

## COP 26: the implications

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### As the dust settles post COP 26, portfolio managers Velislava Dimitrova and Cornelia Furse discuss the main outcomes of the Glasgow event.

While the outcome from COP26 is not a 1.5 or even 2 degrees Celsius scenario, it should lead to incremental improvements to reduce global CO2 emissions in the coming decades. We witnessed several global goals, such as the Global Methane Pledge, commitment to end deforestation by 2030, the agreement to phase down unabated coal, along with green technology initiatives such as the Breakthrough Agenda and the First Movers Coalition. However, the quality of and commitments to these outcomes can only be evaluated over time, with many lacking short term, concrete actions and key regions missing from the list of supporters. The breadth is also insufficient as many sources of GHG emissions have not been addressed.

Whilst the range and scope of agreements is insufficient to prevent the catastrophic events of climate change, it is moving us one step closer. As of 2 November 2021, over 140 countries had proposed Net Zero targets, covering 90% of global emissions, vs 80% pre COP-26 (BNEF, 2021). In an optimistic scenario, if these discussed targets are fully implemented, we are on track for a warming of 1.8 degrees Celsius (International Energy Agency) by 2050. Whilst this is a significant improvement, it is still above the 1.5 degrees Celsius warming limit defined by the Paris Agreement. Furthermore, by aggregating all COP-26 official pledges, the United Nations reported emissions in 2030 would be 13.7% higher than 2010 levels. This is a modest improvement from the 16% increase before these new pledges, but there is a long way to go to reducing emissions by 50% in 2030 (United Nations, 2021).

We believe the outcomes of COP 26 will provide an ever-increasing recognition of the urgency to respond to the climate crisis. Furthermore, the credibility of targets discussed at COP 26 must be proven and short-term policies to achieve these targets will need to be implemented, which should provide significant tailwinds to decarbonisation technologies and solutions. Events such as COP 27 (held in Egypt next year) and the accelerated awareness of climate change, should help drive commitments to achieve 2030 and 2050 decarbonisation goals.

The main outcomes for COP 26, along with the investment implications are as follows:

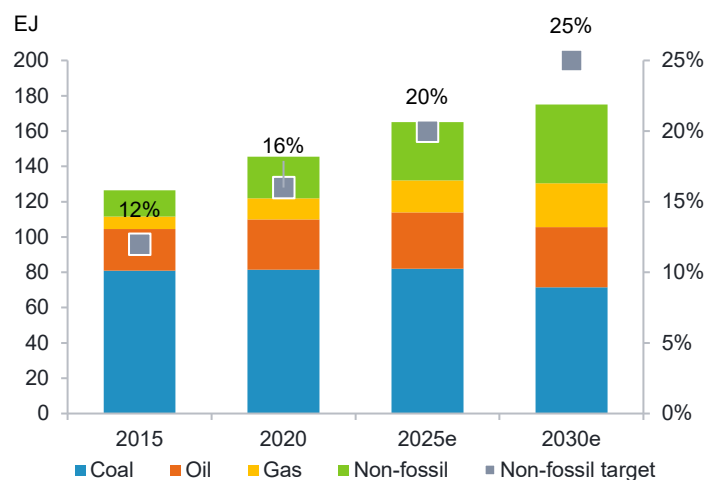
#### Reduction of coal will pave the way for renewable and clean technologies in energy supply

A significant milestone achieved at COP 26 was the agreement to phase down unabated coal. This was the first-time coal was discussed at a COP event and the agreement did not come without debate. The final phrasing of the deal was changed last minute (the initial goal was to 'consign coal to history') due to China and India's decision not to agree to the stricter terms. This is not surprising, given China and India have accounted for 95% of new coal-power capacity in the last decade (BNEF, 2021) and China accounts for > 50% of global coal demand.

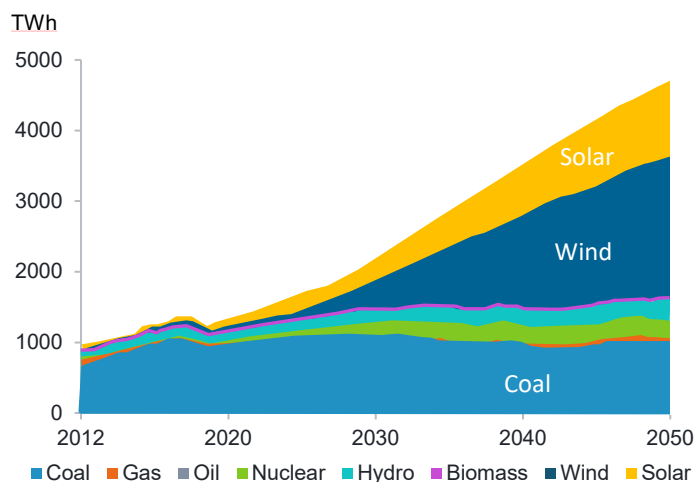
Currently, coal-fired power generation represents one of the largest sources of CO2 emissions at 30% (BNEF, 2021). To meet the Paris Agreement's 1.5 degrees Celsius warming limit, it is predicted that coal must be phased out the power sector globally by 2040 (Climate Action Tracker, 2021). The pledge therefore lacks meaningful commitments and ideally, the climate requires a bolder statement. However, the pledge marks significant progress as governments now acknowledge the abatement of coal is an essential step for the climate transition.

Given that coal accounted for over a third of global electricity generation in 2030, the signing of the agreement should significantly reduce this. This will present elevated demand for renewable and clean energy technologies to fill this gap in energy supply (see charts below).

### China primary energy consumption, historical values (columns) and non-fossil fuel targets (markers)



### India electricity generation by technology



Source: China National Bureau of Statistics, National Development and Reform Commission BloombergNEF. Note, for left-hand chart: Total primary energy consumption and gas consumption is based on the NDRC targets. The oil consumption is from our Global Oil Outlook to 2050, we assume coal consumption to reduce to make room for non-fossil energy.

### Methane and forestry pledges are steps in the right direction for global decarbonisation

More than 100 countries agreed to cut methane emissions by 30% by 2030, with the signatories covering nearly half of global methane emissions. However, its effectiveness was limited due to Russia, China and India refusing to sign, and is below the 40% reduction required to achieve Net Zero by 2050 (Fidelity International, 2021). Nevertheless, this highlights a step in the right direction and should support technologies looking to reduce methane emissions such as alternative protein (plant-based meat and milk, lab grown meat, etc).

Another key outcome of COP 26 was the commitment to end deforestation. More than 100 countries globally signed up to the pledge, representing 91% of the world's forests (BNEF, 2021). This will provide meaningful support for sustainable land use and therefore adoption of solutions such as agricultural automation and vertical farming.

### Carbon pricing is crucial for decarbonisation but will increase the cost base for many industries

The COP 26 step towards international carbon pricing will have significant effects on higher costs for many industries. According to NGFS, the global carbon price must be accelerated throughout the transition, reaching nearly US\$700 by 2050 to cap the temperature increase to 1.5 degrees (up from US\$200 per tonne of CO<sub>2</sub> by 2030). By investing across the value chains of decarbonisation solutions, portfolios can be partly protected from the CO<sub>2</sub> price risk, along with disintermediation risks that the transition to these new low carbon technologies will create.

### First Movers Coalition will facilitate green supply chains in hard to decarbonise sectors

The First Movers Coalition is an agreement between the World Economic Forum and the US Special Presidential Envoy for Climate, John Kerry, aimed at creating green supply chains in hard to decarbonise sectors. The Coalition recognises that many low-carbon technologies required for the global Net Zero target by 2050 are not economic compared to their carbon intensive counterparts. The Coalition is designed for companies to scale up innovative decarbonisation technologies throughout their supply chains and subsequently drive down costs of clean technologies in sectors where there are no commercial alternatives to their carbon intensive counterparts. More than 30 members have made purchases committed to drive demand. The members are mostly from sectors that are the hardest to decarbonise - steel, aluminium, cement and logistics. SSAB, Apple, Boeing, Deloitte, Orsted, Volvo and Amazon, are examples of founding signatories. For example, companies that make the First Movers Coalition steel commitment, pledge that 10% of their total steel purchases will be produced with virtually no carbon emissions by 2030 (Financial Times, 2021). This agreement should translate into direct investment into innovative, green technologies such as green hydrogen or fuel cells.

### Breakthrough Agenda directly addresses the development and adoption of clean technologies

An outcome of COP 26 which directly addresses our portfolio is the Breakthrough Agenda, which aims to 'accelerate the development and deployment of clean technologies' and make sure they are 'affordable for all'. The Agenda includes the commitment to discuss progress annually. This should provide global leaders the forum to discuss additional monetary support required if current decarbonisation technology adoption rates are lacking progress, therefore providing meaningful tailwind behind innovative decarbonisation solutions.

### US & China coalition will provide a powerful coordinated support for adoption of decarbonisation technologies

We believe one of the surprises of COP 26 was the joint declaration on climate action by two of the world largest emitters, the US and China. The statement proposed cooperation on regulation, methane, decarbonisation, renewables, circular economy, carbon capture and storage and illegal deforestation. Whilst the statement lacked clear concrete targets, we believe this is one of the most interesting developments so far. It is not so much the content as the *signal* here that is highly relevant - this was an entirely unexpected coalition, and the two nations will be aware that this kind of statement will not go unnoticed. They are making a very loud statement that they are united on climate change, and if goals are made, they will be likely to achieve them.

The importance of this agreement is in the likely closer alignment in support and timing for specific decarbonisation solutions which should make it that much more effective. It will enable them to become economic and adopted at scale faster.

### Private and public finance is crucial to achieving Net Zero

Whilst these targets are supportive of global decarbonisation, the question remains how governments will fund the climate transition and achieve their Net Zero carbon goals. There were several financing initiatives discussed at COP 26, such as the Glasgow Financial Alliance for Net Zero (c. US\$130trn of assets from private capital, pledged to meet the goals set out in the Paris climate agreement) and the US\$100bn climate-finance commitment for developing countries (which must be completed by 2025). Furthermore, whilst independent of COP 26, the signing of the US\$1.2bn US bipartisan infrastructure bill should provide significant capital to help commercialise clean technologies required for decarbonisation.

### Portfolio implications

Policies with direct positive implications for innovative decarbonisation technologies include the First Movers Coalition and the Breakthrough Agenda. Furthermore, the coal agreement should provide meaningful tailwinds for clean technologies, especially given renewables such as wind and solar are economic and cheaper than their carbon intensive counterparts. Climate funding initiatives such as the Glasgow Finance Alliance for Net Zero and US\$100bn commitment for developing countries, and the recent US\$1.2bn infrastructure deal should provide climate capital to help fund the transition.

Fidelity analysis has concluded that >80% of decarbonisation can be achieved through wide scale adoption of existing decarbonisation solutions. However, their full adoption in time to avoid catastrophic consequences has a price tag of US\$144trn (Goldman Sachs, 2021). COP 26 will accelerate the momentum behind the allocation of some of that capital to low carbon tools, but we are still far from that happening at the scale and timeframe required. Therefore governments, investors, and consumers still have a significant role to play to further accelerate momentum.

### Conclusion

Aligning the world to a Net Zero scenario can be achieved by investing in the solutions and technologies that will drive a step change in the decarbonisation of society. The increasing level of discussion around climate change and long term Net Zero carbon commitments, we believe that the investment implications are still underestimated given the lack of near-term targets and growth rates that are likely to accelerate further. Concrete policies in support of the COP26 agreements, outlining short and mid-term actions should be significant tailwinds for the adoption of decarbonisation technologies.

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