutting the carbon intensity of products it sells by at least half. Of course, the concept of corporate carbon neutrality is quite contentious, and we could easily criticise some of these plans for their lack of clarity or their over-reliance on carbon offsets.

We are continuing to see positive momentum behind these announcements from states, cities and corporates, and we are encouraged as both humans and investors that the long-term trends and forces benefiting sustainable products and services should endure for decades to come. This partly explains why the US withdrawal from the Paris Agreement and the partial regulatory rollback that we saw under the Trump administration did not have a bigger effect on US emissions: there were many other actors, keen to deliver on their own targets, despite the temporary setback at federal level.

Implications and Opportunities for Investors: Good and Bad News

The truly bad news here is that these climate issues will not abate anytime soon and much needs to be done to lower global temperatures and CO_2 emissions, which are contributing to rising sea levels, extreme temperatures and harsher and more damaging storms around the globe. Climate change is a threat multiplier causing extreme weather, health vulnerabilities, damage to critical infrastructure, mass migration, food insecurity, biodiversity loss, poverty and deforestation. A well-regarded study published by the National Bureau of Economic Research calculated that if temperature increases continue to persist, real GDP per capita would decline by 7.22% by 2100. In contrast, if countries cut emissions under the Paris Agreement, this decline would improve dramatically to 1.07%. The annual cost for the United States could be up to

USD 500 billion annually[1]. In reality, it is far less expensive to prevent this environmental damage from happening in the first instance than the massive cost to clean them up afterwards.

From an investor's perspective, the good news is that we can invest alongside companies that are working hard to solve the climate crisis: companies that are lowering emissions, developing new technologies, making use of government subsidies to drive renewable energy adoption and helping industrial companies become more efficient. The enablers of the energy transition from renewable energy equipment makers to electric vehicle manufacturers and battery companies are likely to continue to scale up their expansion plans. Some of these opportunities will come from the start-up world, but others will be investable through public markets.

The lessons for investors go beyond these sectors, though. If a carbon tax is put in place, every sector which consumes energy will suffer a direct financial burden from climate change, and even without such a tax, tighter regulations or other indirect measures will be a reality in virtually every corner of the economy. Consumers are increasingly setting the tone by modifying their consumption patterns, aligning with companies that share climate goals and voting for government representatives that believe in science (such as US President Biden). It will therefore be important to take into account climate change when investing in any company, and investment processes are evolving globally to reflect this reality.

As UBP has made impact investing a central element of its asset management strategy, we are well aware of the fact that sustainability issues are a social, environmental but also financial reality. Our two existing impact funds have exposure to companies that we think will be among the champions of this energy transition process (see Figure 5). Our "Climate Stability" theme is composed entirely of companies which have a net positive impact on tomorrow's emissions. Many companies in the "Sustainable Communities" and "Healthy Ecosystems" categories should also be mentioned, as they are offering more sustainable transport and efficiency solutions, or better solutions for the management of ecosystems. Beyond this direct impact, we also consider the environmental aspect of our investments in the rest of the portfolio.

At Bank level, UBP has tightened its investment restrictions on the sectors most harmful to climate, improved its monitoring of carbon risks and intensified its engagement with portfolio companies on those issues. It has also increased its offering of sustainable strategies with reduced carbon footprints. Governance has been strengthened to better reflect the increased importance of sustainability issues, and our strategy in this area has become increasingly ambitious since we first signed up to the UNPRI in 2012. Like other stakeholders, we hope to do more in the months and years to come.

Figure 5. Thematic fund exposure, UBP Impact Platform

THE UN GOAL

THE UBP THEME	% Positive Impact Equity	% Positive Impact Emerging Equity
BASIC NEEDS	17.1%	14.7%
HEALTH & WELL-BEING	19.4%	7.8%
INCLUSIVE & FAIR ECONOMIES	11.6%	14.4%
HEALTHY ECOSYSTEMS	3.5%	0.7%
CLIMATE STABILITY	15.0%	33.6%
SUSTAINABLE COMMUNITIES	28.8%	24.3%

Source: UBP, 14 January 2021

Conclusion

The pressure to "green the globe" is not about to abate. Climate change is being addressed from the bottom up (individuals, corporates, cities) as well as from the top down (the UN, national governments, state governments). We believe that with the US rejoining the Paris Agreement these trends will only be accelerated, as it has created a situation in which the 3 major economic entities in the world (the US, Western Europe and China) are keen to make progress. We believe this will have profound implications for investors and once again confirm the relevance of impact investing as a tool to address these issues in a constructive way.

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[1] Martinich, J., Crimmins, A. Climate damages and adaptation potential across diverse sectors of the United States. *Nat. Clim. Chang.* **9,** 397–404 (2019).

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