

## A pathway to Paris. Which lane are we in?

In December 2015, world leaders agreed in Paris to limit global warming to below 2 degrees Celsius. In this article we look at two industry wide initiatives that have been set up to aid and monitor companies' progress in this regard and consider how our portfolios are aligned. In particular, we investigate whether those companies we already identify as being resource efficient in our portfolios are better aligned with the Paris agreement than the general constituents of the MSCI World Index<sup>i</sup>

### Targets will not score points in our models

Through extensive research on the productive use of resources by a business relative to the economic value it generates, Osmosis has developed an evidence-based sustainable investment thesis relying solely on publicly available, but often inadequately interpreted, environmental data. Our analysts strip away any hope value from sustainability reports and focus instead on utilising objective environmental data to identify sustainable action over (often meaningless) sustainability intent. It is, through this objective sustainability lens, that we believe we can contextualise the environmental balance sheet of a company.

### The issue of pricing hope

It stands to reason then, that simply alluding to sustainability goals or targets in an annual Environmental, Social and Governance (ESG) disclosure, will not reward a corporate with a higher environmental score within the Osmosis Model of Resource Efficiency. Talk is still cheap, even if placed under an umbrella of good intent. Ambitious targets are impossible to price with any measured objectivity.

However, having a target is seen as good practice, and not having one is bad, it can be as binary as that. So, the simple implementation and amplification of a sustainability strategy can, and does, lead to positive scoring within some data sets. While we acknowledge that setting targets is an essential tool in helping companies to manage and reduce their reliance on natural resources, and for reducing their emissions, simply rewarding intent over action is, we would argue, a fool's errand.

### An industry wide movement

In recent years we have witnessed an increasing interest at an industry wide level to begin aligning emissions targets with the 2015 Paris Agreement<sup>ii</sup>. In order that we are not just simply rewarding the language of sustainability (commonly referred to as greenwashing), the development of industry wide measurement initiatives is a welcome and helpful step in the right direction. In particular, independent analysis from organisations like the Science Based Targets Initiative and the Transition Pathway Initiative have come to prominence.

### Science Based Targets

The Science Based Targets initiative (SBTi) is a collaboration between the Carbon Disclosure Project (CDP), The World Resources Institute (WRI), the World-Wide Fund for Nature (WWF) and the United Nations Global Compact (UNGC). They collectively champion science-based targets as a powerful

way of boosting companies' competitive advantage in the transition to the low-carbon economy. The initiative considers corporate greenhouse gas (GHG) reduction targets to see if they are in line with what the latest climate science says is necessary in order to meet the goals of the Paris Agreement. After committing to the approach, companies can develop a target using a number of sectoral methodologies and submit their targets for validation. The initiative then evaluates the target and if it is deemed to be in line with the science, it will be validated. Currently, over 300 companies have set approved targets, and another 440 companies have committed to setting them in the next two years<sup>iii</sup>.

While the SBTi helps companies to set the required ambition for reducing their emissions, it does not currently track the progress made against these targets. The Transition Pathway Initiative (TPI) tries to bridge this gap.

### **The Transition Pathway**

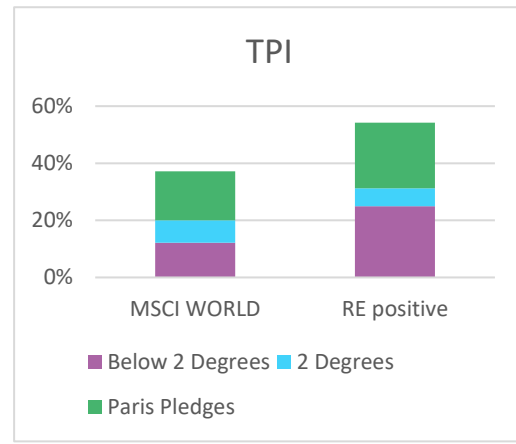
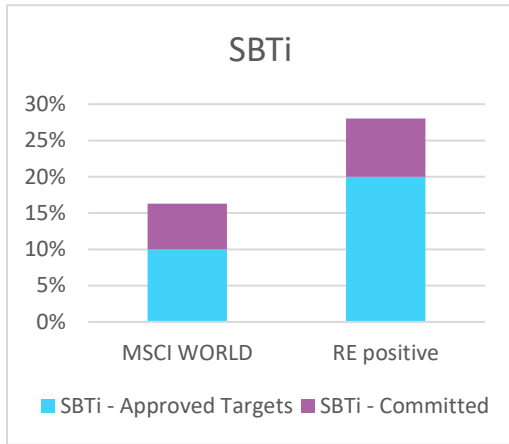
The Transition Pathway Initiative (TPI) is a collaboration between FTSE Russell, LSE's Grantham Research Institute and the UN PRI, developed to enable asset managers to assess a company's performance and its progress towards the low-carbon economy against internationally agreed benchmarks. It uses publicly available data and an academically rigorous approach. Whereas the SBTi can be used by companies across the whole economy, the TPI focuses on assessing those sectors that contribute most significantly to greenhouse gas emissions, and currently provides assessments for about 300 publicly-listed companies across 14 high carbon sectors.

### **Alignment of our portfolios**

We combined our own Resource Efficiency (RE) data with the targets data set from the SBTi and the assessment results from the TPI, to see if there was evidence suggesting that resource efficiency companies were more likely to be signed up to one of these initiatives and how they were progressing in line with their sustainability ambitions.

### **Resource efficiency and Paris**

Firstly, across the whole MSCI World, we noticed that companies with a positive RE score were twice as likely to have set approved science-based targets than the underlying benchmark. Indeed, about 20% of RE positive stocks had set targets, compared to just 10% of the wider benchmark. Additionally, more companies have committed to set targets within our pool of RE positive stocks versus the benchmark, bringing the number of companies that have set or committed to set science-based targets to over one in four of the total of RE positive stocks.



Source: Osmosis Investment Management, SBTi, TPI

For the MSCI World, this figure is one in six. Analysing the TPI results, it's important to note that less than 10% of companies in the MSCI World have been assessed by the TPI. Of the companies assessed, about 37% are considered to be either compliant with the National Determined Contributions (NDCs) set by national governments in the run-up to Paris, or with a (below) 2 degree world (limiting global warming to below 2 degrees above pre-industrial levels)<sup>iv</sup>. When only looking at RE positive stocks, this figure rises to 54%, an increase most visible in the "below 2 degree" category. One in four assessed RE positive stocks fall within this most stringent category, versus only one in eight across the whole benchmark and less than one in twelve within the RE negative stocks.

### Alignment in the Smart Beta Fund

Applying this analysis to the Smart Beta Fund, we reach similar conclusions. The Smart Beta product is uniquely placed as its constituents comprise both RE positive and negative stocks, as well as

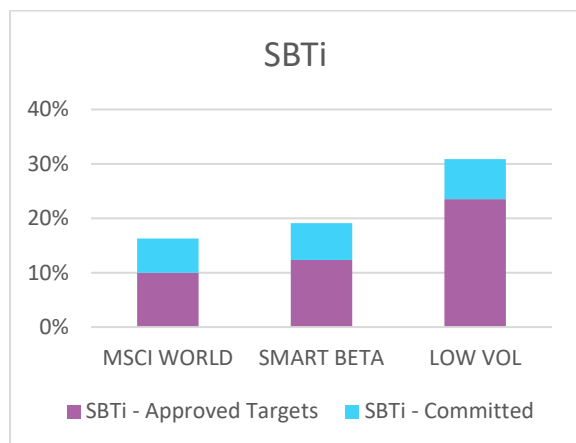
"Companies with a positive RE score are twice as likely to have set approved science-based targets than the underlying benchmark."

companies which have not publicly disclosed their RE data. This portfolio construction approach leads to a portfolio with improved SBTi and TPI characteristics relative to the benchmark. For example, 144 companies in the Smart Beta portfolio, one in five, have set or committed to science-based targets, versus 269 companies, one in six, within the MSCI World. When screening through the TPI assessed companies, 12 of the 67 assessed Smart Beta companies (18%) fall in the "below 2 degrees" category, while only 17 of the 140 assessed companies in the benchmark achieve this (12%).

### Alignment in the Low Volatility Fund

We also applied these figures to our Low Volatility Fund, a portfolio which traditionally has higher exposure to more resource intensive sectors. Within this Fund, almost one in four companies has set an approved science-based target, resulting in the most ambitious set of companies we have compared. While the TPI assessments are also positive, given the size of the portfolio and the number of available assessments it is difficult to draw firm conclusions.

These initial results strengthen our belief that focusing on current, objective data not only results in portfolios that have better environmental footprints, but also that we are investing in companies that are showing greater ambition and are better positioned for the transition to a low-carbon economy.



Source: Osmosis Investment Management, SBTi, TPI

However, we recognise there is a significant opportunity for meaningful shareholder engagement. This research project has identified a need for an enhanced engagement strategy at Osmosis. In conjunction with a focused engagement project to get companies to disclose their environmental footprints, we will also initiate targeted conversations with companies in which we invest, with a view to understanding why they are not achieving a positive RE score, despite having set ambitious targets through the SBTi. And we will be asking what actions resource efficient companies should be undertaking to become better aligned with a low-carbon future. We will report on these findings through our regular client communications and updates.

We are often asked “what is the impact of investing in an Osmosis product?”. The three pillars of impact are as follows:

- ✓ Targeting better risk adjusted returns
- ✓ Reducing environmental ownership of carbon, water and waste relative to respective benchmarks
- ✓ Corporate engagement on environmental disclosure and the ability to measure a company’s action over intent

<sup>i</sup> [The MSCI world index captures large and midcap representation across 23 developed markets countries. With 1,645 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.](#)

<sup>ii</sup> <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

<sup>iii</sup> <https://sciencebasedtargets.org/companies-taking-action/>

<sup>iv</sup> <https://www.transitionpathwayinitiative.org/tpi/sectors>

*The OSMOSIS MoRE World Smart Beta and Low Volatility Funds are not available for U.S.*

*Investors. Separate accounts are available for US investors using the same model and strategy.*

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