

Four challenges to sustain the investment landscape – and the world





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Four challenges to sustain the investment landscape – and the world

Sustainability must be one of the most overused and least well understood terms in financial markets. Is ESG the same as sustainability? What is the difference between sustainability and responsibility? And what if regulators disagree on what sustainability is? It can quickly become very technocratic and acronym-filled.

One of the biggest issues, in my view, is that people think of sustainability as a 'nice to have' or 'ethical' decision. And certainly, some flavours of sustainable investing can reflect the ethical or moral preferences of asset owners and managers. But what is often missed is that the actual definition of the word 'sustain' is to cause or allow something to continue for a period of time. For investors to keep investing in a world that vaguely resembles the one we live in, we need to tackle the greatest threats to sustaining that.

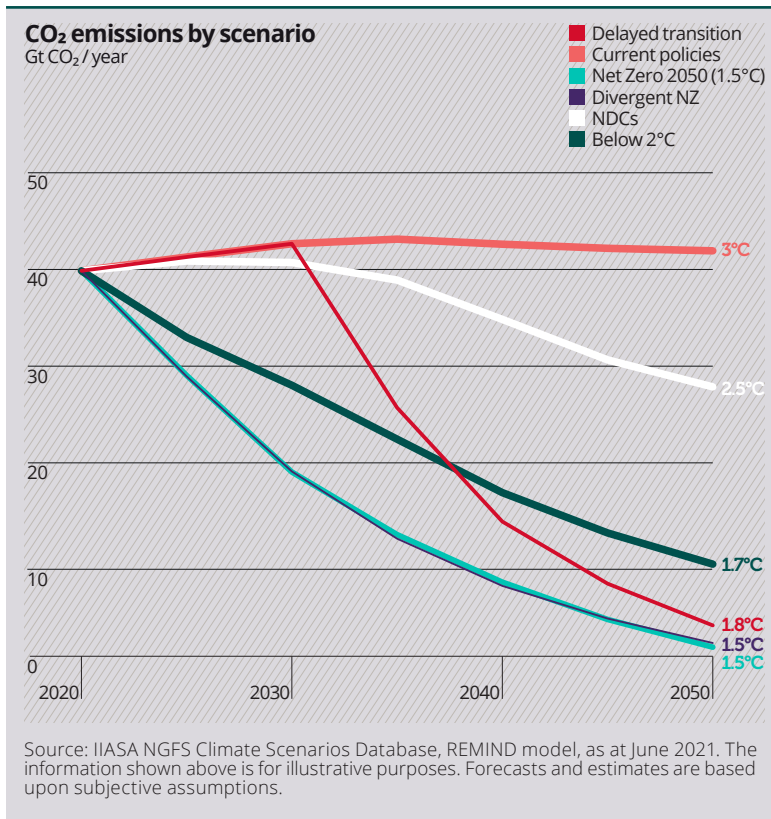
At Redwheel, we have identified four major challenges to sustaining the prosperous existence many of us have come to enjoy and to propagating this prosperity to the rest of humankind – including future generations. These include two major environmental challenges and two major socioeconomic challenges – all deeply interlinked: greening the global economy; defending and restoring biodiversity; supporting sick and ageing populations; and supercharging sustainable growth in emerging markets.



Greening the global economy

Firstly, we need to green the economy. Faster. While more and more people recognise the need to switch to cleaner, greener behaviours, and more businesses are making plans to be 'net zero' – another overused and poorly understood sustainability term – it has not yet generated enough real action to actually halt the growth in global emissions, let alone reduce them at rates consistent with keeping emissions well below 2 degrees by the end of the century.

"Emissions need to come down – and fast."



We shouldn't underestimate the scale and speed of what is needed for the world to produce net zero emissions by 2050. The entire global economy and financial markets still mostly depend on fossil fuels, and effectively changing that will require innovative solutions to complex problems across the energy system and the whole economy. The urgency of the challenge and need for climate technologies and the raw materials that support them will only grow. While this is intimidating, it also presents a compelling structural investment opportunity.

Defending and restoring biodiversity

Secondly, we need to defend and restore biodiversity. Biodiversity is the latest buzzword in sustainable investing circles, and for good reason: there is no greening the economy without defending biodiversity – natural ecosystems absorb over half of humanity's carbon emissions.¹ These ecosystems are under threat from an array of mostly human-made problems like pollution, overexploitation of resources, and even climate change itself. The latter is important: the very thing that is absorbing emissions and slowing the rate of climate change is being impaired by climate change itself, creating a vicious cycle we need to break.

It is my belief that biodiversity is the single most underappreciated driver of economic prosperity. The contributions of ecosystems to our lives are estimated to be worth a staggering \$125-140 trillion per year.² Unfortunately, this value is arguably invisible or taken for granted. Take, for example, the value of crop pollination by animals: it is worth over \$150 billion a year to the agriculture sector.³ In spite of this, ecosystem services worth \$10-30 trillion were lost between 1997 and 2011 alone due to land use change and degradation.⁴



Some natural services can be replaced to some extent with artificial processes (e.g. artificial pollination), but in many cases this is simply not feasible. As such, when biodiversity and ecosystem services degrade, the underlying risk to economies, and human health and wellbeing, grows. The good news is that as pressure from governments, regulators and consumers grows, businesses are increasingly recognising the need to address biodiversity issues in their supply chains, creating a conducive environment for investors to put capital to work in biodiversity solutions.

The investor opportunity: biodiversity solutions

Sustainable materials

Primary raw materials and manufactured materials for the human environment

Circularity & waste management

Products and services that contribute to material reuse, recycling, or recovery, and those with a primary purpose to reduce the pressure of waste material

Terrestrial Ecosystems and Aquatic Ecosystems

- (a) Primary raw materials for human health and nutrition
- (b) Products and services with a primary purpose to directly reduce harm to terrestrial or aquatic ecosystems, or that actively enhance the quality or resilience of these ecosystems

¹ IPBES (2019)
² OECD (2019)
³ Khalifa et al (2021)
⁴ OECD (2019)

Source: Redwheel, as at 30th July 2023. The information shown above is for illustrative purposes. No investment strategy or risk management technique can guarantee returns or eliminate risks

Supporting sick and ageing populations

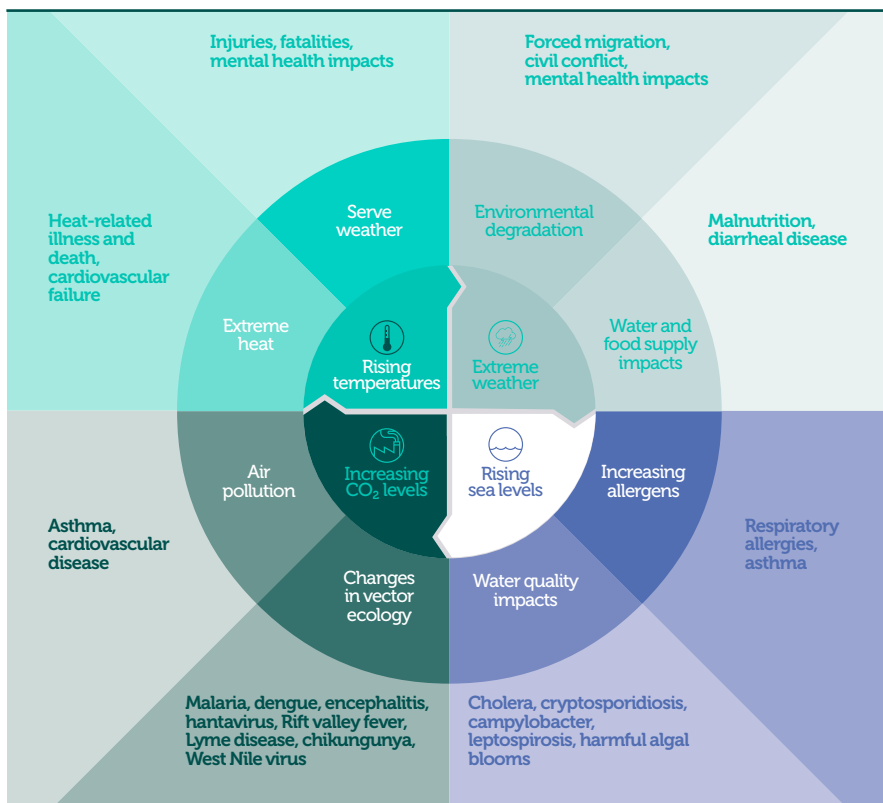
We believe the third major challenge facing the world is supporting sick and ageing populations. The age profile of almost all countries is becoming older and this is only expected to ramp up: in 2019, 1 in 11 people were over the age of 65, but by 2050, the UN estimates this will be 1 in 6 people.⁵ While longer lifespans are cause for celebration in many ways, at the macro level it will have substantial implications for healthcare systems because older people generally face more health challenges both in terms of chronic illness and risk of acute health events.

Human health challenges are an important barrier to productivity, economic growth and life satisfaction. 6 in 10 adults in the US have a chronic disease and 4 in 10 have two or more.⁶ The Centers for Disease Control and Prevention CDC estimates that lost productivity from heart disease and stroke alone amounts to \$147bn lost productivity on the job per year in the US economy, not to mention the cost of treatment and medical insurance.⁷

The costs to individuals and the economy should climb as the effects of climate change increasingly set in, both in terms of chronic conditions – particularly respiratory disease due to air pollution and increasing allergens – but also acute illness from extreme heat and greater risk of infectious disease due to changes in the natural ecosystem.



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The impact of climate change on human health

Covid-19 was a stark reminder for the global population of the risk that new infectious diseases can bring to our wellbeing and economic prosperity, but also the amazing innovation in medical technology and pharmaceuticals made possible with sufficient political and financial capital invested. This has cultivated an exciting investment environment where healthcare innovations that are truly life changing present not only opportunities for people to live happier, healthier lives, but can also bolster labour force productivity and economic growth.

⁵ OECD (2019)

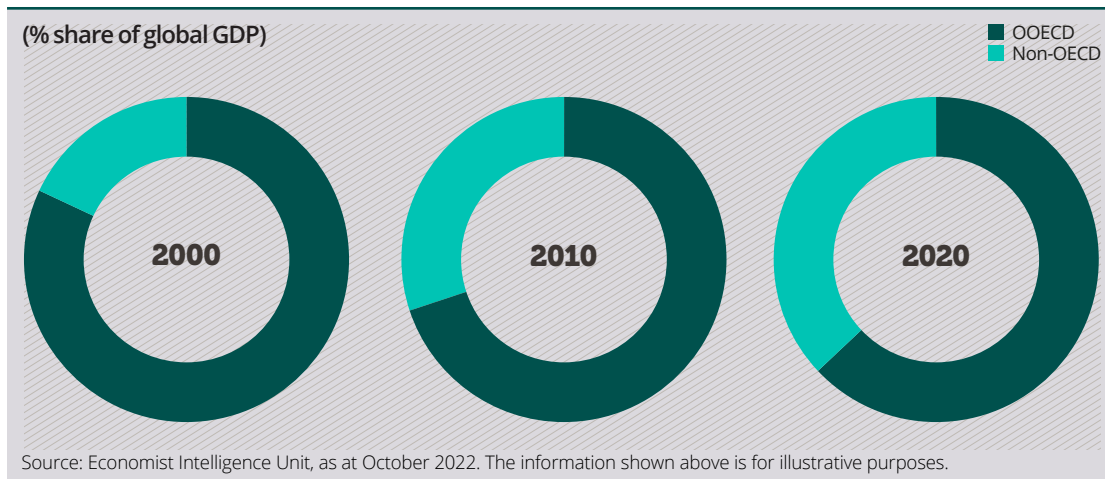
⁶ CDC (2022)

⁷ CDC (2022)

⁸ Economist Intelligence Unit (2022)

Sustainable growth in emerging markets

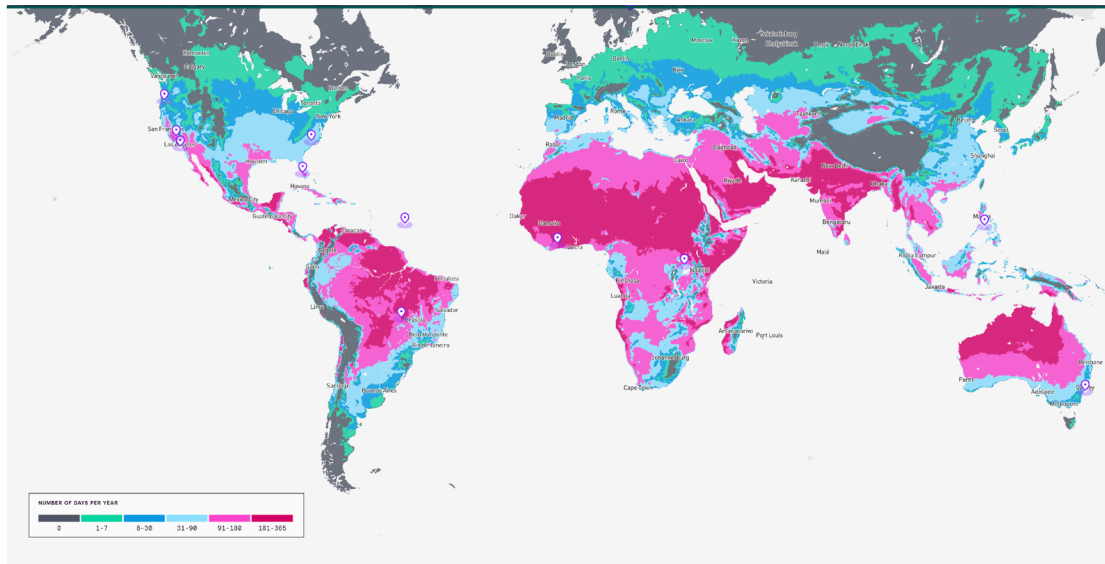
Finally, the fourth major challenge we have identified is supercharging sustainable growth in emerging markets. Emerging markets have experienced rapid economic growth in recent decades, outpacing their developed counterparts, and picking up a rising share of global GDP.⁸ This trend is expected to potentially continue for the most part in the medium term, despite short-term inflationary headwinds.



For emerging markets more than most, growth has profound implications for climate change, biodiversity and human health and wellbeing if that growth continues to be fossil-fuelled. Emerging markets need to grow to fuel local as well as global prosperity, but if this happens without decarbonisation, these very regions of the world will be the most severely affected by climate change – as we are already seeing.

The map below from Probable Futures shows the number of days above 32 degrees that regions will experience at 2 degrees of warming. It is clear that the areas at most risk of high and persistent heat are concentrated in emerging markets.⁹ So, climate solutions and green growth are once again not a nice to have, they are essential to expand and sustain growth and human prosperity.

Emerging markets face the most substantial direct climate effects



Source: Probable Futures, as at 7th July 2023. The information shown above is for illustrative purposes.

The growth potential for emerging markets is truly exciting, for both the populations in those regions who wish for more comfortable, financially secure lives, and for investors seeking opportunities to generate return. Here again, sustainability can and should go hand in hand with growth because ideas like financial inclusion are not just a nice to have, financial empowerment generally spurs economic activity that is at the heart of creating a truly durable long-term growth story.

⁹ Probable Futures

Similarly, particularly for the poorest countries, investing in effective healthcare treatments and systems can allow people to live healthier and more productive lives, maximise labour force supply and boost economic growth prospects. In this sense, many of the UN Sustainable Development Goals should be seen not just as a call to action on ethical grounds, but as a blueprint for identifying real sustainable growth opportunities.

UN Sustainable Development Goals



Source: UN Sustainable Development Goals, as at July 2023. The information shown above is for illustrative purposes.

Conclusion

What is clear from all four challenges we have identified is that drilling down to the real ethos of sustainability allows us to clearly see that these challenges represent not only necessary changes to allow financial markets to sustain, but also true economic opportunity to be tapped into.

Key Information

No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment. Past performance is not a guide to future results. The prices of investments and income from them may fall as well as rise and an investor's investment is subject to potential loss, in whole or in part. Forecasts and estimates are based upon subjective assumptions about circumstances and events that may not yet have taken place and may never do so. The statements and opinions expressed in this article are those of the author as of the date of publication, and do not necessarily represent the view of Redwheel. This article does not constitute investment advice and the information shown is for illustrative purposes only.

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