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Enhanced focus on environmental markets post Paris Climate Agreement

by Bruce Jenkyn-Jones, Co-Head of Listed Equities, Impax Asset Management

Investors may be eyeing 2016 with some trepidation: low growth, rising interest rates and weak demand provide good reason for caution. But, heading into the New Year, we are confident that the resource optimization and environmental markets in which we invest hold the promise of significant outperformance—both in the near term and over longer investment horizons.

The Paris Climate Agreement, struck last month, changes the lens through which governments, companies and investors view the future. After many years of negotiations, the agreement establishes for the first time a truly global mechanism to rein in climate change, and one that will be subject to further tightening through periodic reviews. We believe that the Paris Agreement has fundamentally shifted calculations about risk and opportunity across many industrial sectors—most notably in energy, but also in transport, industrial goods, agriculture, waste, property, pulp and paper and many more.

It looks set to shift corporate positioning and make capital more readily available to businesses specializing in low-carbon goods and services. It could also generate a tailwind for the environmental and resource optimization markets.

Take renewable energy assets. Since 2013, more renewable than fossil fuel-fired generating capacity has been built worldwide. We anticipate further superior growth in investment in wind and solar farms. As part of EU's ambitious Paris pledges and transition to a low carbon economy, the EU Renewable Energy target will be increased to 27% of all energy by 2030, up from 20% in 2020. Continuing cost reductions—with renewables increasingly able to compete with fossil fuel energy without subsidies—will alleviate concerns over affordability.

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KEY TAKEAWAYS

- Environmental issues can have profound effects on company share prices and portfolio performance.
- The Paris Agreement shifted calculations about risk and opportunity across many industrial sectors.
- We believe environmental and resource optimization markets hold the promise of significant outperformance.

Bruce Jenkyn-Jones is the Co-Head of the Listed Equity team and oversees Impax's long-only investment strategies at Impax Asset Management, sub-adviser to the Pax World Global Environmental Markets Fund. Bruce is responsible for the development of the investment process, research and team development. He also has an active role in the day to day management of all Impax listed equity portfolios. Bruce joined Impax in 1999 where he worked initially on venture capital investments before developing the listed equity business. Before joining Impax, Bruce worked as a utilities analyst at Bankers Trust and as an environmental consultant for Environmental Resources Management (ERM). Bruce has an MBA from IESE (Barcelona), an MSc in Environmental Technology from Imperial College and a degree in Chemistry from Oxford.

Paris could also provide a boost to the sustainable property sector. The built environment is responsible for around 40% of global emissions. In a low-growth, low-interest rate environment, income-generating assets such as real estate are already attractive to investors: premium returns are to be had by investing in energy efficiency, simultaneously cutting building emissions and their occupiers' costs.

There are also a number of more immediate drivers that have the potential to generate outperformance across our listed equity strategies in 2016.

Air pollution is likely to be as important a factor as greenhouse gas emissions in driving the share prices of environmental technology stocks in the year to come. Growing public disquiet about poor air quality has already encouraged China to begin to curb its coal burning. In December, Beijing issued its first ever 'red alert' due to local air pollution, closing factories, schools and construction sites. We expect that the country's forthcoming 13th Five Year Plan will significantly increase targets for reducing sulfur dioxide and nitrogen oxides, benefitting pollution control equipment manufacturers. India, while defending its right to exploit its domestic coal reserves, also faces crippling local air pollution. The consultancies that will be called upon to help governments retool their regulatory regimes, as well as companies that supply real-world exhaust testing equipment look set to benefit. While a shift away from diesel towards gasoline vehicles may hurt catalyst manufacturers, we expect the emissions scandal to assist the long term uptake of electric and hybrid vehicles.

The outlook for investment in water infrastructure and associated pollution control equipment is also healthy, driven by construction markets and recovering municipal spending, particularly in the US. In Asia, enormous infrastructure investment is needed to catch up with demographic and economic growth, with water provision and wastewater treatment set to see continuing strong capital flows.

In waste management, generalist groups face headwinds from mediocre global gross domestic product (GDP) growth and ongoing weakness in markets for recycled commodities. But opportunities exist in sector niches, such as hazardous waste, where high barriers to entry are keeping margins healthy. Specialist recyclers that are able to dominate their particular recycling stream are likely to outperform the wider market and we expect this to be reinforced as the demands of the EU Circular Economy Package takes effect.

The food and agriculture industries, which are major greenhouse gas emitters, are being disrupted by environmental and regulatory developments as well as changes in consumer preferences, particularly in developed markets. We see particular opportunities in natural foods, food safety, and advanced packaging solutions.

Population growth, urbanization, resource scarcity, environmental constraints and a global infrastructure deficit continue to gather momentum and we believe that environmental and resource optimization markets will offer long-term investors strong growth in a low-growth macro environment.

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And perhaps most importantly, the Paris Agreement has underscored that environmental risk falls squarely within the fiduciary responsibility of professional investors. Be it the collapse of VW's[1] share price, or the introduction of a global climate regime, environmental issues can have profound short and long-term effects on company share prices and portfolio performance. Investors ignoring them do so at their peril.

Pax World Global Environmental Markets Fund

The Global Environmental Markets Fund's investment objective is to seek long-term growth of capital. The Fund invests in environmental and resource optimization markets and seeks to take advantage of rapidly accelerating global demand for efficiency solutions in the areas of energy (alternative energy, energy efficiency); water (infrastructure, technologies and pollution control); waste (waste management and technologies, environmental support services), and sustainable food, agriculture and forestry.

Pax World Management LLC

Pax World is a leader in sustainable investing, the full integration of environmental, social and governance (ESG) factors into investment analysis, security selection, portfolio construction and risk management. Pax World combines rigorous ESG analysis with equally rigorous financial analysis in seeking to identify better-managed, industry leading companies that meet positive corporate responsibility standards, have a clear vision for managing risk, and are focused on delivering long-term value to shareholders. Pax World launched the first socially responsible mutual fund in 1971 and today offers a family of mutual funds including ESG Managers® Portfolios, multi-manager asset allocation portfolios powered by Morningstar Associates, LLC.

Impax Asset Management Ltd.

Impax Asset Management Ltd, sub-adviser to the Pax World Global Environmental Markets Fund, is a leading global equity specialist, investing in companies active in the rapidly growing and inefficiently priced resource optimization markets. Impax has been researching and managing portfolios of publically traded stocks and private equity in this space for over 17 years, with 27 investment team members. Impax has offices in London, New York, Portland Oregon and Hong Kong.

[1]As of 12/31/15 Volkswagen (VW) was not held by an Pax World Funds. Holdings are subject to change. For the most recent month-end holdings information visit www.paxworld.com.

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