Thoughts from the sustainable investing team

Taking a sustainable approach

China has recently committed to becoming net zero by 2060. This is just 10 years after the UK's commitment of net zero by 2050. China hasn't reached peak-emissions yet, this is targeted to be between 2028 – 2029, so they will need to dramatically adopt green working methods from that point to get to net-zero by 2060. Today, China is the world's largest consumer and producer of renewable energy, it is also the world's largest manufacturer and buyer of electric vehicles in the world, accounting for more than 50% of electric car sales. China also manufactures a staggering 99% of the world's electric buses. China is at the forefront of the transition to a low carbon economy for both economic and political reasons. Economically, China is vulnerable to climate change. 550m of its citizens and the cities producing the majority of the country's economic growth are located in coastal regions, meaning the country is vulnerable to rises in sea levels. Furthermore, China sees production of green hydrogen and renewable energy as its path to energy independence, crucial for stronger political negotiation.

At a corporate level, Shanghai Stock Exchange is introducing requirements for listed companies to disclose more details about their ESG (Environmental, Social and Governance) practices allowing for quantifiable approaches to assessing a firm's corporate responsibility. Hong Kong already requires all listed companies produce a statement setting out the board's consideration of ESG risks, as well as how it determines what ESG matters are material to the business. This is likely to encourage higher levels of integration of such disclosures into a business strategy, instead of merely a box-ticking requirement. Interestingly, the London Stock Exchange only requires data on diversity, human rights and greenhouse gas emissions to be disclosed. The securities regulator, China Securities Regulatory Commission (CSRC), has also integrated environmental factors into the process of public offerings, requiring issuers to disclose the main pollutants emitted during production processes, the facilities handling those pollutants and any other potential environmental issues and corresponding measures in use of raised funds.

Although, the full picture is far from rosy. China is implicated in ongoing human rights violations, such as controversies related to the Xinjiang province. It goes without saying we are appalled by this. Governments around the world have taken action on this subject. In order to ensure Chinese goods are not produced in forced labour camps, the UK government has announced strict trade restrictions that apply to the sale of goods which may contribute to human rights abuses, announcing financial penalties to businesses that fail to meet published modern slavery statements. The US has restricted all imports of specific products from the Xinjian province that forced labour is commonly involved in producing (such as cotton for apparel, and tomatoes).

Application in portfolios

Approaching this mixed picture from a sustainable investment perspective requires careful consideration, and a joined qualitative and quantitative approach. The sustainable portfolios we run exclude exposure to Chinese government sovereign bonds. Using LGT Wealth Management's Sustainability Rating for sovereigns, China scores below average, unsurprisingly impacted by the country's human rights violations. However, for equities we take a different approach. We utilise the expertise of dedicated, specialist Asian and Emerging Markets equity investment managers to selectively allocate capital to businesses based in China. We would not want to make the mistake of tarring all companies operating within China, with the concerns we have at national level. Given China's current renewable energy expenditure and future ambitions, it is unsurprising that the fund managers find opportunities in companies in the solar and wind power production and distribution. There are a number of other interesting investment opportunities in water recycling and treatment companies as well as in healthcare through testing, diagnostics and wider infrastructure.

Mostly importantly, the fund managers we use to select companies operating in China have local presence. Analysts on the ground, based in Asia conduct the lengthy and rigorous due diligence required on companies operating in this part of the world. In our view, China is not a region that should be excluded from sustainable portfolios, it's growing dominance as an economic superpower should be seen through the lens of how much influence the country has on the success, or not, of adhering to the Paris Climate Change agreement, and progress down the path of sustainable development and growth more widely.

Eden Park Investment Management Limited, The Pavilions, Eden Park, Ham Green, Bristol, BS20 0DD, 01275 404 880, enquiries@edenparkim.co.uk, www.edenparkim.co.uk