Addressing Major Changes Relevant to Long-Term Responsible Investors

By: John Streur | May 23, 2023

Washington - As we settle into 2023, we believe long-term responsible investors focused on risk management and opportunity capture must consider material changes impacting four areas:

1. Changes to the global energy system, both in the existing fossil fuel system and in the development of a distributed, lower carbon system, are accelerating and revealing challenges for companies globally.

   Calvert has historically noted two major risks to the fossil fuel based global primary energy system: geopolitical risk and product safety related to carbon emissions. These create the potential for innovative competitive products to disrupt fossil fuel as the world's primary energy source. Businesses dependent on fossil fuels face risks, but also could take advantage of many areas of potential opportunity across the energy system and related industries.

2. Demographic changes continue to impact the workforce and the ultimate size of consumer markets globally; the vast majority of companies have yet to fully adapt to these massive changes.

   Higher levels of labor force participation and educational attainment by women and ethnic minorities have led to changes in overall employee makeup and boardroom diversity. However, we have yet to see this lead to higher levels of women and ethnic minorities in executive and senior management roles. As numerous studies have now linked diverse workforces and corporate performance, long-term oriented responsible investors should be demanding greater disclosure and transparency from companies on how they are attracting, retaining and promoting diverse talent.

3. Increasing costs, including interest rates, wages and raw materials, present unique challenges to every industry; the result will be greater differentiation between companies that are able to manage their cost structure and improve productivity and those that are less efficient or stranded in high fixed cost models.

   Russia's invasion of Ukraine in 2022 and the supply chain disruptions that followed led to an interest rate regime change that altered the cost of capital for companies across all industries and depressed valuations everywhere, except energy. While higher costs create challenges for corporations, they also create greater opportunities for differentiation. Long-term oriented responsible investors will need to study not only the companies that are managing their costs, but also those that are innovating to continue to grow and expand in this high-cost environment.

4. New costs in the form of priced externalities, implemented by governments or through market action, are taking effect serving to raise costs, influence corporate and consumer behavior.

   Governments around the world are signaling that they are willing to step in to force businesses to address externalities, like carbon emissions and waste, by putting a price on these negative effects. For example, the U.S. Inflation Reduction Act places an explicit price on methane emissions, which are a significant cause of climate change. In the EU, recent notable actions to price in externalities include a deal to phase out new fossil fuel car sales by 2035 and a border tax imposed on "high-carbon" products. The UK has also launched a consultation on the introduction of its own carbon border tax as part of a broader net zero strategy.

To read the full article from which this was adapted, click here.

Risk Considerations: *Investing involves risk including the risk of loss. There is no guarantee that any investment strategy, including those with an ESG focus, will work under all market conditions. Investors should evaluate their ability to invest for the long term, especially during periods of downturn in the market.*

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