Water disruption: investment risk from multiple angles

We believe water risk must be accounted for in portfolios today, not in 2030 or 2050. But how can this be done? We outline how water is impacting the day-to-day operations of investee companies and what the risks are.

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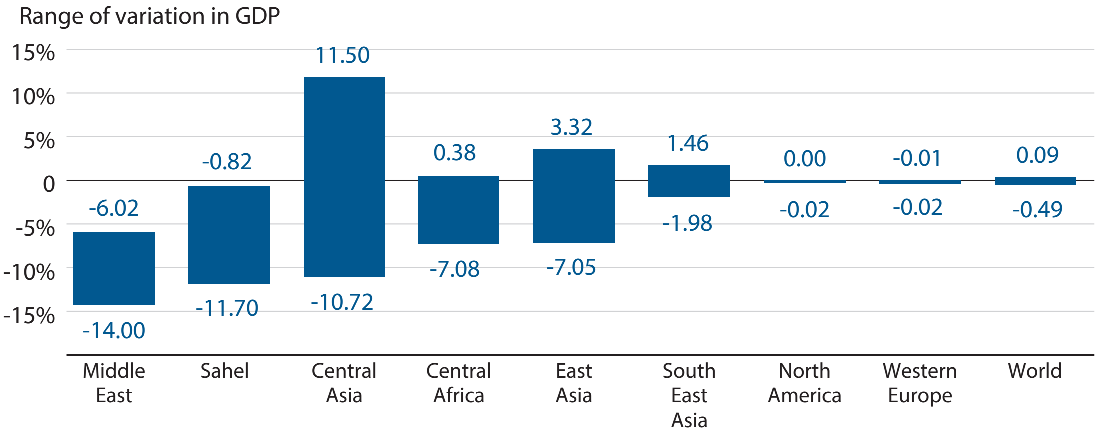
Water scarcity will impact GDP

Exhibit 1: Economic impacts of climate change induced water scarcity by world region, 2050 (As of 2016)



Source: World Bank. "High and Dry: Climate Change, Water, and the Economy," World Bank, Washington, DC. 2016. Note: The range of impacts, as determined by the type of policies implemented to cope with water scarcity, is from a business-as-usual policy (–14%) to a policy seeking to reallocate water to the most productive uses (–6%). There is no assurance that any estimate, forecast or projection will be realised.

The time for investors to understand water risk is now

There is a lot of talk about how regulatory reforms connected to climate change will impact financial markets. However, we firmly believe the leading issue, is that we have been entrusted to look after our clients' assets and are responsible for returning those assets in better condition than when we received them. Therefore, we have a duty to understand the full spectrum of business relevant risks that can reshape a company's or sector's competitive positioning in the marketplace and impact its operational resiliency.

Riffing on Benjamin Franklin's observation if we don't know how much water there is in the well, we won't know until the well goes dry. Meaning: **unknown and undisclosed risks are likely to be mispriced and put assets at risk.** Therefore, companies and sectors lacking understanding of their water sources and footprints, lagging in disclosure of water risk, and/or postponing adjustments to regulatory reforms all present long-term risks to investors.

Our water future

By 2030, the global population will reach nine billion and the world will require 40% more water than it does today[1]. However, the global supply of accessible fresh water accounts for less than 1% of water supplies and will not grow with population. This limited supply is threatened by overuse, contamination, and over-demand. The World Economic Forum (WEF) has identified "Water Crisis" as one of the top five global risks in terms of impact in nine out of its last 10 Global Risks Reports, including 2020[2].

Then, there's climate change. Projections of 2°C increases in global temperature from climate change, expected by 2050, will accelerate water scarcity in many regions of the world. As seen in the chart below, the World Bank estimated that **water scarcity exacerbated by climate change will cost some regions 6% in gross domestic product** (GDP)—without policy change, declines may reach 14%[3].These declines are not limited to frontier and emerging markets; they impact every continent and economy.

Bottom line: water risk imperils investors' assets

The projected declines in water availability, and corresponding dips in GDP, present across-the-board risk for investors. And these risks extend to all asset classes and encompass a broad range of sectors - from those with logical connections, like agriculture and utilities, to those that may not be so apparent, like packaging and semiconductors

As stewards of our clients' assets, we believe water risk must be accounted for in portfolios today, not in 2030 or 2050. But how can this be done? Water is not only a misunderstood commodity but also a basic human right recognised by the United Nations (UN) in 2010. As sustainability-informed investors using environmental, social and governance (ESG) metrics as key performance indicators, how do we address the dual-bottom line of adding value to clients' portfolios while also contributing to positive outcomes?

In the case of water, we see three main areas contributing to information gaps: pricing, risks, and markets. **Our full research explores each of these ideas through the lens of equity, fixed income and alternative investments.**

We anticipate these issues are going to take on much more prominence in the asset management industry and the client landscape. Issues related to climate change—water scarcity, sea level rise, more severe storms and wildfires—can no longer be ignored or be considered latent risks just because many believe they are priced too far out or they will not impact portfolios until a point in the distant future. As a fiduciary for our clients' assets, we must be positioning our portfolios for climate change today, not in 2030 or 2050.

FOOTNOTE

1 Source: The 2030 Water Resources Group, Annual Report: Building Trust, Growing Resilience, 2019.

2 Source: World Economic Forum, The Global Risks Report 2020, January 2020.

3 Source: Food and Agriculture Organisation of the United Nations; World Bank Group, Water Management in Fragile Systems: Building Resilience to Shocks and Protracted Crises in the Middle East and North Africa, Cairo: August 2018

Read the full series covering equity, fixed income and alternative investments.
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