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Sustainable Investment

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Sustainability hits and misses – why it's important for investors to spot the difference

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Never has it been more necessary for us, especially investors with a sustainability view of the world, to be able to spot the difference between a genuine solution to a sustainability problem and a red herring. We are bombarded with claims about how "green" businesses are, or how a certain technology will save the planet. But working out which ones to believe in – and potentially invest in – requires both critical thinking and a skillset and diverse set of resources to get right. And this goes well beyond the simple embarrassment of getting things wrong, it can also have a significant impact on investment returns in those businesses.

The whole point of having a deeper understanding of what is sustainable and what's not as compared to the market average is to gain a competitive advantage which enables you to identify long-term growth trends which are an important ingredient of investment returns – especially if those structural growth trends are not being factored in by the market.

If we think about diesel and the massive rise and fall of its use in passenger cars, we can learn something. When diesel cars first came to market, they were widely welcomed. Not only were diesel cars believed to emit less CO2 than petrol cars, but they were also more efficient to run, making them cheaper for drivers. But it was the dominant focus on miles per gallon – rather than the potential impact on the environment and in particular local air quality (diesel engines produce higher levels of particulate, which can penetrate deep into people's lungs) – where the assessment went wrong. It is for this reason that it is always better to look at proposed solutions from more than one single metric.

When assessing 'how good' a proposed solution is, it is worth looking at it from both a social and environmental standpoint. Other classic sustainability fails have included first generation biofuels, where waste products were seldom used and the gains (through reduction in emissions in use) didn't stack up well when considering the energy required to grow, process, and transport the feedstock as well as the huge amounts of agricultural land it displaced from food production. It came to a head in the mid-2000s when EU regulatory support was removed (because of these weaker sustainability benefits) and many businesses that relied on this revenue stream went bust.

But equally, what may appear to be a potential sustainability fail in the making might be anything but. As an example, media reports suggest that people are turning away from electric vehicles (EVs) after latest industry

figures showed a fall in sales in December and January. Yet more than a million electric cars have now been sold in the UK and there is clear evidence that EVs are significantly better than internal combustion engine (ICE) cars in terms of lower emissions. And with technologies evolving at rapid speed, the emissions from EVs will continue to fall and the barriers to widespread adoption – such as a lack of charging infrastructure and more affordable cars – will be overcome as the UK moves towards net zero.

So how can we all get better at spotting the sustainability wins from fails?

- Are you wearing climate change goggles?
  While climate change is critical and speedy action to respond to the crisis is desperately needed, too often, this is approached through a single lens and even a single metric, such as CO2e emissions. Solving only for this metric can lead to some perverse outcomes, especially if you totally ignore the social aspect (or the Just Transition).

- Critically appraise a solution from more than one angle. Speak to people who have knowledge and have worked in this area, as well as to some people opposed to it to understand their points – and decide for yourself how valid they are. Never take as read the "green" solution from the people selling the service as they are likely to be biased.

- Get educated in important areas of sustainability that are of particular interest or relevance to you or your business. This doesn't have to be a formal education, although a master's degree in an area of particular interest would be very useful in helping you and your team develop their critical thinking. Seek out short courses from authoritative sources in areas of interest. Read books by people experienced in the topic.

- Do your own independent research and look for good quality sources and references. Wikipedia, while useful, is not the definitive source of all knowledge.

Sometimes, it is not that a proposed sustainability solution is all bad, rather that the benefits may be significantly overstated or could only be implemented at limited scale. The best approach to use should be specific to the sustainability problem that is being addressed. For example, while there is merit in paying for conservation, forest restoration, tree planting, regenerative farming in targeted areas, investors should be wary of how the ecosystem services are being accounted for and monetised – and that they are not being aggressively over accounted for.

Considering scale is also key – attempting to offset millions of tonnes of emissions from a business, rather than innovating to make real reductions inside that business, looks questionable to say the least. As does mega-scale biomass to generate electricity from non-waste sources. However, both these approaches can be valid if done at reasonable scale and **not** at the expense of reducing emissions which is what is required.

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For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

The Funds managed by the Sustainable Future Team:

Are expected to conform to our social and environmental criteria.

May hold overseas investments that may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of a Fund.

May hold Bonds. Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result; The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

May encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.

May invest in companies listed on the Alternative Investment Market (AIM) which is primarily for emerging or smaller companies. The rules are less demanding than those of the official List of the London Stock Exchange and therefore companies listed on AIM may carry a greater risk than a company with a full listing.

May invest in smaller companies and may invest a small proportion (less than 10%) of the Fund in unlisted securities. There may be liquidity constraints in these securities from time to time, i.e. in certain circumstances, the fund may not be able to sell a position for full value or at all in the short term. This may affect performance and could cause the fund to defer or suspend redemptions of its shares.

May, under certain circumstances, invest in derivatives, but it is not intended that their use will materially affect volatility. Derivatives are used to protect against currencies, credit and interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The use of derivatives may create leverage or gearing resulting in potentially greater volatility or fluctuations in the net asset value of the Fund. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of a fund than if the underlying investment was held instead. The use of derivative contracts may help us to control Fund volatility in both up and down markets by hedging against the general market.

The use of derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short-dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

Outside of normal conditions, may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

May be exposed to Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

Do not guarantee a level of income.

The risks detailed above are reflective of the full range of Funds managed by the Sustainable Future Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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