



MARKET PERSPECTIVE | AUGUST 2024

Serious, not hopeless



Foreword

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We doubt whether the recent sell-off in stocks, and the latest geopolitical news, reflects a significant change in the investment outlook.

The sell-off follows a further lopsided market advance, and has happened in thin (excitable) summer trading. We are aware (we hope) of cyclical risk: these are securities markets after all, and yes, US recessions can arrive when the consensus is not braced for them (just as they often don't when it is). But we see the setback mostly as noise rather than signal. The scale of the yen 'carry trade' has surely been exaggerated, and the US economy does not suddenly look particularly fragile.

The corollary of course is that revived market expectations of big cuts in US interest rates, soon, may be over-optimistic (again). Net, on our one-year macro view we remain more constructive on stocks than bonds, and still prefer both to cash.

Meanwhile, developments in the US presidential race could be important politically, but as we've argued often, not necessarily financially. The same may be true of the new governments in the UK and (pending) in France – and of the continuing conflicts in Ukraine and the Middle East.

As a result, we are (as originally planned) devoting this issue of *Market Perspective* to some top-down investment questions posed by climate change.

For sure, the signal-to-noise ratio could also be higher when it comes to the public climate debate too. But the stakes are bigger: the issues potentially being signalled are of a different order of magnitude to those which more routinely roil markets.

So we offer here our perspective on some of the long-term macro questions which climate change raises; on its recent inflationary effect; and on some practical issues encountered when we try to invest sustainably.

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Image sources: Bond certificate, detail © Getty Images.

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Climate change: macro questions

“In Berlin, things are serious but not hopeless. In Vienna, they are hopeless but not serious.”

– attributed to Alfred Polgar (1873–1955)

“The biggest big business... is not steel, automobiles, or television. It is the manufacture, refinement, and distribution of anxiety.”

– Eric Sevareid (1912–1992)

Feelings run high – in both directions. There is a lot at stake, but polarised views also reflect their advocates. People who think most things are bad and getting worse have a pessimistic take; those believing the opposite are dismissive. Both sides have hidden agendas, activists and deniers alike.

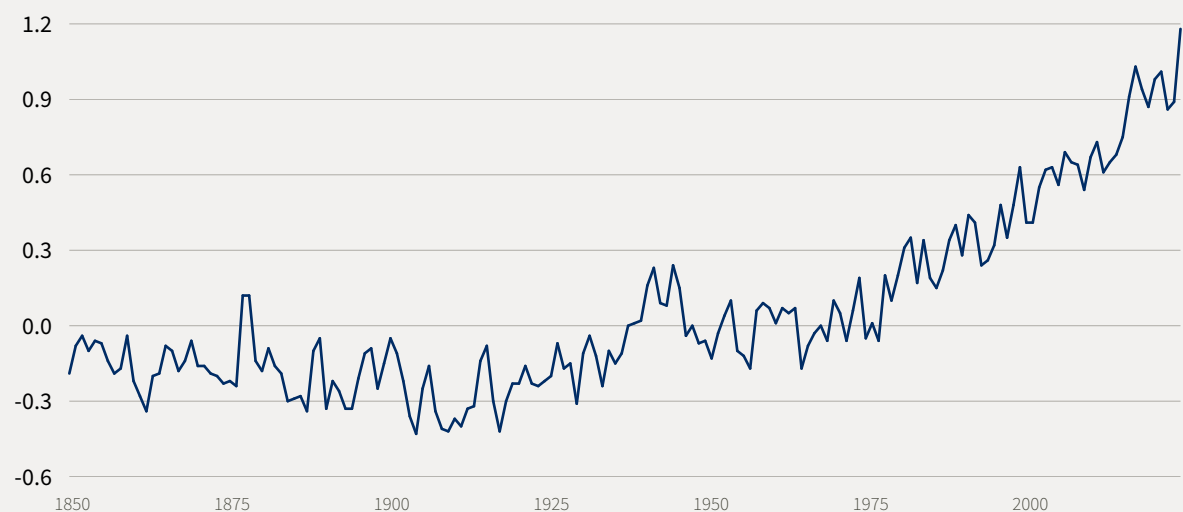
Our bias is towards incremental progress and a middle ground. We see the collective predicament as serious, but not hopeless. The questions below apply this wider view to narrower issues of economics and investing.

Q1: WHAT DO WE KNOW?

The world is getting warmer, and it’s because of us (figure 1). Greenhouse gases (mostly carbon dioxide) produced by human activity (mostly by generating usable energy from its primary sources) are preventing heat from escaping back into space.

FIGURE 1: GLOBAL LAND AND OCEAN AVERAGE TEMPERATURE ANOMALIES

Relative to 20th century average (1901–2000, degrees celsius)



Source: Rothschild & Co, National Centres for Environmental Information, National Oceanic and Atmospheric Administration

The international attempt to limit the rise in temperature aims at cutting net carbon emissions to zero by 2050: this is believed necessary to limit the rise to 1.5°C above ‘pre-industrial’ (1850–1900) levels (further increases afterwards are still likely). This is admittedly an arbitrary amount, but represents a staging post – or a stretch target – at least. The objective is highly unlikely to be achieved, suggesting that the average annual global temperature after 2050 – its level, not change – is likely to exceed 15.2°C, which would be unprecedented in human times.

Reducing global emissions to achieve that objective in practice likely means cutting energy use. Most energy comes from fossil fuels. Other sources might be scalable, though each have their own challenges. With nuclear power, for instance, building lots more fission reactors is politically unacceptable and takes time (nuclear fusion – the source of the sun’s power – is not yet feasible, but could be a game-changer if it were).

Cutting energy use significantly would mean lower living standards. Poorer countries and communities would need some compensation for the loss of actual and potential income. There is currently little political arrangement for this in sight, though the establishment of the ‘loss and damage fund’ at COP27 at least represents a long-awaited start.

Higher temperatures are leading to rising sea levels as onshore ice melts and warmer water expands. The increase in sea level since 1901 has been about 0.2 metres, and by 2100 a further increase of around 0.5 metres seems likely. This might reduce total land area by around a quarter of 1%, but still displace hundreds of millions of people. Weather patterns will change unpredictably, leading to more extreme events and altered agricultural production. Deaths from extreme heat will increase. The impact of these events may initially be localised, but over time the effects will percolate globally: we are all connected.

Q2: WHAT DON’T WE KNOW?

“We are not on the brink of imminent extinction... in almost every way we can measure, life on earth is better now than it was at any time in history... Climate change will have an overall negative impact on the world, but it will pale in comparison to all of the positive gains we have seen so far, and will continue to see in the century ahead.”

– Bjorn Lomborg

Most importantly, we do not know whether there is a threshold level that, when breached, can lead to a domino effect of more significant physical change – a ‘tipping point’ beyond which the game changes dramatically and irreversibly. This must be one of the key risks we face collectively.

‘The science’ does not currently identify a tipping point, though this is not an argument for inaction of course. Nor do we face the human ‘extinction level’ event proclaimed confidently by activists (their hopelessness is not serious). Governments are acting, albeit belatedly and inadequately. Ongoing recovery in the ozone layer, harmed by earlier emissions of chlorofluorocarbons (and unrelated to warming as such), shows that collective action (albeit on a much smaller scale) can work. Similarly, earlier damage caused by acid rain has largely been resolved through tighter emission rules (again, on a smaller scale).

The very fact that climate change is so far-reaching means that we can’t know its likely net impact. As we note so often, there are many moving parts in the global economy: even if we know with some confidence the direction in which one of them is heading, we can’t know its systemic impact on the others. Meanwhile, some of those will be moving independently, and perhaps constructively. Productivity would be one such variable, for example: not because of climate change, but because such gains are the norm, even today.

We see a parallel with how demographic change – another far-reaching ‘Malthusian’ threat to collective well-being – was seized upon as a game-changer several decades ago. The current age profile of the population was relatively easy to forecast then, but its net economic impact has been anything but.

There are three ways to cope economically with climate change. The first, the main focus today, is mitigation – collective action aimed at reducing the size of the threat. This strategy looks set to disappoint, as noted. That said, we should note that one potential source of mitigation, the use of

carbon capture schemes to reduce the net impact of gross emissions, has yet to be widely taken up, and the technology itself can be developed further, though it cannot substitute for other actions.

The second, whose importance is easily overlooked, is adaptation – changes in behaviour which deflect some of the impact. We return to this below.

The third is to contextualise the threat – recognising that climate change is just one of the many drivers of economic conditions. Its effects will not be uniformly negative (for example, some previously uninhabitable and unfarmable parts of the world will become less so, and fewer people will die from severe cold). The two highlighted quotations offer such contextualisation – and despite coming from the two sides of the debate, have a similar flavour.

On this reading, the outlook is more nuanced than it looks. Admittedly, the nuance is not confined to future problems: some of today’s solutions may not be quite what they seem. Electric vehicles, for example, use more energy in total, and their footprint is crucially shaped by the materials used in their construction, and by the source of the electricity which charges their batteries.

“For most economic sectors, the impact of climate change will be small relative to the impacts of other drivers...”
 – UN Intergovernmental Panel on Climate Change

These subtleties are not more familiar perhaps because the typical response to climate activists has been to patronise them. The media reports their youth or age, and their actions, but rarely engages with their arguments.

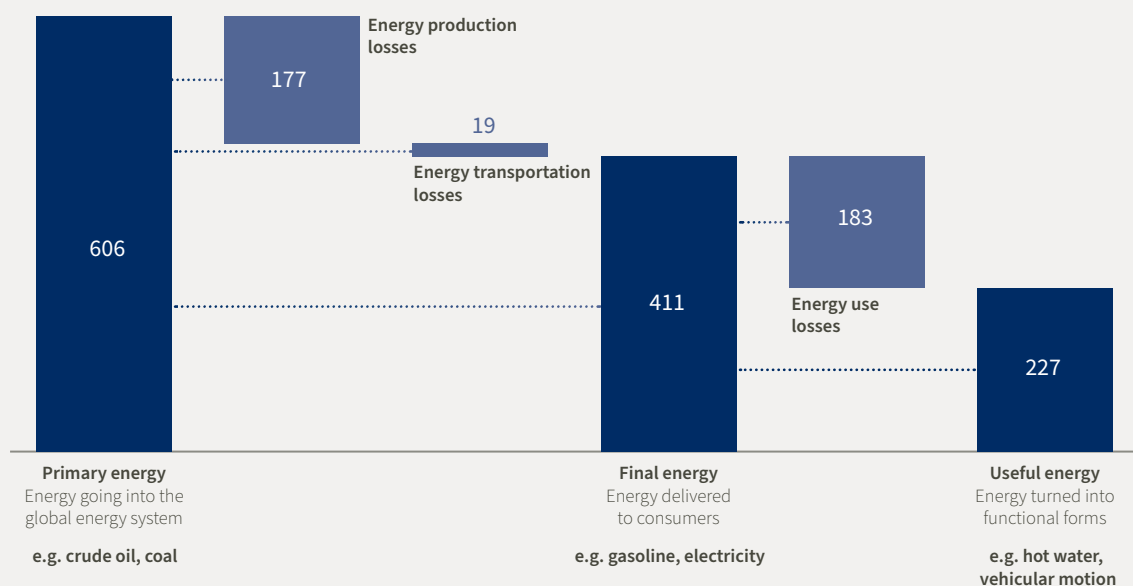
Q3: DOES CLIMATE CHANGE MEAN GROWTH IS OVER?

If living standards are driven solely by material output – by things we grow or mine, transport around the world and bash into shape, then consume – then yes, we will have to think differently about it (though on a long enough timeline, energy innovation could help even there – see below).

Increasingly, however, the things we value are less tangible, and less energy-dependent. Most ‘industrialised’ world output these days comes from services, much of it digitised. Provided our basic material needs are met – as they have long been in the West – then further dematerialisation of output might continue.

FIGURE 2: ENERGY SYSTEM LOSSES FROM PRIMARY TO USEFUL

Global energy flows and waste (exajoules per year, 2019)



Source: Rothschild & Co, International Energy Agency, RMI

Emerging world living standards are more tightly linked to tangible output. But intangible developed world output introduces a degree of global ‘wiggle room’ – both directly, and indirectly if it helps facilitate some of that necessary international compensation.

Meanwhile, in one area at least we can expect a clear *boost* to growth. It is rare to be able to predict transformational innovation, but that is what the global energy industry faces as we transit to higher-productivity and less carbon-intensive forms of primary energy production. The burning of fossil fuels is dauntingly inefficient, with almost two-thirds of their potential energy being lost, according to the think tank RMI (figure 2 on page 5). Never mind AI: there is the potential for huge and sustainable growth here.

Substitution away from carbon-based output, and innovation in technology and working practices, are two of the ways in which adaptation will work. Relocation of economic activity – within and across national boundaries – is another.

Q4: WILL IT BE INFLATIONARY?

Again, not necessarily. Currently, with unemployment low, and the cost of living crisis still in the headlines, extra outlays on energy infrastructure, and further taxes and/or emission controls on carbon-based production, might lead to more, not less, inflation (and see the essay below). But on a longer-term view, the net result could even be deflationary.

We can imagine a world in which even carbon-based energy is cheaper, not dearer, taxes and controls notwithstanding. As people slowly but decisively economise on oil, coal and gas usage, and their supply remains plentiful, prices could easily fall. This would be not a failure to adapt, but its consequence. Meanwhile, the cost of alternative sources could fall as technologies and scale improve.

Q5: WHAT ABOUT INTEREST RATES?

If the long-term impact on growth and inflation is unclear, so is the effect on interest rates.

Central banks’ recent engagement with climate change isn’t – or shouldn’t be – because of its likely monetary effect, but because of the potential impact on financial stability of extreme weather events. A wealthier and more highly mortgaged world has more at stake.

More generally, as we adapt and redirect economic activity, the key variables are real quantities, relative prices, taxes and subsidies, and the rules of the game. Collective economic activity is ‘pay as you go’, or self-funded, with the key drivers (or “factors of production”) of growth being real things such as labour and commodity inputs, physical capital, and innovative and organisational technology. Aggregate financial balance sheets (beyond their potential for fostering short-term financial instability) may not be relevant.

Real interest rates do feature in the literature, not as an outcome but as a key input to quantifying the present value of future costs and benefits. Famously, the UK government’s Stern Review (2006) used a zero discount rate (long before the last decade’s accidental flirtation with negative real rates), effectively placing the welfare of future generations on a par with that of today’s.

Taking climate change seriously assumes that we care about our descendants to begin with. Some younger couples reportedly are taking this to the extreme of deciding not to have children at all, on the basis that the suffering they think (or have been told) that their children will encounter will make it better for them not to be born.

But even if we value our far-future descendants’ welfare equally to our own, a positive real discount rate still makes more sense, not least because of the possibility of an interplanetary accident such as that portrayed in the film *Melancholia* (2011). And as Professor Sir Dieter Helm argues in *Legacy* (2023), it is human nature to care most about people and generations we know.

CONCLUSION

Climate change is the most extensive economic threat we face, and that in itself makes its investment impact impossible to gauge. But there is likely exaggeration on both sides of the debate. Our reading – and instinct – suggests that the warmer world can still be a prosperous one.



The green transition and recent inflation

Inflation has continued to moderate across developed markets, since our last edition of *Market Perspective* (figure 3). Headline and core¹ rates are generally hovering in the 2–4% region, following significant declines in three of the four major inflation categories (food, energy and goods CPI). Services inflation – the fourth category, which also has the largest weighting in CPI baskets – remains elevated in both the US and Europe, though it has started to cool in recent months. We think disinflation overall has largely run its course for now, and see inflation staying above central banks’ targets for the rest of this year.

There were several major supply-side disruptions in this latest inflation bout, largely because of the pandemic and Europe’s energy crisis, and further supply shocks cannot be ruled out, amid the tense geopolitical backdrop. But one particular structural risk has become more visible in recent decades: climate change.

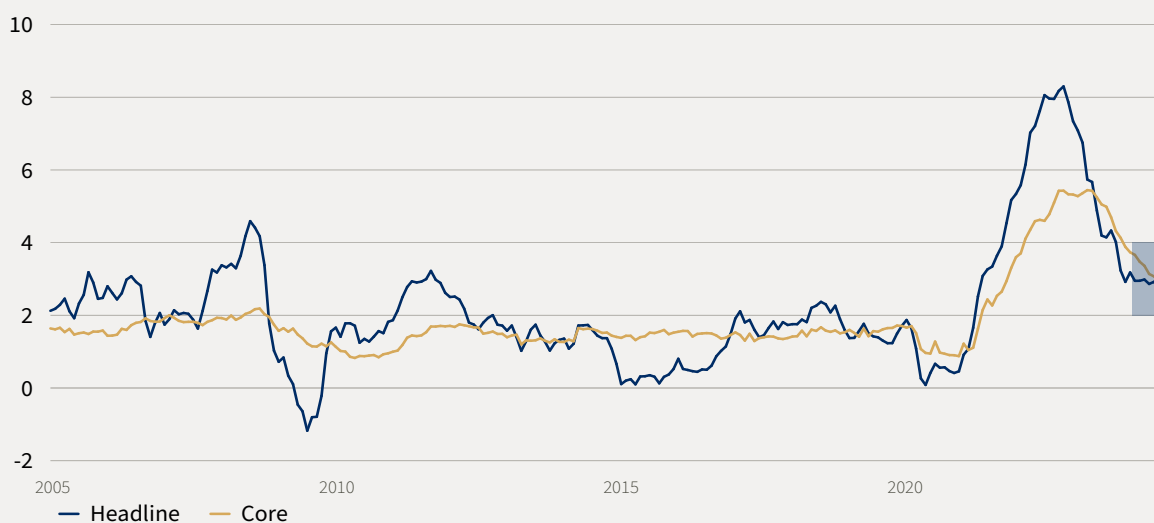
¹Core inflation excludes the more volatile food and energy components.

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FIGURE 3: DEVELOPED MARKET INFLATION RATES

Year-over-year (%)



Source: Rothschild & Co, Bloomberg, Datastream

Note: Inflation series are a GDP-weighted average of US, Canada, Eurozone, UK, Switzerland, Denmark, Norway, Australia, Japan, New Zealand and Singapore data. Shaded area represents 2–4% inflation region.

THE CLIMATE RISK

The frequency of climate-related events has risen markedly since the 1980s (figure 4). While their occurrence has levelled off since the turn of the century, the ongoing warming suggests this may not last. And these events have already affected different categories within inflation baskets.

For example, the European Central Bank² estimates that extreme summer temperatures in 2022 contributed almost a full percentage point to European food inflation over 12 months. Elsewhere, global trade is being disrupted by droughts in Lake Gatun, an essential water source for the Panama Canal, which handles around 5% of world maritime trade volumes: the re-direction of shipping fleets could add some pressure on goods-related inflation. Home insurance premiums have sharply risen in US states susceptible to extreme weather events, such as Florida (hurricanes) and California (wildfires), though they are not directly included in the US CPI basket (otherwise this could have contributed close to an additional percentage point to inflation in 2023, according to some estimates).

Will climate change – and our responses to it – always be inflationary?

A HIGHER PRICE ON POLLUTION

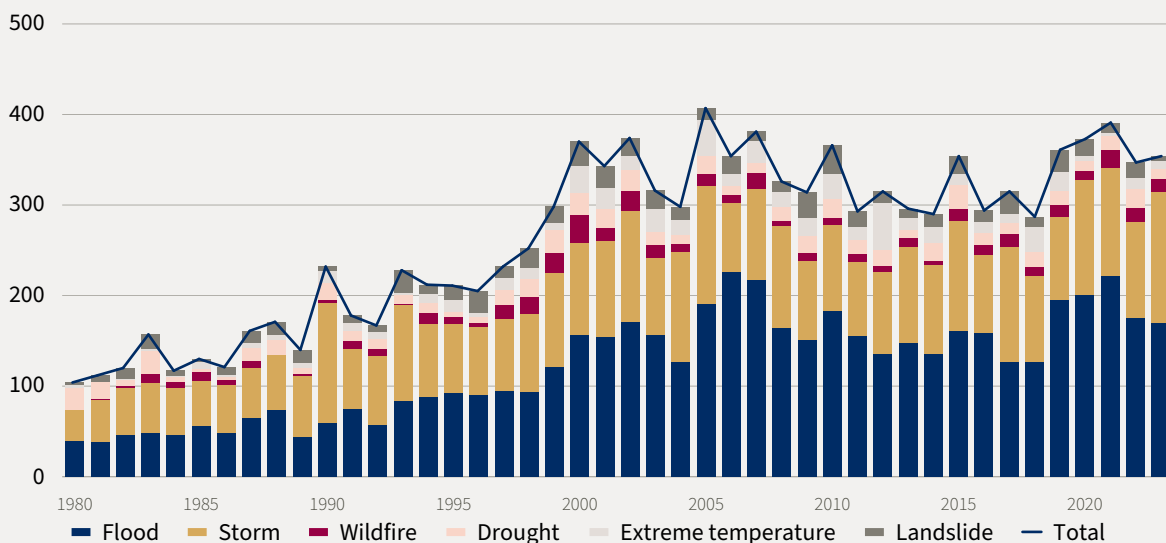
One way that governments have incentivised companies to shift to a low-carbon economy has been to raise the cost of their emissions.

Carbon pricing started in the early 1990s, initially via carbon taxes in the Nordic countries. Market-based emissions trading schemes (ETS) were then introduced, where authorities set a cap on total greenhouse gas (GHG) emissions (which would be lowered over time). The EU introduced the first carbon ETS in 2005, but it has since spread to other parts of the world, including certain US states (such as California) and even China in 2021. Today, almost a quarter of global GHG emissions are covered by some sort of carbon pricing mechanism (figure 5 on page 9). The cost to emit carbon has meanwhile multiplied over the past decade as more of these schemes have been introduced (see box at end of piece).

² ECB Working Paper: The impact of global warming on inflation: averages, seasonality and extremes (Kotz, Kuik, Lis, Nickel, 2023)

FIGURE 4: EXTREME WEATHER EVENTS

Annual frequency (global)



Source: Rothschild & Co, IMF

However, initially at least, the transition to low-emission energy sources may itself be inflationary, as large-scale investments in expensive new technologies drive input costs higher.



Nonetheless, a higher carbon price is not necessarily a precursor to structurally higher inflation. Companies may decide against passing on additional input costs to customers, particularly where demand is more elastic. An IMF Working Paper³ earlier this year concluded that the impact of carbon pricing on overall euro area inflation was negligible between 2000-2019. Of course, carbon prices may continue to rise from here, particularly in the EU as it tries to reduce net GHG emissions by at least 55% by 2030 (relative to 1990 levels). Even so, the study found that this ‘Fit-for-55’ policy may only lead to a modest increase in eurozone consumer prices until then.

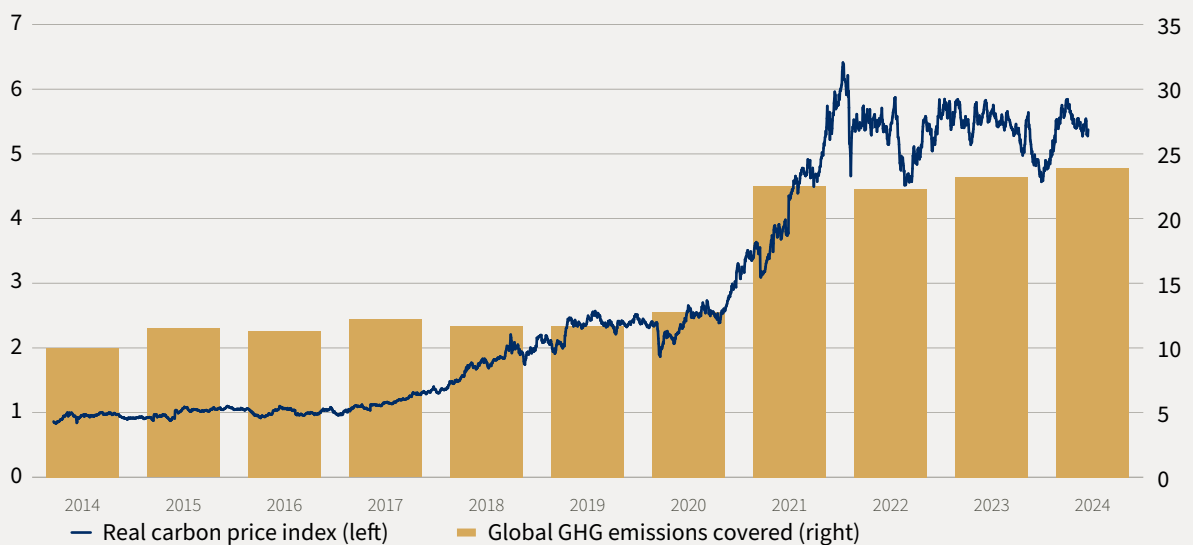
Higher carbon prices will matter less over time anyway, as production processes and consumer demand shift away from carbon-intensive output, reducing their importance in inflation indices. Indeed, a goal of the EU ETS is to spur private sector innovation and adoption of cleaner technologies and processes. Government subsidies, through the US Inflation Reduction Act and Next Generation EU package, have also played an important role in shifting household and business preferences towards greener consumption and investments.

However, initially at least, the transition to low-emission energy sources may itself be inflationary, as large-scale investments in expensive new technologies drive input costs higher.

³ IMF Working Paper: Carbon Prices and Inflation in the Euro Area (Konradt, McGregor, Toscani, 2024)

FIGURE 5: CARBON MARKET DYNAMICS

Global carbon price (USD per tonne, left); Global GHG emissions covered by ETS & carbon taxes (%), right)



Source: Rothschild & Co, Monash Centre for Financial Studies, C2Zero, SparkChange, World Bank

Note: Real Carbon Price Index represents the carbon price across all emissions from all jurisdictions. It includes both emissions subject to carbon prices and emissions with no price.

SHIFTING TO ALTERNATIVE SOURCES

Demand for critical metals (such as lithium, cobalt, nickel, copper) and rare earth metals (such as neodymium, dysprosium, scandium, yttrium) is expected to increase significantly as the world tries to achieve net zero. The International Energy Agency⁴ (IEA) recently estimated that demand for nickel, cobalt and rare earth elements will double over the next two decades in pursuit of that goal, while other inputs, such as lithium, would need to increase nearly ninefold (given it is the critical component in lithium-ion batteries).

Moreover, on the supply side, critical metal production is highly concentrated, and inelastic. Australia, Chile and China account for almost all the world's lithium mining output, for example, and it can take more than a decade for new mines to proceed from discovery to production.

Still, demand will grow incrementally, not abruptly, and will evolve as new greener technologies enter the scene. The IEA's 20-year forecasts are hostages to fortune – a lot can change over such a period.

On a sufficiently long-term view, new supplies may be discovered, and technology will reduce extraction and production costs. An illustration of how scarcity and demand do not always evolve as expected is the famous disagreement between American economist Julian Simon and the environmentalist Paul Ehrlich on the outlook for metal prices in 1980 (they went on to fall in real terms: see *The Bet*, Paul Sabin, 2013).

Some critical metal prices have indeed already declined sharply in recent years. In the lithium market, despite the trends noted above, lithium hydroxide prices have slumped almost 90% from their late-2022 high. Meanwhile, the cost of producing electricity from renewable sources such as solar and wind power has been trending lower (figure 6).

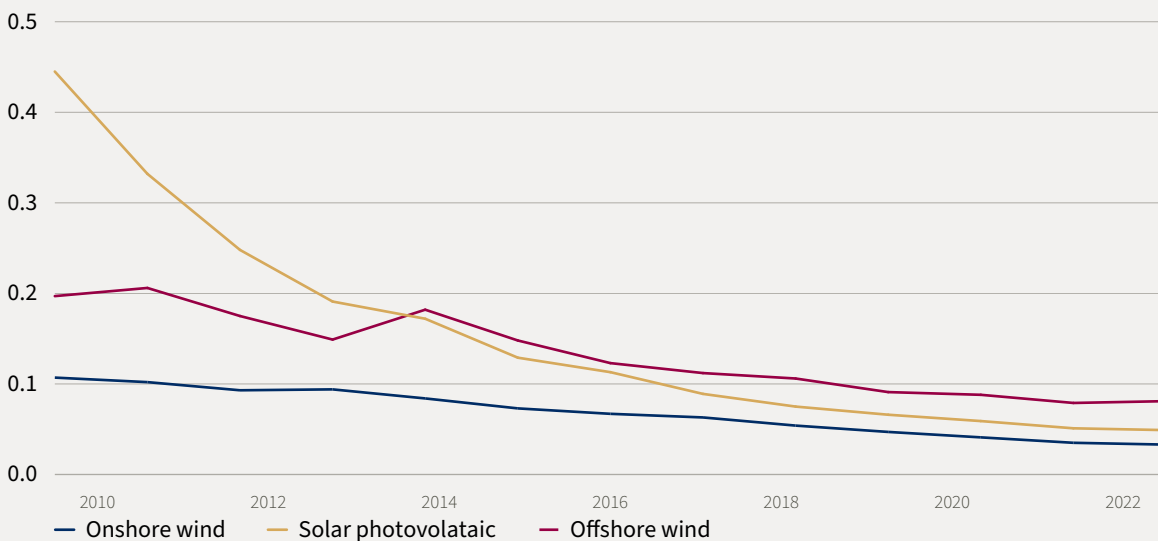
CONCLUSION

It seems sensible to expect some pressure on consumer prices as we move to a greener world. But the longer the time horizon we consider, the greater the room for exploration, technology, substitution, adaptation and more secure supply chains to play a role. And most of the time, the wider business cycle may matter more for inflation than the transition to a greener world.

⁴ IEA Global Critical Minerals Outlook (2024)

FIGURE 6: GLOBAL TOTAL INSTALLED COSTS OF RENEWABLE ELECTRICITY PRICES

Levelized Cost of Energy (2022 USD/kWh)



Source: Rothschild & Co, International Renewable Energy Agency

A FOCUS ON CARBON MARKETS

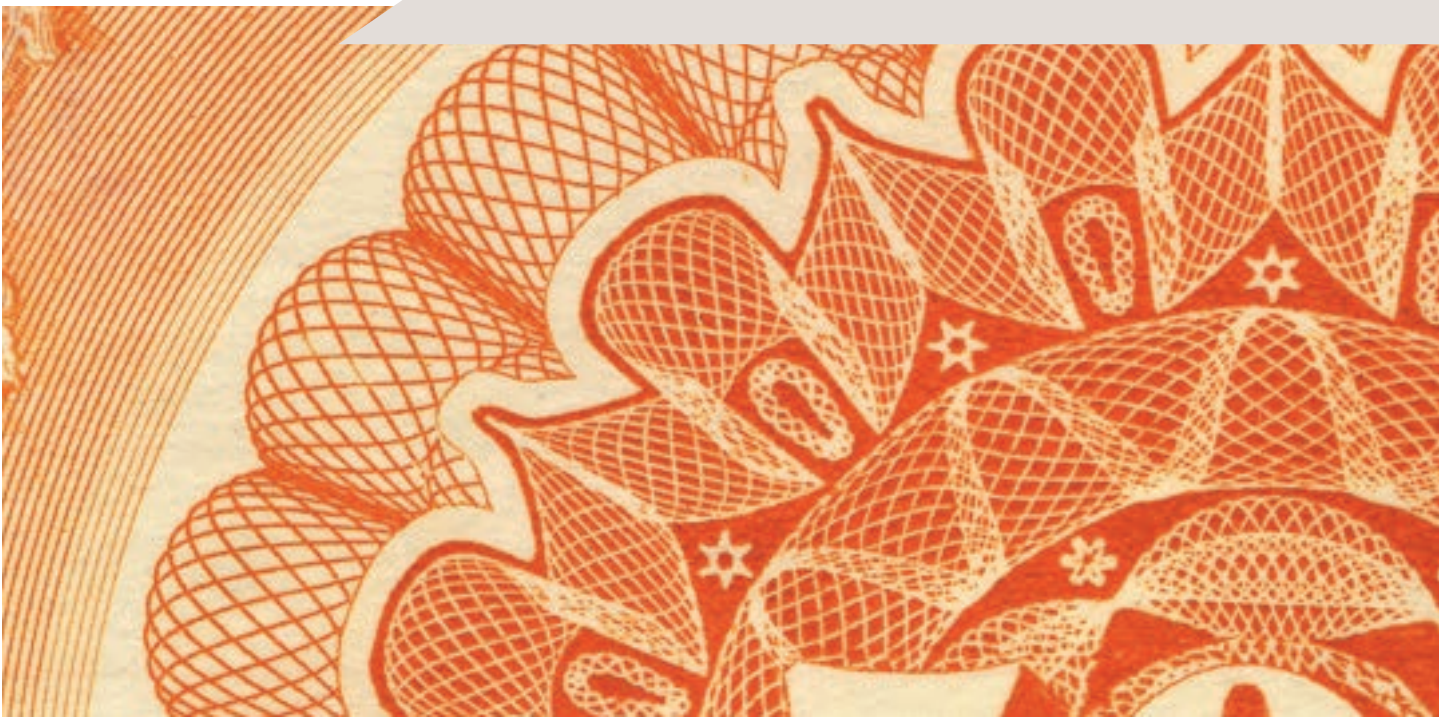
While ESG may not be a distinct asset class, one important component of its growth is the carbon market (both compliance and voluntary schemes exist). Carbon credits essentially allow companies to emit a certain amount of carbon dioxide (or equivalent GHG), and are tradeable.

The idea behind such credit is simple, but powerful: highly polluting and unprofitable enterprises that are unable to change their ways will see their true costs revealed and find it more difficult to secure capital. Industries that emit less carbon dioxide, or which can innovate and adapt their mode of operation, will flourish. As governments decide to reduce the number of available credits over time, and/or as behaviour changes, emissions will be constrained, and the 'true' relative costs of doing business – with today's 'externalities' finally captured by the market – will be more accurately reflected in published accounts.

Today, the price of carbon emission, the cost of polluting under the EU's Emissions Trading Scheme (ETS), is around €72/tonnes of CO₂ (nearly triple its end-2019 level, but well below 2021's highs). Until recently, carbon prices had closely tracked the cost of energy – particularly natural gas – but over the past 18 months we have seen this relationship break down. This development partly reflects changing market dynamics, with (for example) industry replacing power producers as the biggest buyers of carbon allowances.

As noted, carbon taxes were first introduced prior to traded credits, but the expansion of emissions trading markets and the increasing traction in the smaller voluntary market are welcome developments. The latter in particular enables environmentally conscious – but non-regulated companies and individuals – to achieve carbon neutrality or in some cases even sequester carbon through offsets.

Clearly, reduction (lower output of fossil-fuelled output) and substitution (using other forms of energy) are needed to achieve long-term emissions objectives. However, for some industries and technologies this may be impossible or uneconomical and the offset market allows polluting business to phase out their emissions without going ex-growth.



Investing sustainably

A wish to mitigate climate change is a big driver of more socially-aware investing. In particular, ESG-informed portfolios take into account the environmental, social and governance characteristics of the assets in which they invest, and most wealth managers now offer such portfolios routinely.

By avoiding companies which fail to do what they can to mitigate climate change – or to shoulder their wider obligations to their workforce and community, or to offer best practice governance – investors are effectively adding another objective to their investment objectives. For their part, CEOs have for some years now been making their mission statements more holistic and inclusive. The idea that the only goal of management should be the maximisation of profit (usually attributed to Milton Friedman, and often misinterpreted as a normative notion) is firmly out of fashion.

Talk of ‘peak ESG’ is likely overdone, but critics are not in short supply. In the US last year some 19 states introduced measures to discourage ESG-related investing; while Larry Fink, CEO of Blackrock, was forced to reverse some earlier green and social pledges.

They say that everyone wants progress, but no one wants change. But in trying to create a more ethical form of capitalism, ESG-aware investors have to confront some tricky decisions.

WHAT'S IN A DEFINITION

ESG has in fact been around for much of the past half century, though not always as well defined or widely adopted as it is today. In practice, ESG-informed investing comes in many different guises, from simple screening strategies (negative and positive), through deeper integration and engagement, and ultimately to what is termed impact investing – in which the main goal of investing is the delivery of a specific social or environmental objective, with performance relegated to a secondary consideration.

Definitions and interpretations vary. ‘Sustainable’ investing can refer to a passive appraisal of a company’s environmental footprint, or a more active attempt to encourage businesses to do good (and not simply avoid harm), and an even wider notion of financial durability and the avoidance of risk.

Of the three ‘E’, ‘S’ and ‘G’ pillars, often most weight is given to the environmental angle, as noted, with climate-related concerns in the spotlight – though the relative importance of each factor varies across different industry groups. For example, sound governance – accountability and transparency – is hardly an ambitious investment aim, but arguably a prerequisite when making any investment.

And environmental concerns extend beyond climate change and carbon emissions to include wider worries such as pollution, biodiversity, waste, and general despoliation. Even the narrower realm of emissions analysis is not as straightforward to address as we might think. Spurious precision and measurement issues plague scope 1 and 2 carbon emissions, let alone the thorny scope 3 category. But even with this data to hand, should we focus on the level of GHG emissions produced, or changes over time? How do we objectively compare an oil or gas company researching and investing in alternative energy sources with an electric vehicle producer whose global supply chain is hoovering up rare earths?

Classifications and taxonomies are complex and nuanced. There can be no single best way to address the quantitative and qualitative characteristics of the three pillars across the many different sectors and regions. But the compilers of stock market indices and data, such as MSCI and Sustainalytics, have taken the lead. In MSCI’s ESG ratings, for example, the output is a single credit rating type score: AAA represents a leader – best in class for its industry, while CCC signifies a laggard, a company that falls well short of its peers.

Still, ambiguities remain. There is no standardisation, and methodologies vary. The quality and accountability of the data varies too: it can be unaudited, self-reported or obtained from third parties. But perhaps the most challenging dimension is interpretation and assessment, which is unavoidably subjective (figure 7).

Such classifications provide a useful check, but their neat scores can be misleading. Simple is not always meaningful.

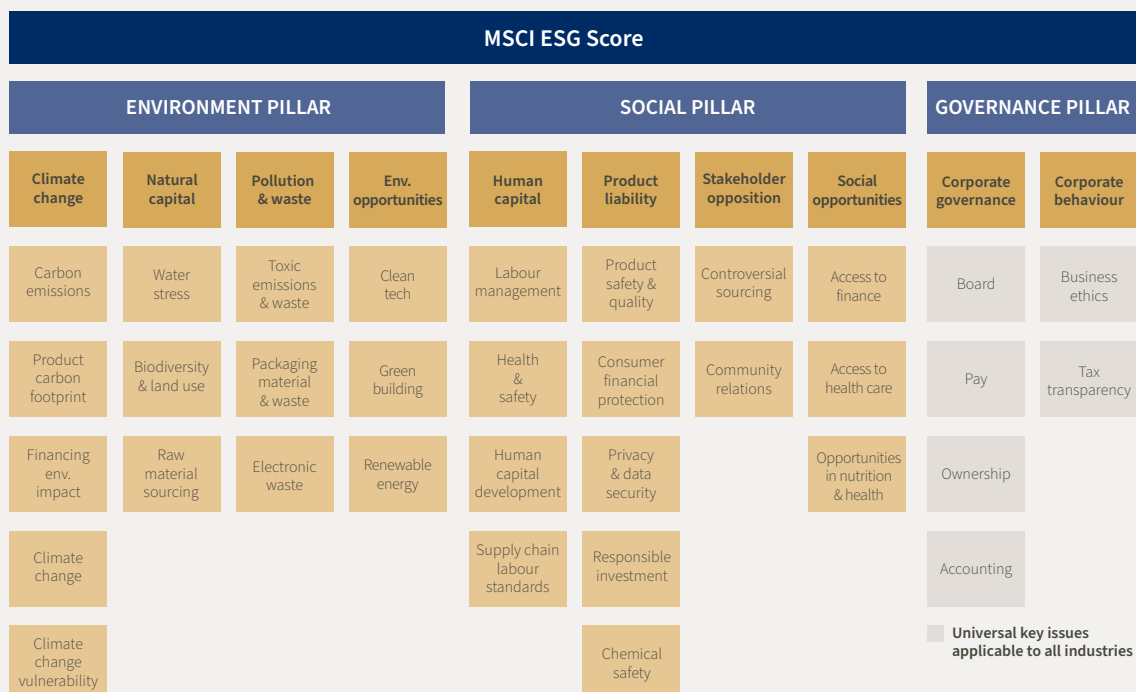
FIRST, DO NO HARM?

Advocates of the older, profit-focused approach to business management and investing are quick to highlight the big drawbacks of what they see as an ideologically driven investment approach. The older approach did not mean that broader issues didn't matter, only that business – as opposed to government – is not best placed to deliver them. And industry hype and 'greenwashing' have been evident.

Moreover, some investors may not have appreciated that in adding an extra objective which effectively narrows the pool of acceptable investments, you could be compromising prospective returns.

Take for example, so-called 'vice' investments, which might now include oil and gas and mining, alongside the more traditional sinful sectors, such as tobacco, alcohol, gambling and defence companies. These can be sound, profitable businesses, and – partly thanks to ESG concerns – trade inexpensively. But where should the line be drawn – should we shun their suppliers too? And if, for some reason, such businesses perform strongly, are we prepared to see our portfolios underperform the big stock market indices because we don't own them? When the oil sector was underperforming, it was cheaper to do the right thing than it has been of late.

FIGURE 7: THOUSANDS OF DATAPOINTS GO INTO THE MSCI ESG SCORE



Source: Rothschild & Co, MSCI

Few of us today would see ESG as an either-or choice. Rather it is an important pillar of wider investment analysis and client engagement. And regulation increasingly encourages such an approach – as with the EU’s Corporate Sustainability Reporting Directive (CSRD) and Sustainable Finance Disclosure Regulation (SFDR). Some have even suggested that investment professionals should take a sort of Hippocratic oath. Adherence to the UK Stewardship Code, for example, implicitly adopts such an ethical viewpoint.

There can be financial incentives for both businesses and investors in pursuing such an approach.

For companies looking to raise capital, leaning into their ESG credentials might lower their cost of capital – through tighter spreads on borrowing costs (particularly where green bond issuance is concerned) and/or possibly a lower cost of equity.

For investors, in today’s world, green – and socially responsible investments generally – might attract a ‘greenium’ (a green premium), and actively bolster investment returns.

As yet the jury is out on the relative performance of ESG strategies relative to more conventional stock and bond investing (figure 8). Frustratingly, the premium paid for green or ethically tilted investments is no less clear – partly undermined by a lack of historical data, as well the empirical challenges noted above (figure 9). It may always be so – and committed ESG investors are not chasing returns to begin with.

Despite the change in attitudes the ESG investment market still remains relatively small – MSCI’s suite of ‘impact’ orientated ESG-related equity strategies account for less than a twentieth of the investable stock market, similar to the amount of outstanding ESG-related bonds – which is perhaps 4% of the broader ~\$140 trillion global bond market.

Logical and practical issues notwithstanding, we suspect there is more growth to come.

FIGURE 8: SELECTED ESG INDEX RETURNS

Returns indexed relative to MSCI all countries world index

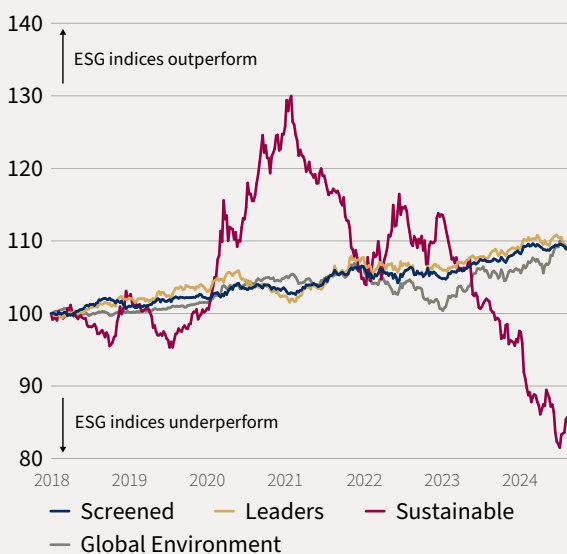
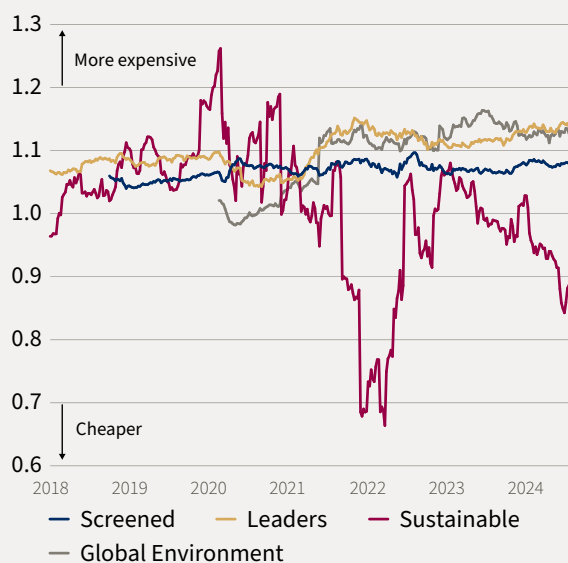


FIGURE 9: SELECTED ESG INDEX VALUATIONS

Forward price-to-earnings ratio relative to MSCI all countries world index



Source: Rothschild & Co, Bloomberg, MSCI

Note: MSCI index methodologies are as follows: Screened is an exclusion-based index; Leaders is a 50% best-in-class sector approach; Sustainable includes businesses that address at least one of the world’s social and environmental challenges, as defined by the UNSDG; Global Environment businesses derive at least 50% of their revenues from environmentally beneficial products and services.

Economy and markets: background

GROWTH: MAJOR ECONOMIES

Business optimism: standard deviations from trend



Source: Bloomberg, Rothschild & Co
Composite of the forward-looking components of manufacturing surveys from China, Germany, Japan, UK and US loosely weighted by GDP

G7 INFLATION

Year-over-year (%)



Source: OECD, Bloomberg, Rothschild & Co

DEVELOPED MARKET STOCKS AND GOVERNMENT BOND RETURNS

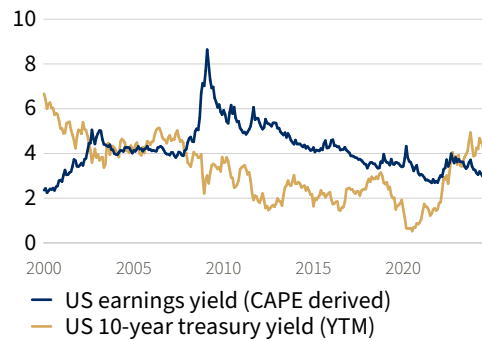
Relative returns since 2005 (%)



Source: MSCI, Bank of America Merrill Lynch, Bloomberg, Rothschild & Co

STOCKS/BONDS — RELATIVE VALUATIONS

(%)



Source: MSCI, Datastream, Bloomberg, Rothschild & Co

EQUITIES

MSCI indices, USD terms

	1M (%)	YTD (%)
Global	-1.5	13.7
US	-2.0	16.8
Europe ex UK & Switzerland	-1.3	7.7
UK	2.3	11.9
Switzerland	2.7	7.1
Japan	-1.7	9.9
Pacific ex Japan	-1.2	2.8
EM Asia	-2.4	11.6
EM ex Asia	0.3	-0.8

FIXED INCOME

Current yields and returns, local currency terms

	YIELD	1M (%)	YTD (%)
Global Govt (hdg, USD)	2.99	1.7	2.6
Global IG (hdg, USD)	4.58	1.6	3.5
Global HY (hdg, USD)	7.88	1.3	6.6
US 10 Yr	3.88	2.4	2.6
German 10 Yr	2.25	1.7	-0.1
UK 10 Yr	3.92	1.5	-0.1
Swiss 10 Yr	0.44	1.1	2.5

CURRENCIES

JP Morgan Trade-Weighted Nominal Effective Exchange Rates

	1M (%)	YTD (%)
US Dollar	-0.6	3.1
Euro	0.0	1.5
Pound Sterling	-1.5	2.9
Swiss Franc	2.2	-2.1

COMMODITIES

	LEVEL	1M (%)	YTD (%)
Gold (USD)	2508	1.6	21.6
Brent Crude (USD)	80	-4.8	3.4
Gas (EUR)	40	20.9	22.5

Chart data as of 16 August 2024.
Table data as of 16 August 2024.

Past performance should not be taken as a guide to future performance.

Table sources: Bloomberg, Rothschild & Co



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