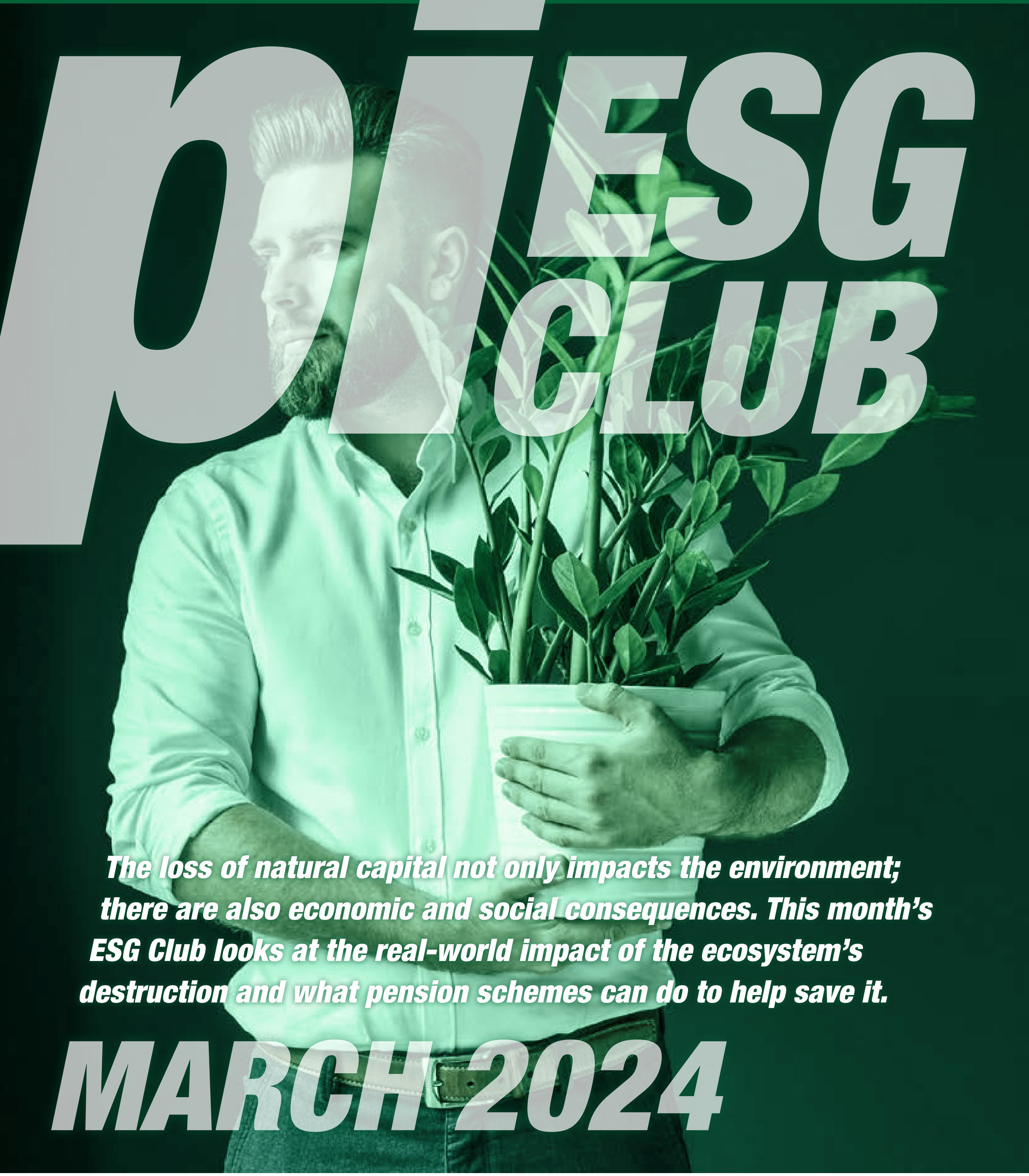

pi ESG CLUB

The loss of natural capital not only impacts the environment; there are also economic and social consequences. This month's ESG Club looks at the real-world impact of the ecosystem's destruction and what pension schemes can do to help save it.

MARCH 2024

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BlackRock

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PENSIONS AND LIFETIME SAVINGS ASSOCIATION

MORE ASSET OWNERS TO SET GREEN TRANSITION TARGETS

Hitting a net-zero target is not easy, finds *Andrew Holt*.

A quarter of asset owners intend to set a formal net-zero commitment within the next 12 months, according to a study.

Research company Cerulli found that while 14% of asset owners have a formal net-zero commitment, an additional 25% plan to set one this year.

Specifically, almost a third (30%) of institutions are investing in strategies that support the transition to a carbon-neutral economy, and 36% plan to invest in these tactics within the next year.

As expected, many are moving away from coal, gas and oil, as half of the institutions surveyed say they will either divest (29%) or plan to divest (21%) from fossil fuel funds.

But even with a rising interest in sustainable investments, fossil fuel funds remain prominent due to their high returns.

One interesting statistic from As You Sow, a not-for-profit that promotes corporate social responsibility, reveals that 19% of the market cap of US fossil fuel companies comes from investments in US 401(k) accounts and individual retirement accounts.

Now, institutions are enacting these changes in order to prioritise and address climate risks, with 61% saying the issue of climate change is the top theme in their responsible investment strategy, revealed Cerulli.

New kid on the block

Despite their determination, investors continue to face difficulties when analysing the carbon footprints of underlying investment portfolios.

Inevitably, the lack of climate transition-related data has been consistently cited as a challenge for investors in understanding which companies are being transparent and dedicated to their climate change commitments.

However, there could be hope here. A new platform called the Net-Zero Data Public Utility database is planning to enter the market to hopefully once and for all establish reliable and accessible climate data across multiple industries.

That would address many of the issues investors have.

The database comes with some big names attached: formed by Emmanuel Macron's and Michael Bloomberg's Climate Data Steering Committee, it is designed to be integrated with the UN Framework Convention on Climate Change's Global Climate Action Portal, which identifies how companies, investors, organisations, regions and cities are engaging in global climate action.

As more investors re-examine their contributions to climate change, Cerulli said it expects to see a rise in collaborations that promote transparency when analysing climate-related funds.

A new framework

The survey's findings come as GLIL Infrastructure, a £3.6bn investment fund, revealed that it has adopted a new investment management framework to help it become net zero by 2050.

The adopted approach – the Institutional Investors Group on Climate Change (IIGCC) Net Zero Investment Management (NZIM) framework – sets out clear methodologies and approaches for investors to align their portfolio goals with the Paris Agreement, supporting them to make informed decisions and work towards achieving net-zero global emissions.

The NZIM framework was published in March last year and GLIL was one of the first investors to adopt its guidance for infrastructure, which builds on IIGCC's broader NZIM framework.

It is said to be the most implemented net-zero methodology for investors across all financial institutions within the Glasgow Financial Alliance for Net Zero.

The GLIL executive committee said it has worked "swiftly to select the new framework" to support the business with structuring its net-zero strategy and to allow for a consistent framework across its portfolio.

GLIL believes the NZIM approach will enhance its work in the energy transition by providing further support for its existing portfolio companies to ensure they have achievable net-zero pathways.

Beth Breen, ESG analyst at GLIL Infrastructure, said: "As a fund which delivers valuable investment into critical infrastructure projects across the UK and beyond, we know it is our responsibility to ensure that net-zero commitments are carried out within an effective strategy to achieve our 2050 targets.

"We believe the NZIM framework will allow infrastructure investors to bring further substance to their net-zero ambitions in a sector where it has been largely lacking.

"Our adoption of this new framework aligns with our members' commitment to driving the energy transition towards a sustainable net-zero economy."

GLIL is the partnership of UK pension funds specially designed to help pension fund members tap into the stable, inflation-linked returns that infrastructure investment offers.

It manages £3.6bn of committed capital, with more than £3bn deployed into a portfolio of infrastructure assets spanning renewable energy, battery storage, regulated utilities, ports and logistics, trains, hospitals and schools.

GLIL's focus on the energy transition can be seen in the fund's latest investment in a portfolio of 247MW of operational UK solar assets.

ESG INTERVIEW – KEITH GUTHRIE

"I prefer sustainability to ESG."

The head of UK sustainability for Now Pensions and Cardano talks to *Andrew Holt* about making a real impact, the systemic challenge in addressing sustainability and learning the lessons of collaboration.

You took up your new role in December, but you came from within the organisation. Despite knowing the operation, how would you describe the first few months?

Intense is the word I would choose. There is a lot going on and I took this role on because of that. It is an opportunity to add value in sustainability, not only just in the context of Now Pensions, but also in the wider industry, where there is an opportunity to influence organisations and individuals to have clearer thinking about how to tackle sustainability.

I am very much a first principles person. That is what I like doing.

What are your ESG and sustainability priorities?

There are quite a few things on the go at the moment. There is a lot of industry reporting and development around the Task Force on Climate-related Financial Disclosures. That is more the reporting function. What I want to focus my efforts on are where we can get up close and make a difference.

In the case of Cardano, it is working with all the different defined benefit pension funds we operate with. In the case of Now Pensions, it is working with the trustees on the on-going development of their sustainability efforts. What can we do in the portfolio that will improve member outcomes? The foundations are there already.

How do you view the Now Pensions approach to sustainability?

The trustees are engaged. That makes my job a lot easier. Their belief in sustainable investment needs to be tackled from financial risk and real-world impact perspectives. Having clarity of both in our investments is an important connection.

That is at the heart of what I believe is how sustainability should be done. It is where much of the industry gets it wrong, because it is usually about the risk perspective, which isn't terribly helpful.

Does the industry get lost on the real-world impact?

Few organisations set real-world impact as an objective. Therefore, they can end up getting themselves in knots. There is a lot of tick-box exercises going on.

How can that change?

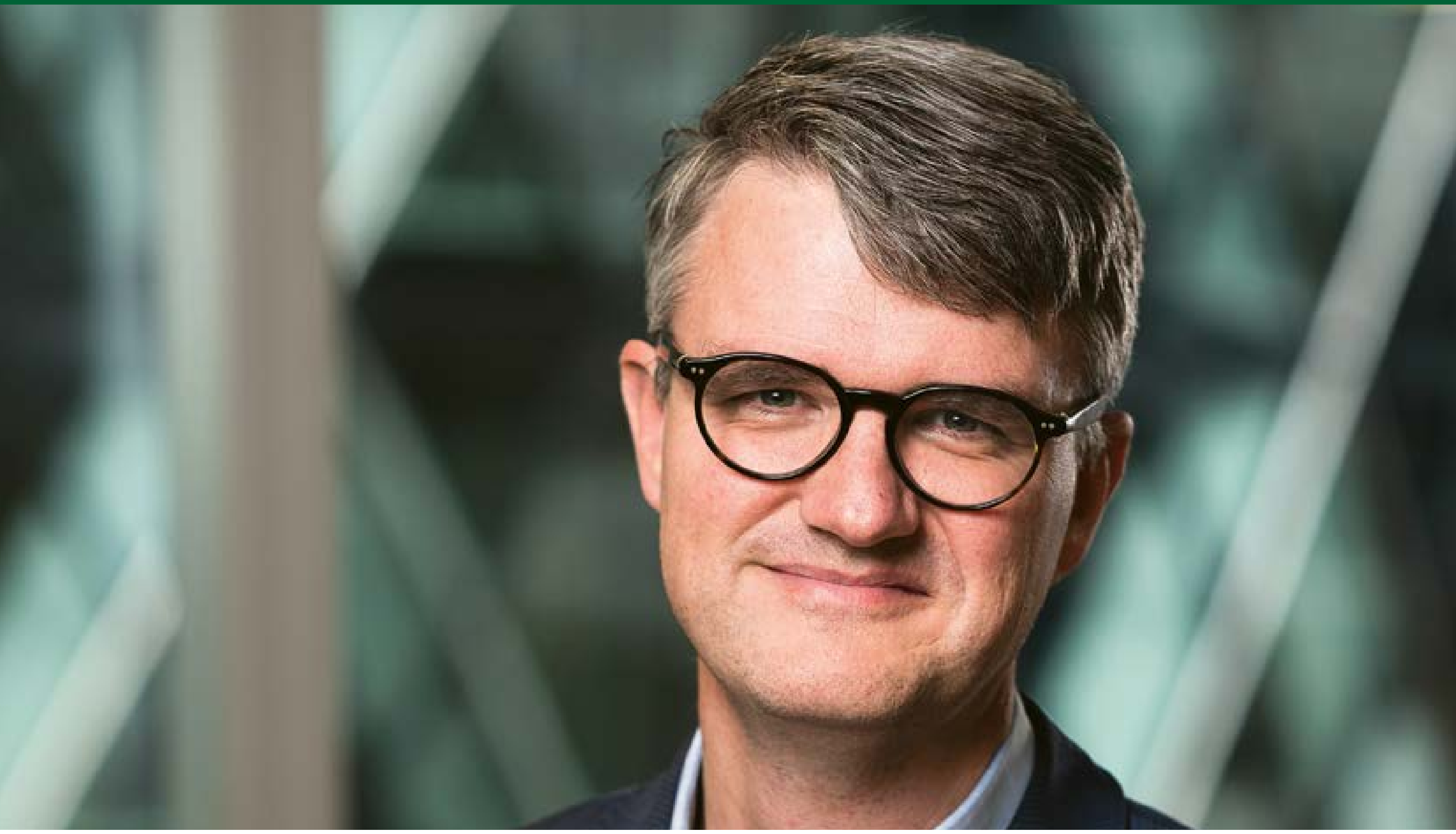
I hope more will adopt a dual mandate. We define it as assisting in the transition towards a more sustainable society – which comes with all the environmental and social issues. That is how we define our real-world objective.

How central is sustainability to Now Pensions' investment approach?

It is hugely central. It has grown over time. We run the whole portfolio on a sustainable basis. The trustees then decide which portions of the portfolio have a specific sustainable objective – that is about 82% of the portfolio.

About 17% of the portfolio is made up of green bonds, while the equity portion has a growing allocation to green strategies.

Now Pensions has identified three sustainability priorities: climate action, the living wage and gender equality. Why are they so important?



Those are the trustees' themes and objectives and tied to our membership because it will make a difference to their lives. Two are social – the gender equality and the living wage – and then the climate focus, which we approach quite broadly.

Biodiversity feeds massively into climate. In our equity mandates there is a focus on deforestation and engaging businesses on the issue. The trustees have signed up to the PRI's Spring initiative, which is around deforestation.

What is the biggest challenge for investors who are committed to sustainability?

It is around how to do it well. People always say there is a lack of data. In some areas there is, but in others it is a lot better. You use what data you can. But you cannot stop data from making sure you have an influence and doing the right thing on sustainability.

One challenge is governance, in that you want to make sure the managers are aligned with the trustees and their beliefs. And on stewardship, it is about being part of the right alliances to do the right sort of engagements.

The relationship between Now Pensions and Cardano is reasonably unique. What, for you, are the benefits and flaws of such a relationship?

It is unique. The benefits have been in the ability to align what the trustees are looking for with what is executed. We have spent a lot of time understanding the trustees and what they are looking for.

A strength is the strong independent governance where the trustees have their own independent advisers. This creates a good dialogue. We worked together on measuring the decarbonisation in the portfolio by putting in place a framework that monitors how that is going versus the broader market.

It is also what I can bring to the role. I have a lot of experience with the group and I sit between the businesses. I need to know what is going on from an operational perspective and present to the trustees that side of the business.

Is there any time when there is conflict, where Cardano wants to do one thing and Now Pensions something else?

What we are cautious of is having good governance in place. If there are decisions where there is a conflict of interests, then Cardano leaves the room and the decision is made by the Now Pensions' trustees. So it is clear how potential conflicts are resolved. But it hasn't come up as an issue. Now Pensions works well with Cardano, the advisers and trustees.

Is the relationship therefore like an outsourced chief investment officer (OCIO) relationship?

You could say it is a bit like an OCIO. It is definitely an asset manager relationship. Cardano is not the adviser but works closely with the Now Pensions' trustees to devise the investment phases. And the trustees are very much engaged, particularly when it comes to sustainability. They challenge what we are doing in this area.

Cardano has the responsibility of appointing the asset managers. The trustees don't have that responsibility, but don't shy away from asking questions about it.

Cardano is also focused on impact in the portfolio. That involves engaging with third-party asset managers to up their standards. There are also in-house teams at Cardano managing assets directly according to the sustainability standards set.

And those sustainability standards are set by Cardano?
It is double layered. Cardano has its own sustainable investment policy. This drives its internal strategies. Now Pensions appoints Cardano to manage the assets, which are managed in line with Cardano's policy. Now Pensions' trustees then add their sustainability priorities, and it gets implemented by the Cardano team.

The term ESG has come under criticism of late. Do you understand those criticisms?
It has become a real hot potato, particularly in the US. It has stopped being a description of investment risk assessment and has become a political term. I prefer sustainability to ESG. Our trustees believe sustainability is about the transition, not just about focusing on companies that are not truly green.
We have a large proportion of the market that has a negative impact on the environment and we need to figure out how it gets positive: things like airlines and cement companies. These companies are not going to disappear.
What we need to do is work together with them towards what a good transition plan looks like. So thinking about sustainability when investing across that spectrum.

Our trustees believe sustainability is about the transition, not just about focusing on companies that are not truly green.

Where does this leave ESG?
We may have an explicit bifurcation in the market, between investors who only have a financial risk ESG objective and investors who say the impact is more important.
I hope more and more of the market adopt that second approach. The real impacts are systemic and matter to long-term outcomes.

What has been the biggest change in how investors approach sustainability during your time working in this area?
It started off as a risk integration problem. But the biggest change is understanding that these issues are systemic. They are bigger than just being tackled at a company level. Governments have a huge role to play.
I also think collaboration has grown and individuals and organisations are figuring out how to do that better.

You mentioned the importance of government, how do you view the various initiatives from government and supranational bodies when it comes to sustainability?
Government has a huge role to play. They regulate industries, which is interconnected to sustainability. For investors the key challenge is that we are investing over the long term, which is why we take the systemic approach over the long-term risks we are exposed to.
What is important as an investor is: where I am investing? Do I understand the rules of the game? So what is important is that government keeps a level of consistency in its approach. If things change, you understand the impact on the risk premium. So government needs to give certainty of trajectory on sustainability.

What did you make then of Rishi Sunak and Keir Starmer backtracking on their ESG commitments?
That backtracking creates uncertainty and increases the risk and cost of making sustainable investments. But we have to also work within an economic reality. What is unhelpful is the mixed messages on the trajectory of travel.

Why is sustainability so attractive to you?
It has been a wonderful journey for me. I have, as I said, always had a first principles approach in how to figure out how I can make a real difference to our business and contribute to the world. There is still a lot of thinking that is still unclear and therefore there is a lot I can contribute.

Where do you aim to take Now Pensions on the sustainability front?
We have done a great job. We had a strategy review over the last year to push sustainability in all parts of the portfolio.
There are parts of the portfolio where it can go further. We have been talking to the trustees about impact investing but haven't worked out yet how to do that.
The cool parts of the portfolio are the green bond investments. The equity investments needed substantial change after the review. The equity portfolio now has real-world impact at its core, but we need to think about how to push it further.

What has been the biggest lesson you have learned in your career?
If I look back on my younger self it would have been to understand the collaboration aspect earlier. I was like, 'I am smart enough to do this myself'. And that then becomes an appreciation of the team I am working with.
Mental health is also important to me. So a real appreciation that this not just a numbers and mathematics game, it is a real-world game, or not even a game, its people's lives.

NATURAL CAPITAL: STAYING ALIVE

You can't fight climate change without a vibrant ecosystem, and you can't have a vibrant ecosystem if you have climate change. *Mark Dunne* looks at how institutional investors are tackling the problem.

Summer in Australia is a mixture of joy and despair. Alongside barbeques on the beach and playing cricket the sky often turns black from the bushfires that sweep across the country.
Such events are an annual occurrence, causing widespread destruction. Indeed, 10 people lost their lives and 170 homes were destroyed in December when fires engulfed almost 1.5 million square kilometres of bushland. Above average temperatures and below average rainfall were blamed.
Climate change is lighting the spark on Australia's bushfires and lives are being lost, but its impact on the natural world is creating other threats to life.

Extinction list

A chubby frog, a broad-toothed rat and various types of crayfish are among the 144 animals and plants that were added to Australia's threatened species list last year, bringing the total to more than 2,200. The list is growing due to habitats coming under threat from the destruction of land in the country, such as from bushfires.

This is a big issue as animals and plants are part of the natural capital that supports human life. Water, soil, coral reefs and bacteria are also elements of the ecosystem that provide us with nourishment, fresh air and medicine. The loss of this natural capital can lead to famine, drought, poverty and lower life expectancies.
Yet the biggest threat to such biodiversity are people, specifically in how we manage land. Ploughing fields to grow food, for example, may mean animals, plants and microbes are forced out of their natural territories or face extinction.
Pollution (including fertilisers), over-fishing, hunting, animal farming and human construction are other threats to the ecosystem, which could result in the loss of food and medicine as well as increasing the risk of people catching diseases from migrating animals.
We have already reached the point where we are exploiting nature faster than it can renew itself, according to the UN's Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services.

Natural defence

Climate change is another aggressor. Rising temperatures, changing rainfall patterns, extreme weather events, droughts, floods and bushfires are affecting ecosystems by changing what can grow and live in certain places.

So some plants, for example, are unable to flourish, while rising temperatures have seen the number of coral reefs almost halve in the past 150 years.

Yet a vibrant ecosystem is the natural defence against the impact of climate change. Plants, the ocean and soil remove carbon from the atmosphere, but deforestation transforms carbon sinks into carbon emitters. It needs to be the other way around.

It's not just about trees. The World Bank says that 85% of wetlands, such as carbon absorbing salt marshes, have disappeared. Pollution, agriculture and freshwater being diverted elsewhere are among the reasons why.

Such loss is a huge dent in the fight against global warming with estimates suggesting that natural capital can provide 37% of the mitigation needed to achieve the Paris Accord's 1.5-degree warming target by 2030, says Lee Backhouse, a senior responsible investment manager at Scottish Widows. "We have become more aware as a society of the connection between nature and climate change," he says. "That the two are inextricably interlinked, are mutually reinforcing one another.

"We know that the environmental processes that biodiversity supports, ultimately support the fight against climate change."

So investors are not going to achieve carbon neutrality if they ignore nature. "We need to bring nature in as part of that, because it is a major tool in reaching our decarbonisation goals, particularly when we consider that 37%," Backhouse adds.

The cost of nature loss

The impact of natural capital loss stretches beyond the environment in that it has serious consequences for the global economy. Indeed, more than half (55%) of the world's output, around $58trn (£46trn), is dependent on nature, according to PwC.

The World Bank believes that global GDP could lose $2.7trn (£2.1trn) by 2030 if ecosystem services collapse, such as pollination, carbon storage and timber provision.

However, it is some of the poorer countries in the developing world that could suffer the most if their ecosystem is not functioning as it should with the hit to GDP estimated at 10% a year.

One of the reasons is that the natural world provides people with a living, such as tourism. It can also give them a home. According to the World Bank, 1.6 billion people rely on forests for their livelihoods, while 300 million people live in them.

So there are also social benefits to having a vibrant ecosystem.

> **We have become more aware as a society of the connection between nature and climate change.**
>
> Lee Backhouse, Scottish Widows.

"You can't understate the social impact [of nature loss]," Backhouse says. "There is a huge drain on society as a result of biodiversity loss."

Backhouse adds that the social aspect is not just about earning a livelihood but being able to thrive in a particular area.

"We are incredibly lucky in the UK in that we don't experience wild events," he adds. "We get bad storms, but we are not at the forefront of the battle whereby the ecosystems that we depend on to live within are impacted.

"It is not just the earnings side, it is the continued survival of communities because of the increased risk from extreme weather of the loss of a particular material that we might depend upon for survival," he adds.

Hard targets

The world has had a difficult time in trying to protect its ecosystem. It failed to meet all of the 24 Aichi Biodiversity Targets, the deadline for which expired four years ago. Those targets included reducing pollution and deforestation by a certain level, while protecting 10% of the oceans.

A lack of financing was blamed. Indeed, the biodiversity funding gap is believed to be an average of $711bn (£561bn) a year between 2019 and 2030.

So institutional capital is needed to halt deforestation and pollution while protecting biodiversity against its other threats, providing greater access to freshwater and growing food more sustainably.

Despite climate change taking center stage in institutional portfolios, pension schemes are factoring natural capital into their decision making. One such scheme is the £900m Scottish Borders Council Pension Fund. In January, it invested an undisclosed amount in a timberland fund. This is its first allocation to natural capital and aims to sell land and timber as well as carbon offsets.

Meanwhile, the £35bn Access pension pool has launched a global timberland mandate. The initial size of the portfolio will be around £300m.

Scottish Widows' approach has been to create a Global Environmental Solutions fund, which pushes the insurer's focus beyond climate change. "We are seeing an opportunity in the technological innovation that supports the preservation and restoration of biodiversity," Backhouse says. "Companies that are focusing on addressing pollution issues, not just those that are driving carbon dioxide down."

A benefit of investors looking at funding the transition is that the investment universe is huge, he adds. "Because economies are so dependent on nature, if you want to invest in the transition, the entire global market is pretty much an open field because every company needs to transition, every company has to address their environmental impact," Backhouse says.

High interest, low coupons

Then there are debt-for-nature swaps, which is where institutional capital encourages corporates to invest more in protecting the natural world in exchange for paying less interest on their borrowings.

In May 2023, Ecuador agreed a refinancing that will shrink the interest payments on its debt by more than $1bn (£793m) if it steps up efforts to support marine conservation around the Galápagos Islands.

The waters around the Islands are home to 3,000 species, 20% of which cannot be found anywhere else on earth, and inspired Charles Darwin's theory of evolution. But climate change and overfishing are putting pressure on this ecosystem.

Under the terms of the debt-for-nature swap, Ecuador will protect the Galápagos' marine reserves and promote sustainable fishing over the next 18 years to prevent habitat loss.

Barbados and Belize have agreed similar deals.

Legal & General Investment Management (LGIM) was an investor in the Ecuador deal. "Our financial systems are embedded within the natural environment, but the models that we use ignore it," says Wendy Walford, head of climate risk at Legal & General.

"We're extracting from the natural environment faster than it can replenish itself," she adds. "That's when the financial models need to be reappraised to understand how we make sure that we operate in a sustainable long-term way."

It is believed that the debt-for-nature market could soon exceed $800bn (£632bn), Bloomberg says, highlighting that putting a price on nature conversation is increasing interest in this space.

Risks and opportunities

Despite growing interest, barriers remain to investing in preserving natural capital. One of which is the lack of data.

"Being able to understand the impacts and dependencies of a financial portfolio on the natural environment means really detailed disclosures," Walford says. "That's where the Taskforce on Nature-related Financial Disclosures (TNFD) comes in."

The TNFD published its framework for nature-related risk management and disclosure in September to help organisations understand and report on their natural capital risks.

Perhaps this framework could encourage more institutional investors to factor biodiversity into their investment decisions. It is needed because there appears to be a lack of understanding in how to approach nature protection.

Backhouse says that those who decide to look at this issue in their portfolio, need to become "nature smart".

"To protect biodiversity, we need to understand biodiversity," he says. "We need to understand how it all plays out within the natural world.

"We need to break down what natural capital is to develop that critical capability to understand nature in order to identify the dependencies and impacts within a portfolio."

Backhouse adds that this lack of understanding of these risks is a barrier to pursuing opportunities in this space. Natural capital loss is a big issue; therefore some big opportunities will present themselves to investors as more and more people realise how crucial biodiversity is to fighting climate change.

If proof is needed, just look at the bushfires that engulf Australia each year and the resulting growing endangered species list.

Our financial systems are embedded within the natural environment, but the models that we use ignore it.

Wendy Walford, Legal & General

Bill Hughes is global head of real assets at LGIM

WHICH FOUR MEGATRENDS WILL DEFINE THE NEXT DECADE IN INVESTING?

Bill Hughes offers his view of the key drivers of performance into 2030 and beyond.

The plates underpinning the global economy are shifting.

Advances in technology, changes in population structures, geopolitical pressures and the drive toward decarbonisation are catalysing the development of new industries and rendering some assets and investment behaviours obsolete.

We believe there are four core megatrends that will influence the investment environment over the short, medium and long terms: **demographics**, **decarbonisation**, **digitalisation** and **deglobalisation**.

We expect these megatrends to be significant determinants of long-term investment performance and capital allocations in real assets for the remainder of this decade – and beyond.

There has always been a danger that megatrends are perceived as factors that matter tomorrow and not today. Investors will often guiltily put them on the back burner, knowing that they are important but allowing a lack of urgency and confidence to prevent them from incorporating them in their strategies.

However, change is accelerating. In just the past decade, in some countries we have seen the e-commerce revolution undercut the role of retail property. The office property sector is arguably undergoing a similar transition now, and allocations to it are increasingly being replaced by residential and industrial property.

In infrastructure, renewable energy generation has emerged as a material asset class, significantly displacing the role of fossil fuel related assets in many investors' portfolios. In parallel, private credit has emerged as a major asset class, partly boosted by long-term trends in banking regulation that have opened up potential opportunities for investors.

In this light, we believe investors may wish to consider constructing their portfolios to align with these megatrends – so here are the grand narratives we see as key determinants of performance:

1 Demographics

To an extent, demography is economic destiny.

Tailwinds deriving from the post-war baby boom played an important role in many major economies' development after the 1950s. Alongside a growing and healthier workforce, improving life expectancy and increasing urbanisation contributed to a period of reasonable economic growth, improving living conditions and rising disposable incomes.

In most developed economies, this demographic tide is now receding. Many face the dual challenges of shrinking labour forces and increasingly elderly populations. In the absence of the natural boost delivered by a young, growing population, these economies will need to increase their productivity to maintain living standards. This should in turn require greater adoption of technologies like robotics and AI that can take the place of a shrinking workforce.

These trends will create increased investment opportunities in emerging markets that display favourable demographic characteristics and growing labour forces. Weak fertility rates in high income countries and China means their share of the global population is expected to fall from 15.7% and 17.8%, respectively, in 2022, to 12.6% and 12.0% in 2060[1].

Meanwhile, sub-Saharan Africa's share of the global population is forecast to balloon from 14.6% in 2022 to 24.4% in 2060, with India and Southeast Asia's proportion remaining relatively stable over this period[2].

Meanwhile, in developed markets with ageing populations (and shrinking workforces) we see increasing physical and capital requirements for healthcare facilities and technologies, along with specialist accommodation for elderly communities. From a lifestyle perspective, we expect a continued growing emphasis on wellbeing and leisure, which should stimulate associated industries.

2 Decarbonisation

According to the Intergovernmental Panel on Climate Change (IPCC), the world will have to reach net-zero emissions by 2050 if we are to limit global average temperature increases to 1.5°C above pre-industrial levels. This is the threshold outlined in the 2015 Paris Agreement and committed to by almost every country in the world.

However, progress in decarbonisation has been patchy and global greenhouse gas (GHG) emissions are yet to meaningfully decline. One of the key challenges impeding progress is decoupling emissions from economic growth in emerging nations, where rapid increases in population and GDP have in recent decades been correlated with large expansions in GHG emissions released.

That said, decarbonisation has received significant policy focus in the EU and US, with considerable subsidies now introduced in support of constructing the infrastructure required for achieving net-zero carbon emissions. This is resulting in increased electrification as transport, home heating and certain industrial processes substitute burning fossil fuels for electricity. Simultaneous decarbonisation efforts in the power sector have accelerated the buildout of renewable energy capacity, mainly in solar and wind farms. Increased deployment of renewables is placing pressure on power networks and demanding increased battery storage to deal with the intermittency of wind and solar output; addressing both challenges will require significant investment.

However, constraints in technology and remaining carbon budgets will likely lead to build-out of carbon capture and storage assets in certain sectors such as cement and power generation. This is likely to contribute to a greater focus on nature-based climate solutions that can assist in offsetting the impacts of hard-to-abate emissions.

3 Digitalisation

We define 'digitalisation' as the integration of new digital technologies into existing business processes[3].

These technologies have already radically altered business practices across many industries; the pace of development in big data, AI and machine learning is only likely to accelerate, with the scope of their impacts set to grow in parallel.

The growth of robotics, automation and AI-assisted design is likely to facilitate the modernisation of a range of industries and ultimately deliver broad-ranging efficiency savings. At the same time, the enormous computational demands of generative AI alone are likely to support long-term demand for associated services like data storage, cybersecurity, connectivity networks and hardware components. This should have follow-on impacts for materials, labour and real estate.

Digitalisation is also likely to reshape the global labour force, with some jobs replaced, other jobs requiring new skillsets to develop and deploy emerging technologies. As with demographics, this should create opportunities in further education and vocational training and could usher in a new era of productivity growth in economies burdened with unfavourable demographic trends.

4 Globalisation

We use the term 'deglobalisation' to describe the process of weakening global integration of trade, capital flows, people, intellectual property and co-operation.

At present we have seen a slowdown in globalisation, rather than a reversal. Nevertheless, the consequences of weakening global economic integration and political co-operation, particularly that between the US and China, represents a material shift in the world's economic landscape. Growth in global trade has stagnated following the GFC; with protectionism on the rise, as exemplified by the US' Inflation Reduction Act and weakening international trade in China, we believe that 'peak globalisation' may well be behind us.

We believe this will result in a permanent reconfiguration of supply chains, with resilience and diversification of supply prioritised over efficiency, and supply risks mitigated with larger inventories. We anticipate a trend towards onshoring, where supply chains that were once international can be reshaped to favour domestic production that carries less political risk, or friendshoring in countries with more stable relationships with companies' home nations.

In our view, this should translate into more real estate demand, with onshoring and friendshoring likely to be highly selective and focused on key strategic sectors where diversification of supply will remain a priority. Meanwhile, weaker global co-operation and heightened geopolitical tensions is likely to create more macro-economic risks and volatility, favouring more needs-based and counter-cyclical asset classes.

1) UN, 2022 Revision of World Population Prospects, https://population.un.org/wpp/
2) UN, 2022 Revision of World Population Prospects, https://population.un.org/wpp/
3) By contrast, we define 'digitalisation' as the conversion of information and documents from analogue to digital formats.