Ep66: Sustainable Investing: Pro Tips from Sarah Bratton Hughes of Shroders

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PATTI BRENNAN: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow and use your assets to live your very best lives. We are so excited to have Sarah Bratton Hughes with us.

Sarah's with Schroders, and she is Head of Sustainability for Schroders. This lady knows everything there is about socially responsible investing, or what is often referred to as ESG or SRI or SDG. Lots of different names, and frankly, they mean different things depending on what you're looking for.

Sarah, thanks so much for joining us today.

SARAH BRATTON HUGHES: Thanks, Patti. Thank you for having me.

PATTI: I just threw out a whole bunch of acronyms. When we think about socially responsible investing, especially over the last year or so, we saw a lot of emotion as it relates to equality. Whether it be gender equality, climate change, clean water, lots of different things that people feel very passionate about.

It's wonderful because here we are in America, and we can voice our opinions and our thoughts. I can't think of a better way to do that than also put your money where you feel things need to change. What do you think about that?

SARAH: Yes, I definitely agree. One of the most challenging parts about being in the field of sustainable investing is sometimes the alphabet soup of acronyms that are referred to when we're talking about this.

I think about it across a spectrum. My preferred term is sustainable investing, focusing on that all encompassing stakeholder approach, in which a company's sustainability practices are paramount to the investment decision.

Yes, ESG analysis forms the cornerstone of that investment process. If we think across the entire spectrum with often known as sustainable investing, down one end you have what I would consider integration. That's where you're looking to obtain the financial benefits of systematically incorporating sustainability as part of your investment process.

If you move over to the right, you have more somatic investing. Sometimes how it's termed is SDG investing, investments that are targeting solutions for the UN Sustainable Development Goals.

If you move one notch over to the right, I would then consider much more socially responsible or values based investing or sometimes also called screened investing, where you're screening out certain industries that you don't want to have, from a value perspective, exposure to in your portfolio.

You can remove it or even further to the right where you have impact investing, where your targeting impact is crucial, alongside the return and then finally all the way over on the far this part of the right hand spectrum is philanthropy where you're investing and expecting no return, whatsoever.

There is a broad spectrum when it comes to sustainable investing. Interestingly, I like to also say, just to add another acronym and here, is focused on the ABCs. I think this is also a great way to organize it when you're thinking about the whole spectrum of sustainable investing, and this was developed by the impact management project.

It puts sustainable investing into three categories. A, that's avoid, so that's the do no harm. That's when you will have some of these value based strategies, where you will screen out certain industries. You're looking to manage your sustainability exposure from a risk perspective.

You move over to B, and that's for benefits. You're looking to benefit your return alongside benefits that have been stakeholders.

Within B, those who go broad based sustainable solutions as well as your integrated funds that are systematically incorporating sustainability as part of their investment process. Where the market is moving right now is away from some of those broad based sustainable or ESG strategies and moving into the C bucket.

That's contributing to the solution. That's where you're finding somatic and impact products that people are looking to allocate the funds that are focused on climate change, energy transition, diversity.

You're seeing a lot of funds continuing to grow here. You're seeing a lot of assets go here. Quite candidly, you're seeing a lot of innovation for different solutions that people are looking to target in the C category.

PATTI: That's interesting. What does C stand for?

SARAH: Contribute.

PATTI: Contribute.

SARAH: A is avoid. B is benefit. C is contribute, so contributing to the solution.

PATTI: That's phenomenal. When I think about sustainability, that speaks to me, Sarah. Honestly, what we do was very similar as it relates to people and families. We want to make sure that their assets can sustain them for the rest of their lives.

It feels like this longevity is a part of it, that we want the earth to be here for a very, very long time, and I think it's terrific. I think that the fact that the market seems to be moving more towards that C. Let's focus on the solutions, and really fund those potential solutions.

Before we got on live like this, we were talking about this whole concept of carbon capture. Does it make sense to really focus on the nasty stuff that our cars emit, and capture it in the atmosphere? Would that be a solution rather than having us lose thousands of jobs because we're closing down a pipeline?

It's a different way of solving that problem. I speak, you're the expert. I don't know that anybody is truly the expert on these things, in terms of where we are, as it relates to that technology and the practicality of its application. What are your thoughts?

SARAH: I think what is first and foremost as I say, there's…Many people often think of what kind of jobs are going to be lost? I always point to the great state of Texas, because everybody looks at them as our large oil producing state.

Actually what's going on behind the scenes in Texas is really phenomenal. They're our largest producer of renewable power out of all the states in the US right now. You are seeing a transition occur within the economy. It's also a very…I'll use the term "Just transition."

Thinking about…there are many people. It's the same topic for something like coal. What you see happening – particularly around the utilities that are shuttering down these coal plants – they're very conscious that they are in many towns, the economy there.

They're providing job training, they are providing education, to ensure that that economy continues to thrive in the future. I think that it's not just as simple as shutting some of this down, as it relates to carbon capture storage. I think that's a really interesting technology.

It is something that is continuing to grow. What I'm really watching is how politicians and how countries are embracing it from a policy perspective. Over 50 percent of the world's population lives in areas that have made Net Zero commitment. That is almost no different here in the US.

One third of Americans live in communities that have made Net Zero or decarbonization commitments. Key to that will be the growth of hydrogen power, and key to the production of green hydrogen is carbon capture storage, as well as the production of electrolyzers.

What's really important, what's really interesting, where this gets really interesting from an investment perspective as you're looking as you said, you like to do with your families, it's first that preserve, and then the growth.

From an investment perspective, you're seeing this massive shift and this growth into these technologies that are going to allow us to meet these Net Zero commitments that we're seeing pop up, not only in countries around the world, but also with both asset managers as well as some of the leading institutional investors we have here in the US as well.

PATTI: When you talk about Net Zero, basically, what I'm hearing is that the goal here is not to make things worse. The fact is, if we continue doing everything we're currently doing, our children and grandchildren – and maybe even ourselves – are going to be in deep trouble, that we're already seeing the impact of these choices that we've made.

Net Zero would…OK, it is what it is. Let's just not make it worse. What do you think about the idea of 50 percent? What about the other 50 percent, because we're all part of that same atmosphere? Why should we take the economic risk of changing the source of our energy when other nations don't care, that they're not going to do it? What are your thoughts on that?

SARAH: A couple of different thoughts on that. What we've seen happen, we've seen significant policy happening out of Europe. We are seeing significant indications of policy coming out here in the US.

There's also talk not just only on Net Zero but there was this wonderful 660 page report issued by the UK on biodiversity this morning that also spoke of the concept of border tax and implementing tax on some of these economies that are heavy pollutants and not making that transition to Net Zero.

What I think is really important, just to take a step back because I think policy is the third leg of the stool. We're two thirds of the way there already in terms of not just taking it broader than green transition and green solution but all of sustainable investing.

Hitting on a lot of the themes that you've touched on early on in the podcast, Patti, is that we have, from an economic standpoint, in many cases green energy and renewable energy is a lot more economical than legacy fossil fuel. That economics is really going to drive the transition.

It was a signal to the market and a signal here in the US when in October you saw NextEra overtake Exxon Mobile in terms of market share. NextEra is our largest producer of renewable energy here in the US. They took over Exxon in terms of market share on the S&P 500.

To me, that was a signal of where the future was and where the future is going and much so from an economic standpoint. I don't think any of us five years ago could ever have imagined that, and maybe not even three years ago, any of us in mainstream population.

The other bit is you're seeing this end consumer demand and that end consumer demand significantly start to rise. Schroders does a Global Investor Survey every year. There's two things I would like to highlight.

In 2019, we saw this massive shift. Historically, it had always been, "Oh, the millennials and the women, they're the ones that really care about sustainable investing."

Actually, in 2019, we saw a shift where Gen X started leading the pack. They were more focused on sustainable investing than any other generation. We saw not only a continuation of that in 2020, but we also saw a broadening out across all levels of generations caring about sustainable investing, including baby boomers.

The other bit is that there was a real shift this year how people thought about sustainable and ESG investing, and it was on the return perspective. Historically, I had gotten a lot of push back from investors saying, "I don't want to sacrifice return to invest sustainably." That's really not the case at all.

However, I do think today's sustainable investing did get its first test in the early innings of the COVID crisis. It really proved itself to no longer just be a bull market luxury.

What we saw in our Global Investor Survey is that 55 percent of Americans now feel like if they don't invest sustainably, they'll miss out on performance. This was a real mind shift from what we had seen happen historically. Actually, this is a real mind shift or divergence from the rest of the world.

The rest of the world often thinks about sustainable investing from a beta or a risk perspective, where Americans are really focused on that alpha perspective. We are seeing a significant amount of capital that is going to have to move to meet both the goals of Paris as well as the UN Sustainable Development goals.

We're seeing a massive amount of shift of capital in motion. I think that there is a real opportunity not only to maximize return but to maximize return and leave society a better place.

PATTI: It's fascinating to hear those stats because we're seeing this in our own firm. People are talking about sustainable investing more and more. What I find fascinating is your point. Clean energy, for example, is actually more economic than investing in companies that focus on fossil fuels.

I can't help but wonder what those companies are doing, the Exxons of the world, in order to catch up. Are they going to be the next Kodak, for example, that didn't believe the writing on the wall and will become the next company that's the has been, or is this just a temporary glitch?

Based on what I'm hearing is that you are saying that, 10 years ago, it was expensive to focus on clean energy, green, etc., where the cost to provide that has come down significantly. From an economic perspective, it can be a great investment as well.

SARAH: Exactly.

PATTI: From your perspective, when you think about your clients, because I know Schroders has such an influence not only here in the US but globally.

What I've understood is that Europe, for example, they almost don't even categorize things as ESG anymore because they believe that every company should be focusing on that. Is that an accurate statement?

SARAH: Yes. I would say that in terms of Europe, or at least in terms of Northern Europe, ESG has become a hygiene factor. What do I mean by that is that it's something that everybody is doing.

It is part of the entire investment value chain from the corporates to the investors to the end clients to plan participants. It is something that they're clearly paying attention to.

Some of that is driven by, historically, Northern Europe, particularly the Nordics being a lead in the field of sustainable investing. Other bits of that is being driven by EU's sustainable finance policy, where the EU has come out and not only put their flag in the ground to be the leader from a policy perspective around sustainable investing globally.

They've also developed a taxonomy that is actively looking to drive capital away from "brown or dirty industry" into green industry. They are trying to not only influence policy but also influence how capital is being driven. It's not just the EU. We're seeing pockets of regulation pop up globally.

Interestingly, if you looked at what had occurred in the form of regulation in 2017, there were just over 100 bits of policy or regulation around sustainable investing.

By 2019, it had exploded to around 250 global policies or regulations around sustainable investing by governments. I would say most of them because we were in a bit of a different scenario here in the US. We're very supportive around sustainable investing.

Just to touch on, something we were talking before the podcast, Patti, is that we're continuing to see that grow. We're particularly continuing to see that grow around climate, as we think about and as we hear continuations of carbon prices and how they're going to be potentially implemented at global levels.

PATTI: You know what Sarah? I think that is a great tee up for our next podcast. What do you say you and I come back on and talk a little bit about – or maybe, a lot – our new leadership here in America and some pretty dramatic initiatives in President Biden's first week of office.

I'd be interested in learning what you think about that and where you think that could drive the United States, as well as the rest of the world.

Thank you so much for joining me today, Sarah. This is phenomenal. I can't tell you how amazing you are at these different topics. I would not doubt for a moment that you read that 662 page paper this morning before our podcast even started.

Thank you for doing your homework. I so look forward to bringing you back on because I'm interested in learning a little bit of what's going on behind the scenes down in Washington. Thank you so much for joining us.

SARAH: Great. Thank you for having me.

PATTI: By the way, thank you for joining us as well, all of you who continue to tune in week after week, month after month. Boy, the feedback that you've been giving us is phenomenal. I'm so grateful.

It's because of your feedback that we get to bring on incredible people like Sarah to talk about issues that are important to all of you, so keep coming back.

Thank you so much for joining us. If you have any questions, go to our website, keyfinancialinc.com. Until next time, I'm Patti Brennan. I hope you guys have a great, healthy day.