Insights into responsible investing
CREATE A POSITIVE IMPACT

Wealth Management

Issue 13 | Q4 2023

ESG TRENDS FOR 2023

Transition and carbon investing defined

What is net zero? What are greenhouse gases? What is transition investing? With the multitude of terms and acronyms, it can be confusing. The opportunity: understand the buzzwords.

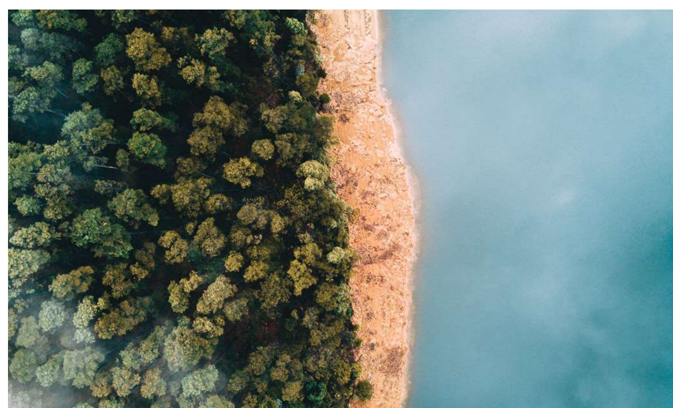
The sector of transition investing is rapidly growing with many innovative solutions. Businesses working to transition to net zero are preparing and adapting for future policy, legal and regulatory regimes, evolving consumer preferences, new technologies, etc. Many are investing in the transition theme, and there will be winners and losers. Those who are able to quickly adapt and navigate the evolving global landscape of the climate transition theme will be more likely to capture market share and maintain a competitive and investable advantage. Learn what it is and the key terms to know in this thematic investment style.

Transition investing

In the simplest terms, transition investing provides financing to support progress towards net zero. Instead of removing support through divestment, it covers investments in high-emitting and hard-to-abate sectors that require substantial financing to implement their climate strategies and lower emissions. The transition to a net-zero future is no small undertaking and one of the greatest challenges humankind has faced.

Net-Zero

Net-Zero[1] means cutting greenhouse gas (GHG) emissions to as close to zero as possible, with any remaining emissions re-absorbed from the atmosphere, by oceans and forests for instance. It is about achieving a balance between the GHG emissions produced by human activity and those removed from the atmosphere.



The journey to net-zero emissions must be orderly and inclusive and balance society's current energy needs with a vision of a more sustainable future. The path to net zero investing means supporting companies with ambitious carbon reduction goals and compensating for remaining emissions that cannot be mitigated using carbon removal technologies.

1.5 and 2˚C

The Paris Agreement[2] is a legally binding international treaty on climate change, adopted by 196 Parties at COP 21 in Paris, France on December 12, 2015, and became effective on November 4, 2016. The goal of the Agreement is to hold "the increase in the global average temperature to well below 2˚C above pre-industrial levels" and pursue efforts "to limit the temperature increase to 1.5˚C above pre-industrial levels".

1. https://www.un.org/en/climatechange/net-zero-coalition
2. https://unfccc.int/process-and-meetings/the-paris-agreement

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The transition to net-zero is a multi-decade journey. It is essential to understand that the 2050 net zero goal is not an end point but a midpoint in a century-long effort to stabilize emissions. In recent years, world leaders have stressed the need to limit global warming to 1.5˚C by the end of this century.

Greenhouse Gas Emissions

Greenhouse gases[3] (GHG) are naturally occurring gases, such as carbon dioxide (CO_2), methane, nitrous oxide, and fluorinated gases, that trap heat in the atmosphere. For example, CO_2 enters the atmosphere through burning fossil fuels (coal, natural gas, and oil). Each of these gases can remain in the atmosphere for different amounts of time, ranging from a few to a thousand years. Some gasses are more effective than others at warming the planet and "thickening the Earth's atmospheric blanket".

Scope 1, 2, 3 Emissions

- **Scope 1:** Direct greenhouse gas emissions that occur from sources that are owned or controlled by a company. (i.e. Fuel combustion, Company vehicles)
- **Scope 2:** Indirect greenhouse gas emissions associated with a company's purchased electricity, steam, heating and/or cooling. (i.e. Purchased electricity, heat, and steam)
- **Scope 3:** All other indirect greenhouse gas emissions (not included in Scope 2) that occur in a company's value chain. Scope 3 emissions can be further broken down into upstream and downstream emissions. (i.e. Purchased goods and services, use of sold products, transportation and distribution, investments, business travel, employee commuting, waste disposal, leased assets)

Decarbonization

Decarbonization is the reduction of carbon and other greenhouse gases in the atmosphere in order to reach net-zero. Decarbonization can be achieved across all sectors. Carbon removal solutions will be needed for those hard-to-abate sectors. Other examples for reducing CO_2 emissions are through strategies including energy efficiency, energy conservation, fuel switching, carbon capture and sequestration (CCS), and changes to uses of land and land management practices.

Climate Change

The warming of Earth's atmosphere caused by human-generated emissions of carbon dioxide and other GHGs is causing sea levels to rise and endangering human health, biodiversity and property.[4] Climate change is the long-term shifts in average weather patterns and temperature.

3. https://www.epa.gov/ghgemissions/overview-greenhouse-gases
4. https://www.msci.com/documents/1296102/32315172/Chapter-01-MSCI-ESG-Advisor-Guide.pdf

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Transition and carbon investing defined, continued from page 2

Changes observed in the earth's climate since the mid-20th century have been driven by human activities that increase greenhouse gas levels in the earth's atmosphere and have a warming effect.[5]

Carbon footprint

The total amount of greenhouse gas emissions that a person or entity generates through their activities. This indicator allows for comparison of activities, products, companies and countries. Carbon footprints are reported in tons of emissions per unit of comparison. According to the Nature Conservancy, the average carbon footprint for a person in the U.S. is 16 tons, one of the highest in the world.[6]

Carbon investing

One of the most cost-effective ways of incentivizing emissions reductions is to assign financial value to them, thereby putting a price on pollution. Carbon markets are a growing sector where emissions credits are purchased and sold and derivatives are traded. Carbon credits are a commoditized product that permits companies to legally emit greenhouse gas—at the rate of one tonne of CO_2 or GHG per credit. The credits enable carbon to be tracked and traded like any other commodity. Ultimately, the carbon markets incentivize companies to reduce their GHG emissions in two ways: they have to spend money on extra credits if their emissions exceed their allowance or they can make money by reducing their emissions and selling their excess credits. Some examples of carbon offsets include direct air capture, reforestation, and methane capture.

Climate change

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Carbon innovators

Those who are leaders in advancing solutions or actively working to transition their current business model to make future improvements that will help reduce carbon emissions in support of the net-zero initiative are carbon innovators. Essentially these firms and organizations, in their respective industries, find and invest in innovative ways to be more efficient in order to reduce their carbon emissions faster than peers. A carbon innovator doesn't have to solely focus on carbon reduction as its main mandate (i.e. solar and wind energy firms) but can be a firm that is uniquely positioned to lead the energy transition and chooses to pursue that opportunity. For example: investing in energy efficiency capabilities, innovative technology like direct air capture that works to extract CO_2 directly from the atmosphere or auto manufacturers investing in the electric vehicle industry.

5. https://www.rbc.com/community-social-impact/climate/learning-centre/index.html#glossary
6. https://www.nature.org/en-us/get-involved/how-to-help/carbon-footprint-calculator/#:~:text=A%20carbon%20footprint%20is%20the,highest%20rates%20in%20the%20world.
7. RBC, Climate, Glossary of Climate Terms

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Biodiversity

The genetic diversity across all living organisms, both terrestrial and marine. It has a role in ensuring the resilience of natural capital assets which are essential for economic activity. However, land use change, climate change, exploitation and pollution are driving biodiversity loss—creating risks and opportunities for society, business and investors.[8]

Greenwashing

Misleading or inaccurate statements about the sustainable performance or environmental benefits of a product, practice, firm or investment. Deceptive persuasion is an increasing risk that is being combated through increased regulatory bodies and industry disclosure frameworks.

TCFD

The Task Force on Climate-related Financial Disclosures (TCFD),[9] established by the Financial Stability Board (FSB), has developed a framework to help public companies and other organizations more effectively disclose climate-related risks and opportunities through their existing reporting processes. The TCFD focuses on the main categories of governance, strategy, risk management, metrics and targets.

ISSB

In 2021, the IFRS Foundation created the International Sustainability Standards Board (ISSB).[10] The ISSB is responsible for developing IFRS Sustainability Disclosure Standards, to provide a truly global baseline of sustainability disclosures to further inform economic and investment decisions. The better information investors have, the better investors can act in supporting economic and investment decision-making.

NZBA

The Net-Zero Banking Alliance (NZBA)[11] is a global, industry-led initiative to accelerate and support efforts to address climate change, convened by the UN. It is a group of leading global banks committed to financing ambitious climate action to transition the real economy to net-zero GHG emissions by 2050.

RBC joined[12] the NZBA as we recognize we have an important role to play in accelerating clean economic growth and helping our clients and communities thrive in a socially inclusive transition to a net-zero economy. The NZBA will provide a structured forum to support banks' and our clients' transition to net-zero in an orderly and inclusive way.

8. Biodiversity | Environmental, social and governance (ESG) issues (unpri.org)
9. https://www.fsb-tcfd.org/
10. https://www.ifrs.org/groups/international-sustainability-standards-board/issb-frequently-asked-questions/
11. https://www.unepfi.org/net-zero-banking/
12. https://www.rbc.com/community-social-impact/climate/net-zero-banking-alliance/index.html

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The path forward to net zero for investors

All of society will play a role in this transition including governments, regulators, businesses, and individual investors. An orderly and inclusive transition also means that the communities that depend on the jobs within hard-to-abate sectors aren't left behind. Upskilling workers throughout the transition is one way to address this obstacle positively and proactively.

A balanced approach is critical. It's not just an energy transition, but an economic transition – the implications of moving to net zero are broad across all sectors and in our everyday lives. We can't just turn the tap off to high emitters, as they are fundamental to society functioning and the way we live, eat, and move; helping to reduce their emissions is the logical way forward and is where we can really make a difference. Often described as "turning a dial" versus "flipping a switch" for high-emitting sectors.

The transition will not happen overnight – without risking significant harm and disruption to lives and livelihoods everywhere. The reality is that society still needs a variety of forms of energy, including fossil fuels, to power the economy and people's lives.

Investors – both institutional and retail – are increasingly aware of the role they can play in the transition and the integration of environmental, social and governance (ESG) factors into portfolios through responsible investment. Read more about why transition investing is key to a net-zero future.

For information about RBC's commitment to reach net zero by 2050, access its Climate Report 2022 and Net-Zero Report.

How an ESG integrated portfolio can own oil, alcohol and tobacco

How the so called "sin stocks" can fit into a responsible investing strategy

Can you own oil, alcohol, and tobacco in an ESG integrated portfolio? Yes. With ESG integration, there are no exclusions or screens. By nature, no sector or company is off limits, which means everything is investible. ESG integration deliberately incorporates and combines ESG data—or material extra-financial factors—alongside traditional financial analysis to identify potential risks and opportunities and improve long-term, risk-adjusted returns.

On the other hand, aligning investments and personal values can be accomplished with ESG screening and exclusion. Values are unique to everyone, and the application of ESG screening and exclusion can help remove assets that conflict with certain moral or religious beliefs.

ESG data: an additional layer of research

It is not about good versus bad companies or ratings, it's about data that focuses on the factors that are likely to have a material bearing impact on a company's financial performance, either today or in the future.

This additional layer of data is used to check the blind spots when investing in companies or products. Using extra-financial data alongside traditional financial analysis can provide a more complete picture of potential risks and opportunities lurking in those blind spots.

Case study

Industry	Traditional factors	Material extra-financial factors
Non-alcoholic beverages	Revenues and earnings per share (EPS)	Fleet fuel consumed
	Industry competition dynamics	Operational energy consumed
	Dividend policy	Total water withdrawn

While the traditional factors listed in the table above are important in understanding the risk and return potential of an investment opportunity, consideration of material extra-financial factors specific to the industry can help us to better understand strengths and weaknesses in the operations of various companies. For example:

- **Fleet fuel consumed:** Fleet fuel, such as diesel or unleaded gasoline, is needed to move vehicles from point to point to transport beverages, and fuel has a monetary cost. All else equal, using less fuel and diversifying fuels and/or fleet vehicles results in lower costs and higher profitability.
- **Operational energy consumed:** Energy is consumed in the production of soft drinks to light buildings, mix ingredients, bottle beverages, etc. But energy also has a cost, which can vary based on the source of energy. Lowering energy usage and/or investing in a diverse energy mix results in lower costs and higher profitability.
- **Total water withdrawn:** Water is a critical ingredient in beverages. While water is currently a low-cost input in much of the world, companies that source water from areas with high baseline water stress may be more

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exposed to risks stemming from droughts and other adverse events that can cause a company to reduce or pause operations.

Note that the set of extra-financial factors listed above are specific to the industry in question and vary from industry to industry. Those listed above may help an investor understand another beverage company but would be less helpful in understanding an airline, a smartphone producer, or a clothing retailer.

Divestment is not always the solution

It is important to look at business models and their future path forward. Divestment is not always the solution as there is an immediate loss for funding, support, and engagement. Integrated extra-financial factors can provide insights to understand a more complete picture of a business or industry and position investors to make better investment decisions.

Notable investment considerations

1. **Time horizon of an investment** – how will a company be impacted 5, 10, 15, and 20 years? Are they leading in market share? Improving their operations? Will parts of their business become absolute or stranded assets? Have they experienced regulatory issues resulting in fines or workplace safety issues?
2. **Supply and demand** – for example, today, fossil fuels are used to make almost everything. Turning off oil would dramatically impact lives. Consider consumer trends and how alternative sources will impact the future supply and demand levels as they are brought to market and scaled.
3. **Capital Expenditures** – Is a company investing in innovative technologies like direct air capture or carbon sequestration to help lower their carbon footprint? Are they preparing for future policies, regulations, and/or potential carbon taxes?

Know what you own inside your portfolio. Is ESG data utilized or integrated? If so, understand how the data is being used. By integrating ESG data, it provides a more complete view of companies and leads to less blind spots to worry about when making investment decisions. Material ESG factors vary according to industry. See the chart below for examples.

Examples of material factors

Industry	Sub-industry	Some ESG factors material to the sub-industry as per SASB
Consumer goods	Apparel, accessories & footwear	• Materials sourcing & efficiency • Product quality & safety
Extractives & minerals processing	Oil & gas	• Employee health & safety • Critical incident risk management
Financials	Insurance	• Selling practices & product labeling • Systemic risk management
Food & beverage	Processed foods	• Materials sourcing & efficiency • Product design & lifecycle management
Health care	Drug retailers	• Data security • Customer welfare
Infrastructure	Electric utilities & power generators	• Access & affordability • Business model resilience
Renewable resources & alternative energy	Wind technology & project developers	• Employee health & safety • Materials sourcing & efficiency
Resource transformation	Chemicals	• Waste & hazardous material management • Employee health & safety
Services	Hotels & lodging	• Labor practices • Ecological impacts
Technology & communications	Telecommunication services	• Customer privacy • Competitive behavior
Transportation	Automobiles	• Product quality & safety • Materials sourcing & efficiency

Source: Sustainability Accounting Standards Board (SASB)

Are you ready for the great wealth transfer?

With $84 trillion dollars expected to transition from baby boomers to their heirs by 2045 according to Cerulli Associates[1], now is the time to start engaging the next generation with discussions to help proactively accumulate, sustain and protect the family wealth.

The great wealth transfer has begun, with trillions of dollars expected to pass hands from the baby boomers to their adult children over the next two decades. Millennials may expect wealth to be invested and put to work in a contrasting way from their parents' and grandparents' views, giving rise to the lack of interest or frustration among song next-gen inheritors.

Cerulli anticipates $84.4 trillion to be passed down from elder generations to beneficiaries and charities through 2045.[1] It is time to start engaging the next generation into family discussions to help proactively accumulate, sustain, and protect family wealth.

Values, needs and goals are unique to everyone. Creating a tailored Wealth Plan that reflects what's most important to you can help you achieve your financial goals. Your aspirations may involve your family, business, or the legacy you want to leave.

Responsible investing can help bridge the generation gap

As parents think about the legacy they want to leave, planning now can set your family up for a sustained wealth into the future. Bringing something new to the table to discuss what this data looks like and how to bring it into a portfolio. Family members may have various values and principles, and that's why responsible investing is a great way to spark the discussion.

The topic of responsible investing gives the next generation a starting point for a two-way conversation. Responsible investing is a process that deliberately incorporates environmental, social and governance (ESG) considerations into an investment portfolio.

The next generation may have their own principles around what they're investing in. It can even be enlightening for parents, to be in the room together and hear about what is important to their kids.

Engage the next generation sooner rather than later

Having a conversation can help prepare the next generation with strategic tools, knowledge, and resources to help guide them along the RBC wealth management experience. Advisors have a wealth of knowledge and resources to help all family members throughout the wealth planning process.

It's not too late to gather the family and invite them to have a discussion or to set up reoccurring money talks. Set up a family meeting or add it to your dinner time conversation to start. Make sure to listen for input from all generations in order to have a fruitful discussion.

1. "Cerulli Anticipates $84 Trillion in Wealth Transfers Through 2045", January 2022
https://www.cerulli.com/press-releases/cerulli-anticipates-84-trillion-in-wealth-transfers-through-2045

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Are you ready for the great wealth transfer?, continued from page 8

Are your adult kids looking to start planning their financial future? Connecting with young professionals can be a great way to assist them with mastering the fundamentals of saving and investing in order to help them feel more confident towards achieving their financial goals.

Create a lasting legacy for your family

Current leaders of the household can take time to think thoughtfully about the ideals, values, and legacy for their family. Check this off your financial health "to-do" list to help prepare the next generation and teach them how you see the purpose of your family's wealth live on for generations.

- What impact do you want your family legacy to have?
- What values do you hope to leave to the next generation?
- How would you like to see this wealth impact your lives and the lives of your children?
- What is your ideal giving plan?

Incorporating a charitable giving strategy into an overall wealth plan can help develop a strong legacy for the entire family to enjoy. Your advisor can guide you through the gifting and philanthropic solutions available to your family.

Gifting is often more rewarding to do while you are alive so you can witness the impact you are making. A few common gifting examples, include:

- Gifting for your child's education and/or first house,
- starting a college fund for grandchildren, and
- meaningful philanthropy gifts to an important cause, etc.

Research tells us that being generous and spending money on others makes us happier and brings purpose to our wealth. It also has the added benefit of the next generation being able to see generosity in action.

Women and Millennials express interest in responsible investing

Women control 52% of personal wealth in the U.S., and are expected to control two-thirds, or $72 trillion, by 2030.[2] As women gain power, interest in responsible investing grows. RBC Wealth Management U.S. client survey results over the past few years have confirmed that women are more likely to have a discussion with their advisor about this topic. Clients can look to their advisor for more education on topics that might be new to them in order to jumpstart future conversations.

Millennials represent the next big wave of wealth. According to a survey[2] conducted by RBC Wealth Management-U.S., 84 percent of the high-earning and high-net-worth millennials survey respondents said it's important to consider environmental, social and governance ESG) factors and that ESG investments are an integral part of their investment strategy.

Consider setting up a family financial wellness check-in or invite your children to your next meeting with your advisor. Discussing your family values, legacy, and ideal gifting plan are a few of the many topics to help bridge the gap among generations. Accumulate, sustain, and protect wealth by working with your advisor to discuss your family's wealth plan in the coming year and for generations to come.

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1. National Association of Women Business Owners, 2017 https://www.rbcwealthmanagement.com/en-us/campaign/women-and-wealth
2. https://www.rbcwealthmanagement.com/en-us/campaign/millennials-financial-future

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