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# Keeping up with the transition

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## The war in Ukraine, the energy crisis, COP27's modest ambitions, the unintelligible tightening of regulations... all these factors led us to consider 2022 as the year of doubt. Six months on, is the picture any clearer? Are we about to turn back the clock on sustainable investment? What approach do we think is appropriate?

One thing remains certain: sustainable investment is still a difficult subject to grasp. And yet, the thematic continues to grow in popularity, with more and more investors and financial institutions integrating investment practices that respect environmental, social and governance (ESG) criteria. However, many people wonder what the "how-to" is, and we won't pretend to be able to provide one, as many questions remain unanswered and continue to emerge. As a result, this divisive topic generates several media debates, and the challenge now is to separate content from form and distinguish between preconceived ideas and reality.

Since the beginning of the year, the anti-ESG movement in the United States has grown considerably stronger, generating a great deal of controversy. The anti-ESG legislation has even been introduced at national level by the Republican Party. This opposition has also contributed to the fragmentation of certain Net Zero initiatives based on "anti-trust" laws, arguing that this type of alliance encourages the formation of "cartels". Many asset managers have also readjusted the tone of their communications on the subject, putting the issue of fiduciary duty back as a priority. Nevertheless, this situation is proving to be a blessing in disguise, given the risk of "greenwashing" inherent in the growing interest to the subject.

In the United States, however, sustainable investment continues to make inroads. The US President quickly vetoed the anti-ESG legislation, regulations on ESG criteria integration, reporting and transparency for US companies continue to strengthen and the SEC[1] has issued some high-profile fines for misleading statements about sustainable practices. It is also on this side of the Atlantic that we are seeing a significant acceleration in economic initiatives. American pragmatism is paying off, notably through the Inflation Reduction Act (IRA). This $360 billion program allows companies to benefit from direct subsidies when they initiate programs to promote clean energy, whether in renewable energies, batteries, components, etc. The initiative has generated a remarkable amount of interest, with a number of resounding announcements: the launch of a battery mega-factory in Nevada, a truck gigafactory, etc. The initiative is nonetheless tending to annoy Europeans, as some companies, lured by the economic benefits, are choosing to transfer their projects to the other side of the Atlantic.

(1) Security and Exchange Commision: The SEC's mission is to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation.

This is where the problem lies. While the United States is dangling the carrot, Europe is wielding the stick, with a regulatory framework that is becoming increasingly complex through a jumble of regulations and a proliferation of labels. This pile-up tends to annoy investors and companies alike. These regulations are increasingly complex and require ever-greater resources because of their lack of clarity, even for specialists. The SFDR regulation, despite its intrinsic quality, is a good illustration, and MiFID 2 an even more blatant example. Financial institutions must now ensure that their clients have the knowledge and experience required to measure the sustainable impact of their investments through a time-consuming and complex process. Given the divergence of views and the difficulties inherent in the subject, one might legitimately wonder whether the global trend would be to back-pedal on sustainable investment.

We are firmly convinced that this is not the case. The momentum seems to be well underway and set to continue, becoming a standard for all investment universes, whether listed or unlisted. This conviction is based on several factors. Firstly, whether in political, economic or social terms, there is no fundamental questioning of sustainable investment. This approach continues to be supported by numerous governmental and supranational plans, including the IRA mentioned earlier, the European Green Deal or the Chinese 14th Five-Year Plan.

Companies are therefore continuing to make the necessary efforts and to integrate sustainability issues into the heart of their strategies. They are strengthening their teams, demonstrating greater transparency, engaging in dialogue with their shareholders on these issues, consolidating their climate ambitions and, increasingly, validating their alignment with the Paris Agreements through scientific initiatives. In concrete terms, 80% of the world economy is currently engaged on a Net Zero trajectory[(2)]. Despite the political debates and the media noise, 2023 is the year in which the largest investments will be made in energy in the broadest sense: 2,800 billion dollars, including 1,700 billion dollars in decarbonised energy[(3)].

More than ever, for asset managers, sustainable investment is an element of both elimination and differentiation for their customers, for all products and not just article 9 or labelled funds, both in terms of cash flow generation and value creation. In view of that, we believe that we need to adopt a long-term, pragmatic and reasoned approach, always driven by the ambition to create value. To this end, we have built our approach around three pillars. The first is the integration of sustainable analysis within financial analysis, because we believe it is essential to analyse these two aspects at the same time. The second, at the heart of our approach, is transition, with the willingness to involve and invest in all sectors, even those that are currently seen as the least virtuous. In this respect, we pay particular attention to the sustainable trajectory of companies. In concrete terms, almost 90% of greenhouse gases are concentrated in five sectors[(4)]. If companies in these sectors manage to substantially reduce their emissions, the impact will be all the more significant. From a more financial point of view, this approach also allows us to benefit from management flexibility, and not to be dependent on thematic shifts that have particularly impacted sustainable investment over the past year. Finally, the last of our pillars focuses on the notion of inclusion, with all its social implications, because the transition can only be successful and viable if it is socially accepted.

Facing trends through consistency, our approach has enabled us to navigate in very different economic and geopolitical environments, and leads us to engage in dialogue with all our stakeholders. In this respect, the various exchanges conducted as part of our engagement initiatives foster our belief that this favorable trend towards transition shall pursue. Currently, 100 % of our assets incorporate ESG criteria, and 97 % of our open-ended funds are classified Articles 8 and 9[(5)]. Furthermore, within our industry, working groups on transition are multiplying and we wish to contribute to defining its contours by becoming fully involved in those to which we can bring concrete contribution. These considerations help us to define our development priorities and strengthen our expertise. In this way, we position our sustainable strategies to benefit from this dynamic environment, whether through a thematic, sectoral or geographical perspective, always with the ambition of combining sustainability and performance.

(2) Source: University of Oxford, 2021.
(3) Source: IEA, 25 May 2023.
(4) Sources: Our World in Data (2020), MSCI ESG Research, Rothschild & Co Asset management Europe - 31/12/2021.
(5) Source: Rothschild & Co Asset Management Europe, 30/12/2022.

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