

Investment perspectives

The Journey to Net Zero Starts Here



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Global consensus has rarely been as unified on a single environmental idea like the current push to cut greenhouse gas emissions to net zero in order to limit global temperature rises.

The concept of net zero emissions (“net zero”) has become mainstream so quickly that more than 60% of countries now have some sort of net zero goal, as do at least 20% of the 2,000 largest, publicly listed companies, and investors managing nearly \$43 trillion (almost half of the asset management sector globally)¹.

Yet for many, the sheer complexity of the issues related to net zero presents the greatest hurdle, rather than an inability or lack of motivation to act. Setting a net zero target, or a timeframe for achieving this can be daunting when the technologies needed to tackle the issue are still on the drawing board, government policy support is limited, and stakeholder pressure to make a commitment rises day-by-day.

To help reduce that complexity, this article provides an explanation of the key points to consider when beginning to develop a net zero investment strategy.

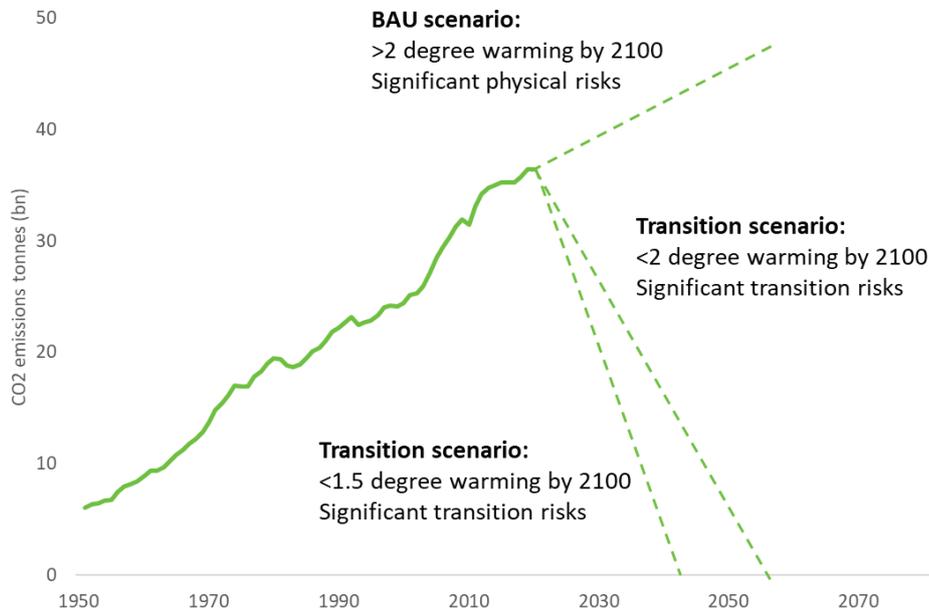
What does net zero mean?

Simply put, a net zero target means achieving a balance between the amount of greenhouse gases discharged into the atmosphere by human activity and the amount that can be safely removed or absorbed by natural processes. A gross zero target would mean reducing all emissions to zero – this is likely not realistic, so instead a net zero target recognises that there will be some emissions but that these need to be fully offset.

¹ Source: FT.com

The scale of change needed to find this balance within the mid-century timeframe defined by the 2015 Paris Agreement is illustrated below:

Illustrative emissions pathways to net zero



Source: Global Carbon Project. BAU means business-as-usual. CO2 emissions are highlighted here as they are the bulk of the six major greenhouse gases identified in the Climate Change Act 2008. Transition risks are risks from the realignment of the economic system towards low-carbon, climate-resilient or carbon-positive solutions. Physical risks relate to the impacts of climate change such as rising temperatures, changing rainfall, flooding risk and extreme weather. Transition and physical risks are both short-term and long-term risks, and therefore relevant for most investors' time horizons.

Why does net zero matter for my investment strategy?

Climate change will be one of the most significant themes affecting the global economy over the coming decades. This theme can be viewed as both an opportunity to take advantage of and a risk to mitigate.

Businesses and governments that position themselves to benefit from this opportunity or mitigate this risk are likely to fare better than those that don't. As an example, to mitigate the physical risk, governments are likely to introduce additional costs such as carbon taxes for companies that produce high carbon emissions. These additional costs are likely to reduce profits and lead to a negative impact on returns from the equities and bonds of such companies.

Given the expected financial impact on investments, we believe it is important for investors to position their investment strategy accordingly within the context of a broader plan, ensuring that all factors are properly addressed.

Planning for net zero

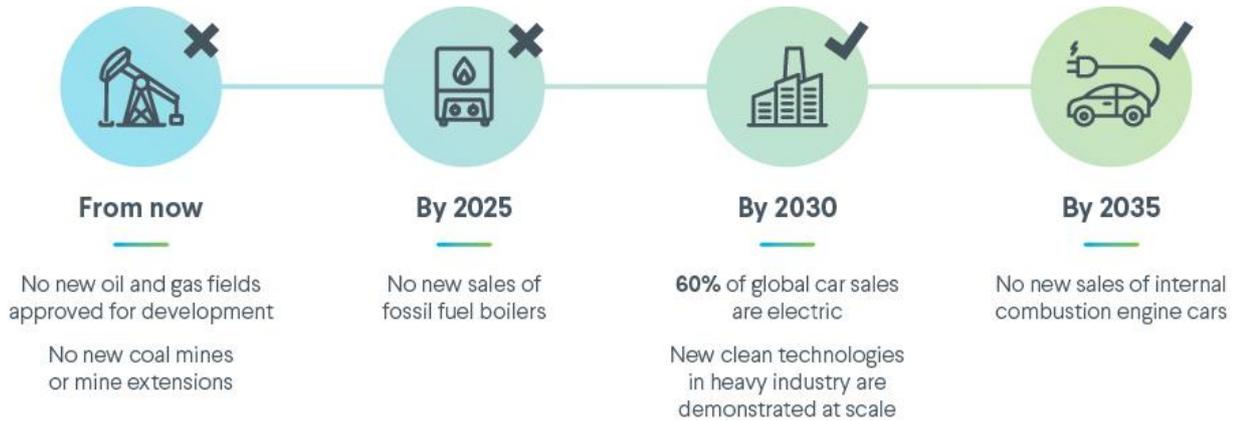
Investment themes are often best addressed by setting a target level of exposure, a timeframe to achieve the target, and monitoring progress towards the target by using interim milestones.

With net zero, the target level of exposure is already set at net zero emissions, so the main points to consider are the timeframe to achieve that target and setting interim milestones. Many governments, institutional investors, and asset managers have adopted a 2050 target date (or sooner) with interim milestones set between 2030 and 2040².

² Source: Net Zero Asset Managers Initiative (<https://www.netzeroassetmanagers.org>) and www.gov.uk for UK government targets

Setting a net zero timeframe is important from an aspirational point of view, but it is more important to have a plan for how to get there i.e. set a journey plan to net zero.

Various pathways have been proposed by organisations such as the IPCC³ and the IEA⁴, all of which make different assumptions, including the deployment of technology such as carbon capture. To give a flavour of a pathway, the IEA's recently published net zero roadmap for the global energy sector envisages changes such as:



Source: IEA as of May 2021

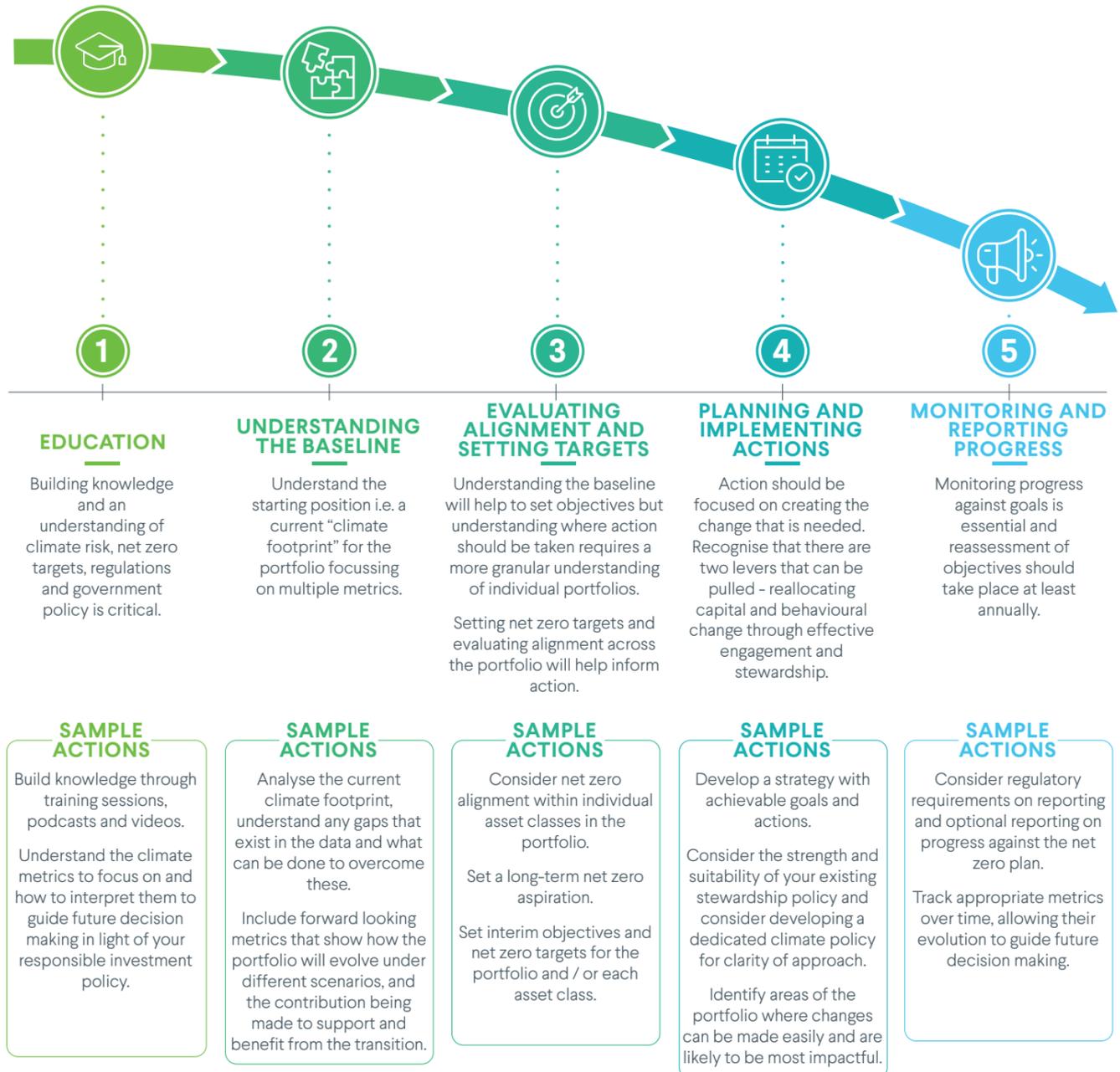
It would be impossible to predict which pathway is most likely given the theme will take a few decades to play out. As such, an effective net zero journey plan will require adaptability and regular updates of the interim milestones to reflect the different risks and opportunities along the way.

³ Intergovernmental Panel on Climate Change (<https://www.ipcc.ch/>) is the United Nations body for assessing the science related to climate change

⁴ International Energy Agency (<https://www.iea.org/>)

The Hymans' Journey Plan

We believe that evolving an investment strategy to meet a net zero aspiration should be done within the context of a broad framework to ensure that all issues are properly addressed. To help you plan your journey, we have set out 5 key steps in the framework below.



Ready, set, go!

As the saying goes, a journey of a thousand miles begins with a single step - take that first step and what seems like a daunting journey could become easier along the way.

Our view is that climate change will be one of the most significant themes affecting the global economy over the coming decades and all investors should have a credible journey plan to navigate through the different risks and opportunities along the way.

The framework provided above can serve as a good map to start the journey. Tailoring it to meet each investor's circumstances, beliefs, and timeframes can turn it into an effective journey plan.

[Find out more](#) about our commitment to support you on your net zero journey plan.

[Read more](#) on Hymans Robertson's net zero pledge.