Impact investing in industrials and materials?

Evgenia Molotova, senior investment management at Pictet Asset Management and manager of Pictet Positive Change, an impact equity strategy with a difference, explains how her experience in industries not usually associated with impact investing was the source of inspiration for the strategy

In my past life I ran the subsidiary of a major US chemicals company that produced paint and ink at a factory in the middle of Moscow. I saw first-hand the repercussions of our processes – the snow outside of our factory turned all possible colours depending on the pigment we were producing that day. Workers handling toxic chemicals had little health cover and no social safety net when jobs had to be cut. The West has moved a lot of dirty industrial production to emerging markets, essentially shipping the social and environmental issues abroad but the problems remain.

Later I moved into a financial career in the City investing in cyclical stocks like oil, gas and energy. I saw the attitude towards heavy industrials gradually change during the golden age of tech, as the energy sector's weighting fell from 10 per cent of the MSCI World Index in 2011 to 3.5 per cent in 2021. Today energy companies still generate good cash flows and returns but nobody wants to invest in them. The transition will take time. We need to continue to invest in old economy sectors, but responsibly. They are a vital part of the global economy and often the place where we most need to see change.

Engage with the laggards

We need to look at the entire value chain and consider both positive and negative externalities. Electric vehicles need lithium, nickel or cobalt for their batteries and even the most energy-efficient new building requires cement and steel. You may think investing in solar panels is virtuous, but a lot of coal was burnt in China to produce them.

My experience has made me look at the problem holistically. I don't want to just buy clean energy stocks and tech stocks. Investing only in companies that have already made the transition or whose activities have a positive impact is a worthy goal, but it doesn't solve the whole problem. We miss out on a chance to engage with the laggards, those that really need to change.

Industrials and materials are disregarded because of negative externalities yet they are very important for society. By engaging with companies' managements, we have the opportunity to find solutions that are socially or environmentally conscious and good for the bottom line. When companies manage to transform, valuations improve. I want to look at all sectors through this impact lens.

Are companies ready to change?

Companies are facing pressure on all fronts, from consumers, governments and investors.

Consumers' buying habits have changed. It is now mainstream to care about the recyclability of a product or its packaging. Governments too are shifting policy and regulation. The EU's EUR2trillion Covid-19 recovery package came with green strings attached and governments around the world, including in emerging markets, are imposing rules on companies to drive social change. Investors themselves are gravitating towards companies that adopt ESG strategies. All that means that companies take notice when we approach them with our engagement ideas.

How does engagement work?

Not all companies can change. A coal mine will always be a coal mine, and even in industries that can change, management teams may be complacent, doing what they have always done. For the most part though, where there is potential to improve, we have found management teams to be receptive to our engagement objectives and keen to be part of the change – especially when we show that it creates value. We have been in talks with a major US maker of contact lenses. Each year 14 billion disposable contact lenses are flushed down sinks or toilets, so we are exploring with them the possibility of making biodegradable lenses. We have checked the feasibility with other contact lens producers, we think consumers would like that and it would create value for the company.

With the Positive Change strategy, we want to democratise impact. By investing in companies who are improving their alignment to the UN SDGs, rather than only those generating a positive impact already, investors are able to help drive change where it's most needed and capture alpha opportunities as companies improve and re-rate.

Written by Evgenia Molotova, senior investment manager, Positive Change Strategy, Pictet Asset Management

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