

Emotion and the energy investment debate - finding a way forward

By [Philipp Wörz](#)

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Arguably, awareness of environmental issues has never been higher. Extreme weather events and our sense of urgency are on the rise, and the UN Climate Change Conference (COP 26) in Glasgow resulted in a steady stream of headlines on this topic towards the end of last year.



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While COP 26 succeeded in reinforcing the importance of agreeing on measures to limit global warming, it still fell short of the hopes and ambitions of many, especially after a last-minute push to water down the commitment to exiting coal. Despite the latest agreements, the world remains on track to miss the targets of restricting temperature rises to 1.5°C by 2100 - for which we would need to achieve global net carbon neutrality by 2050.

Undoubtedly, the consensus opinion has shifted from one of climate-denialism to the view that urgent climate change action is needed, and the realisation that a fundamental reconsideration of the economy itself is required. This rise in climate awareness has coincided with something of a disenchantment with the capitalist model itself (consider the rise of stakeholder capitalism). Thus, a rapid rise in ESG (environmental, social and governance) investing has followed, and with it, at the opposite end, active disinvestment from 'old economy' stocks, and the energy sector in particular. This seems to be reflected in the miniscule weighting of energy in global indices. Despite its importance to the global economy, the energy sector accounted for 3.1% of the MSCI World Index at the end of December 2021 compared to 6% just three years ago.

Disinvestment as a gut reaction

The answer to climate change at its heart seems simple. Stop using fossil fuels, and switch to renewables, problem solved! Scale this response up, and the wholesale disinvestment from the carbon-economy makes sense. But such simplifications also belie the enormity of the task ahead of us. Since the United Nations Framework Convention on Climate Change was signed in 1992, CO₂ emissions have increased by 60%. In its 'Net Zero by 2050 Roadmap', the International Energy

Agency outlines some 400 milestones that need to be achieved and states that "achieving net zero emissions by 2050 will require nothing short of a transformation of the global energy system".

Simply put, we are not in a position to give up fossil fuels yet, and won't be in a position to do so for some years to come. As recently as 2020, fossil fuels (oil, gas and coal) made up about 83% of the energy mix, with low emission sources such as solar, wind, hydro, geothermal and nuclear only contributing roughly 13% and 4% respectively.

The extent of our reliance on fossil fuels was underscored by the fact that during last year's energy crunch, Great Britain was forced to generate more power from coal, despite its intentions to the contrary. Part of the strategy to achieve CO2 reductions involves switching to less dirty fossil fuel options, typically by substituting gas for coal, at least in the shorter term, rather than moving away from fossil fuels immediately.

Often, all-or-nothing approaches also lose sight of the extent to which fossil fuels are an omnipresent part of everyday life. Oil, for example, is also used to make plastic, asphalt, fertiliser and chemicals, and in various forms it finds its way into your everyday life: from your contact lenses, to shoes, soap, lipstick and smartphones, to name a few. We not only have to replace the obvious uses of oil in fuelling cars or planes, but also have to find substitutes for these less obvious uses, even as green technologies such as wind turbines still require oil to be produced. Even in the scenario of electric vehicles reaching 35% of global car sales by 2030, according to International Energy Agency (IEA) data and analysis done by research provider Bernstein, global oil demand is still expected to grow from current levels. This makes the coming energy transition not only a very complex one, but also one that needs to happen very swiftly.

Global primary energy consumption by source



Source: PSG Asset Management and BP Statistical Review of World Energy, 2021, 70th Edition, data based on global energy use for 2020.

Meeting the energy (and economic) needs of a growing population a complex issue

The added problem is that our current renewable energy source technology is not adequate to deliver on the energy needs of a growing population while also cutting back on the use of fossil fuels. In the developing world, the challenge will be to meet increasing energy demand sustainably: according to the World Bank, only 46.7% of sub-Saharan Africa's population had access to electricity in 2019.

Some African countries such as Kenya, Angola, Ivory Coast and Ghana have also raised the point that they rely on the development of their gas and oil reserves to fund their growing populations' economic development. The move to decarbonise the global economy could further jeopardise energy equality and potentially harm the continent, especially

from a social perspective, even though it is itself considered to be highly vulnerable to the effects of climate change and thus should have a high inclination towards decarbonisation. It is concerns like these that have led words like 'just transition' being added to our climate change lexicon.



An energy revolution is possible - but only if leaders get imaginative about how to fund it

Michael Grubb 20 Jan 2022



Rethinking the energy equation

In investments, it is often argued that emotions fuel poor decision-making, and the same may apply when it comes to decisions about investment in energy stocks. Climate change is a highly complex problem and addressing it will require that we make far reaching, and sometimes unpopular, changes to our broader energy system. It will still take a long time before the globe will be successfully weaned from its reliance on fossil fuels. In the interim, it is critical that resources that are still required for global energy security and economic development are extracted as cleanly and sustainably as possible. Even though the global energy sector rebounded from the 2020 lockdown-induced slump (and subsequently was the best performing sector in both the S&P 500 and MSCI World Indices for 2021), investors have been punishing energy companies, depressing the valuations of these companies even as many of them are re-evaluating their business models and are themselves making an effort to transition to cleaner energy.

Ironically, the pressure to decarbonise has led to chronic underinvestment in fossil fuel supply with resultant strong prices. High energy prices put fossil fuel companies such as integrated oil majors in a prime position to return significant cash to shareholders, accelerate their sustainable energy programmes, and make the transition from dirty to clean energy faster than many may anticipate - an aspect that is often overlooked in the rush in the opposite direction. As these companies distribute cash to shareholders and are increasingly seen as part of the solution to a cleaner future, a rerating of select stocks in the energy sector could therefore be more 'sustainable' than many anticipate.

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