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# Table Talk

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## **Q: How can one invest towards combatting climate change?**

**A:** Climate change is no longer a distant threat but an immediate and pressing challenge that affects every facet of our lives. Before looking at investment opportunities, it's important to understand the framework, the Paris Agreement, in which the world is seeking to combat climate change.

## **What is the Paris Agreement?**

Adopted by 194 parties on December 12, 2015, and effective from November 4, 2016, the Paris Agreement represents a global commitment to address climate change. The primary objective is to limit global temperature rise to well below 2°C above pre-industrial levels and pursue efforts to restrict the increase to 1.5°C above pre-industrial levels, since this would significantly reduce risks and the impacts of climate change.

Achieving these targets requires substantial reductions in greenhouse gas emissions and a transition towards a more sustainable economy.

Governments worldwide, including South Africa, are increasingly committing to these goals. They are implementing policies and regulations to enforce decarbonisation and achieve net-zero emissions by 2050. As global leaders work towards the ambitious targets set by the Paris Agreement, investors have a crucial role to play in driving the transition to a low-carbon economy. This creates a fertile ground for investors to align their strategies with these global efforts while potentially reaping financial rewards.

For South African investors, this presents both opportunities and risks that must be carefully navigated. This article explores how investing towards combatting climate change can be approached and assesses its contribution to portfolio performance.

## **Unpacking Paris-aligned investing**

Paris-aligned investing involves directing capital towards companies and sectors that are in line with the goals of the Paris Agreement. This approach not only supports the global climate objectives but also manages investment risks associated with climate change.

Here's how Paris aligned investing works:

- **Carbon footprint reduction**  
Investors focus on companies with a lower carbon footprint or those that are committed to reducing their emissions. This involves identifying businesses that are making significant strides towards minimising their environmental impact. By investing in these companies, investors mitigate exposure to carbon-intensive industries and support sustainable practices.

<sup>1</sup>Climate Change Act No. 22 of 2024

- **Fossil fuel exclusion**

A critical component of Paris-aligned investing is avoiding companies involved in fossil fuel extraction, production, or distribution. This strategy aligns with the global shift towards cleaner energy sources and reduces the risk associated with investments in industries that are likely to face increasing regulatory and market pressures.

- **Renewable energy investment**

Investing in renewable energy sources such as wind, solar, and hydro power is central to a Paris-aligned strategy. These sectors are vital for transitioning to a low-carbon economy and offer significant growth potential as the world moves away from fossil fuels.

- **Climate risk assessment**

Investors evaluate the potential risks and opportunities related to climate change when making investment decisions. This involves assessing how climate-related risks, such as extreme weather events or regulatory changes, could impact a company's performance and integrating this analysis into the investment process.

- **Sustainable Development Goals (SDGs) Alignment**

Paris-aligned investing often intersects with the UN's Sustainable Development Goals (SDGs). Investors target companies that contribute to goals such as affordable and clean energy, sustainable cities, and climate action. This alignment ensures that investments not only address climate change but also support broader social and environmental objectives.

- **Active Ownership**

Active ownership involves engaging with companies to promote climate-friendly practices and improve transparency in environmental impact reporting. Investors, such as M&G Investments, use their influence to encourage companies to adopt more sustainable practices and achieve their climate goals.

## **Investment opportunities on the path to net zero**

At M&G Investments, we are facilitating investment into this prevalent trend with the [M&G \(Lux\) Global Sustain Paris Aligned Fund](#). In constructing the fund, we leverage comprehensive primary research to identify high-quality companies making real progress toward the Paris Agreement goals. We seek firms with robust business models capable of delivering compound returns over the long term, and trading at an attractive price relative to our valuation assessment, with a margin of safety. Over the past decade since the fund's launch in 2014, our extensive research has provided us with deep insights into various companies, enabling us to make timely investment decisions when valuations are compelling. We maintain a highly selective approach and usually hold fewer than 40 well-understood stocks in the portfolio.

Our investment edge lies in our long-term approach and holding period. When selecting stocks, we aim to retain them for a decade or more. Since the fund's inception, the average holding period has been eight years, with the management team typically changing only two stocks per year. This contrasts with the broader market, which often reacts to short-term events like sudden selloffs with a one- or two-year outlook, potentially impacting many stocks. Our long-term perspective means that such short-term fluctuations are less consequential for us, allowing us to add attractively valued stocks and patiently wait for their recovery. Over time, this approach enables us to accumulate high-quality companies at favourable valuations, contributing to portfolio outperformance.

## **Flexible approach**

We take a flexible approach to portfolio construction, identifying companies that fit into one of two broad buckets – 'stable growth' or 'opportunities'.

'Stable growth' companies are those that have a proven track record of producing stable earnings. They are generally perceived as the long-term 'winners' by the market and tend to have very strong market positions or powerful brands. Individual weights in the fund of stable growth companies tend to be between 3% and 6%, with returns generated by both the 'safe margin' entry point, as well as the effect of long-term compounding.

'Opportunities' companies sit in out-of-favour corners of the market where change is not appreciated, or risk is overstated. These tend to be less predictable, but with significant upside potential, with weights tending to be between 2% and 3% of the fund.

It is important to note that position sizes are primarily based on our assessment of risk, rather than on 'conviction' in the investee companies. Generally, we choose to hold larger positions in companies that we consider to be less risky. In a typical high-conviction portfolio, we typically expect to see half of the fund's total risk attributable to the five largest holdings. In the [M&G \(Lux\) Global Sustain Paris Aligned Fund](#), we aim to 'flatten the curve', taking relatively larger positions in companies that we deem to have less business and valuation risk. In practice, this means that a 5% position in a more stable company and a 2% position in a riskier high-growth company can provide equal contributions to overall risk.

Importantly, we do not seek to add volatility risk; instead, we aim to achieve outperformance primarily through selective stock picking. We expect the output of this framework to be a fund exhibiting a similar level of relatively low volatility compared to the benchmark, despite its concentrated nature.

We believe that active management offers a more nuanced approach to climate-aligned investing. It involves deep analysis and continuous engagement with companies, focusing on real-world outcomes rather than just carbon intensity metrics. For these reasons, we employ an active strategy in our Paris-aligned fund, conducting thorough research into companies' governance, strategy, and decarbonisation targets.

A notable example is Weir Group, a mining equipment producer with significant Greenhouse Gas (GHG) emissions. Despite its high emissions, Weir Group is committed to decarbonisation and has set science-based targets for reducing its GHG intensity. Additionally, its products help mining companies lower their energy consumption and emissions. Weir has a science-based target to lower its GHG emission intensity from operations by some 30% by 2024 and to decrease its absolute level of GHG emissions from operations by 50% by 2030. Through our lengthy and extensive engagements with management, we know their plans are credible and aligned with the mining industry.

Our investment in companies like Schneider Electric and Ball Corporation highlights this approach. Schneider Electric, a leader in energy management and automation, and Ball Corporation, a major aluminium can manufacturer, both play crucial roles in reducing emissions through their products and services. Ball has its own science-based targets to lower its GHG emissions from its operations by 55%, as well as 16% of its GHG emissions across its value chain, by 2030. It is also aiming for 85% of the aluminium content in each of its cans to be recycled by 2030.

An active approach focuses on real-world outcomes rather than just metrics. For instance, we evaluate the absolute GHG emission reductions achieved by the companies held in the portfolio, not merely their carbon intensity ratios. This approach ensures that investments contribute to meaningful climate progress rather than just meeting predefined benchmarks.

## Conclusion

Paris-aligned investing offers South African investors a way to support global climate goals while potentially enhancing portfolio performance. By focusing on companies that are committed to reducing their carbon footprint, excluding fossil fuels, and investing in renewable energy, investors can align their portfolios with the Paris Agreement's targets.

By focusing on real-world outcomes, engaging deeply with companies, and supporting their decarbonisation journeys, active investors can drive meaningful progress towards climate goals. For investors committed to making a real-world impact while achieving sustainable returns, an active approach is key for navigating the path to a net-zero future. With its proven process and a successful 10-year track record, supported by a dedicated team of 10 experts in fund management, and research team, the [M&G \(Lux\) Global Sustain Paris Aligned Fund](#) presents a compelling opportunity for discerning investors.

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