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Interview, 9th January 2024
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«Real world impact is best delivered through private markets investments»

Mr. Duncan, the COP28 Climate Change Conference has recently been held in Dubai. Its results are qualified differently: from «too little to late» to «historical commitment to phase out from fossil fuel». What is your judgement?

I've been following the COP process for many years and attended COP 17 held in Durban, South Africa, in 2011. It is a tremendously complicated political process, so any consensus developed on one level should be seen as a victory. It is historic that the language of transition away from fossil fuels is now formally into text. All this being the result of a COP held in the Middle East, where a large part of those nations' fiscus stems from oil. I believe this collective acknowledgement probably signals the begining of the end of fossil fuels, which as we know is targeted for phase out by 2050. But at the end of the day, these agreements are just agreements. What's going to be important to see is what happens in the markets and in terms of country commitments, and future capital deployments to decarbonise. For fossil fuel majors this implies consolidation and a race to the bottom, as each player seeks to moneytise its assets.

Can the UN goals for decabornisation be reached at all?

We're talking about 28 years of debate, we're currently in what I see as the third iteration of the COP process from a «governance perspective». What is unique about the Paris accord, is that governments voluntarily choose to reduce emissions through their Nationally Determined Contribution, so it's a kind of opt-in system. We don't know whether humanity is capable of this scale of global co-operation, particularly at this point of enhanced global tensions. On the other hand, this is now an issue of the voting population, so politicians do have an interest in it. But more than that, it is an issue of global stability and long-run economic competitiveness, the winners being those countries that can decarbonise GDP ahead of their peers. It seems this message has hit home with large economic stimulus packages in the form of the «EU Green Deal» and the «US Inflation Reduction Act». Both packages are massive government programmes pushing forward «green» economic growth. While I am interested in the COP political process, I think the real innovations that we need in order to decarbonise growth will come from the private sector.

ESG seems almost dead in the market as a measure for change. Your impact approach is guided by a systemic view including society, the environment and the market, to find solutions that balance risk, return and impact. How will impact investing develop?

ESG is an acronym that simply represents the economic, social and governance issues which are collectively used to describe the broad category of sustainable issues. I believe considering and integrating material ESG issues in investment processes, is simply good practise and sets the new benchmark for high-quality investment practices. Considering ESG issues is an acknowledgement of systemic risk based on an understanding of the inter-connection between biophysical, social and market systems. ESG as a way to understanding risk is an important input into the investment process. Impact, on the other hand, is just one set of investment outcomes that you may choose to pursue. I believe there is a nascent cohort of investors who would like to have an impact with their wealth. However, it is important to consider that direct real world impact is best delivered through private markets investments, and that such investment are not suitable for all investor types, especially when considering ticket sizes and liquidity constraints. Having said that, indirect impact is possible to access via publicly traded securities, especially via green bonds, or buying stock of companies who make their revenue from goods and services that are aligned to the green economy. The task of the Wealth Manager is to understand their clients' sustainability/impact motivations and then to guide them towards what is practically achievable, given the size of their funds, their liquidity constraints, and long-term return goals.

What are the implications of COP 28 regarding the «greening» of investments?

From a financial perspective there are two things that come out of COP: on one side, the ambition to scale up renewable energy and electrification. Here, COP has refocused the attention of the world on this opportunity set and I see growing innovation in financial sectors to scale the flow of capital. The bulk of those opportunities will be in the private markets, with a select number of listed companies that will have some revenue coming from aligned activities. Much of the current global wealth management market does not include private markets due to ticket size and liquidity constraints. However I think this is evolving through innovation of digital platforms that facilitate access to institutional scale private market opportunities. On the other side, it's the thinking about the fossil fuel companies themselves, and how one could consider them in the context of a transition-aligned portfolio. The implications of phasing out of fossil fuels is that if these companies keep doing the same thing, then at some point they will become stranded assets. This shifts the calculation from viewing these companies not as capital growth companies, but yield companies.

What options do investors have if they want to invest in a sustainable economy?

In the public bonds and equity market, the actual pure «green» economy aligned thematic set is a small percentage of the total market capitalisation. A consequence of this is that a lot of money is chasing a small amount of opportunities, which is translating into some of these green economy thematic ETFs having blown-out PE ratios. It is important to consider that public markets offer liquidity and scale but less direct impact. Meanwhile, private markets offer real world impact, but are constrained in terms of capital deployment and liquidity. Additionally, emerging market exposure is seen to offer greater levels of impact per unit of capital deployment than a similar sector allocation in developed markets. As mentioned above, it is important to understand customers' sustainability motivations. These can range from a desire to have a profound impact, to a commitment to green economy issues, to a simple desire to be able to sleep at night knowing that their capital is not invested in controversial companies. This insight will help align client expectation with what is practically achievable. Fortunately, there is a fast-growing opportunity set to meet the range of investor motivations: from ethical ETF's, to micro lending, «green» bonds, single name listed equities to traditional funds that actively deploy ESG risk & «green» economy insights in their processes.

About the person

Jon Duncan has an Engineering degree followed by Master's degree in environmental science. He began his career in 1996 in South Africa, where he held roles in environmental research, consulting, and engineering. As a senior sustainability researcher and consultant at Trialogue between 2004 and 2006, he designed and implemented corporate sustainability and social investment strategies. In 2006, he became a partner at Environmental Resource Management, where he led the climate and sustainability practise for Southern Africa. There, his work focused on enhancing businesses' understanding and ability to manage the key risks and opportunities presented by sustainability and climate change. In 2011, Jon Duncan became Head of the Group Responsible Investment Program for Old Mutual, where he led the development and implementation of the Responsible Investment Program across the business' global operations. He developed Old Mutual's ESG research and analysis capabilities and the Groups sustainability focused product propositions across the various investment capabilities and asset classes. Jon Duncan joined REYL in 2022 as Chief Impact Officer where he is tasked with developing, implementing and leading REYL's impact strategy to maximise the value-add opportunities that arise from the global economic transition to a low carbon footprint.

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