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FLAT WHITE

Will big financial institutions destroy our resources sector before the Greens?

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Last month Paul Kelly wrote that Australia was being inescapably propelled to adopting a Net Zero CO2 emissions policy, not by green activists or government policies but by global investment funds, “now mobilised in the climate cause”.

Traditionally, investment funds have been passive stakeholders, buying and selling shares based on prospective returns. An active approach, based on environmental, social, and governance — ESG — criteria is replacing this. The cornerstone of ESG is net CO_2 neutrality.

The common view is that investment in firms with rich ESG pedigrees is "closely linked with business resilience, competitive strength, and financial performance." As evidence of this strong performance, "25 of 26 ESG equity index funds followed by Morningstar beat index funds tracking the most common traditional benchmarks in their category."
In Australia, the latest Chant West results show half of the top 10 investment performers avoid or exclude firms with no stated program to achieve net neutrality in emissions.

Rank	Fund	Return	Investing in Firms without a Net Zero program
1	Hostplus – Balanced	25%	Avoid
2	BT Panorama Full Menu – Multi-manager Balanced Fund	23%	No exclusions
3	CFS-FC FirstChoice Wsale Multi-Index Balanced	22%	No exclusions
4	AustralianSuper – Balanced	21%	Exclude
5	Sunsuper for Life – Balanced	20%	Avoid
6	MLC MKey Business Super – Horizon 4 – Balanced Portfolio	20%	No exclusions
7	QANTAS Super Gateway – Growth	20%	No exclusions
8	smartMonday PRIME – Balanced Growth – Active	20%	Avoid
9	Suncorp Brighter Super Pers – Multi-Manager Growth Fund	20%	No exclusions
10	Vision SS – Balanced Growth	20%	Exclude

There is, however, a problem with this "virtuous circle" being sustained.

The price of stocks is related to their earnings. Price to earnings ratios of firms and sectors diverge based on their different earnings prospects, risks, volatility and so on. If sentiment pushes particular firms' share prices higher than their underlying values, earnings outcomes will eventually bring about a correction. But this can be a protracted process if there is a bandwagon effect. If the proportion of investment funds attracted to ESG-verified firms is increasing, the growing demand for those firms' stocks will raise their share prices, providing early ESG adopters with an increase in the market value of their portfolios.

The prospect of an eventual price correction is doubtless one consideration behind the urgings of climate worrier, Mark Carney the former governor of the Bank of England. Carney exhorts investment funds not to disinvest from ESG recalcitrant firms but rather to pressure them to decarbonise from inside the tent.

Carney's approach is that of Climate Action 100+ the members of which manage over $54 trillion in assets, equivalent to sixty per cent of the market capitalisation of all the world's stock market exchanges. Climate Action 100+ seeks to ensure "the world's largest corporate greenhouse gas emitters take necessary action on climate change".

Even with all this financial muscle, a lack of corresponding earnings follow-through will eventually restore sentiment-boosted share prices to their underlying values. If ESG-oriented investment funds thought otherwise, they would not, as they do, press for regulatory changes forcing firms to introduce and publicise their ESG measures.

We have, over the centuries, seen many corrections following periods of sentiment-driven price effervescence. Examples include the seventeenthcentury Dutch tulip mania, England's eighteenth-century South Sea Bubble and more contemporary events, for instance, booms and busts like Poseidon nickel and the Dot Coms.

The availability of finance is a vital issue for all business activities. But a constrained availability of funding for coal generation is demonstrably absent for the 263,000 MW (over tenfold Australia's existing capacity) of new coal plant being built in Asia.

Though a significant problem for Australian firms seeking hydrocarbon investments (especially with Chinese finance unwelcome), availability of finance is less important than the nation's regulatory environment with its regulations and subsidies to generation sources other than coal. To foster lower CO2 emissions, Australian taxpayers and electricity customers outlay some $7 billion a year in renewables subsidies (consequently handicapping coal).

Added to this are judicial imposed planning constraints. One effect of these factors is that Australia is the world's highest per capita installer of wind and solar facilities. (And by applying here, you can help the government further undermine the Australian economy by pointing to additional ways to prejudice low-cost energy. Using 2021 doublespeak, Energy Minister Angus Taylor wants to "encourage, incentivise and unlock" in order to impose further burdens, gaining applause from beneficiaries in ways that the losers won't notice.)

An ostensibly climate-driven alliance of activists from business and individuals, backed by the governments is seeking to replace low-cost hydrocarbon (and nuclear) energy by high-cost green energy. Ranged against this are iron laws of economics resting on people in general who, for most of the time, seek the best value for their own money both as investors and consumers.

Over time, it is unlikely that – for the first time ever – sentiment, even with political support, will prevail over consumer and investor-driven economic forces periods. Even so, firms like Adani may be disadvantaged over long periods from discriminatory treatment by banks and insurance companies.