Global Asset Management

Fossil fuel divestment

In recent years, there has been a growing interest in fossil-fuel-free portfolios. This interest, which initially began with larger institutional, foundation and endowment clients, is now attracting considerable attention from an increasing number of individual investors. With the signing of the Paris climate accord in April 2016 and growing awareness of climate-related issues, investors are seeking ways to incorporate climate-related concerns into their portfolios. To meet this demand, RBC Global Asset Management (RBC GAM) launched the RBC Vision Fossil Fuel Free Global Equity Fund in August 2017.

Why divest?

The fossil-fuel divestment movement initially gained traction on university campuses where both students and faculty began to put pressure on administrations to sell fossil-fuel holdings from the institutions' endowments and pension plans. However, fossil-fuel divestment has recently gained momentum, moving from a niche screen for some investors to the mainstream for large and small investors alike. The motivations for divestment seem to be moral and financial in nature.

The moral argument equates fossil fuels with other undesirable or ethically dubious products, such as weapons, gambling, alcohol and tobacco, in which a variety of investors may choose not to invest. For example, RBC Vision Funds (with the exception of RBC Vision Fossil Fuel Free Global Equity Fund, a crucial difference to which we return later) exclude a number of these so-called "sin" industries from portfolios. Fossil-fuel companies can certainly be screened from a portfolio in the same way and, indeed, such an exclusionary screen has been incorporated into RBC Vision Fossil Fuel Free Global Equity Fund. Eliminating fossil-fuel producers, processers and transporters from a portfolio to accommodate moral concerns about the industry is a valid and direct approach as well as a very public statement of the investor's views on the fossil-fuel industry. As a method of accommodating moral trepidations about the fossil-fuel industry, divestment is a very effective approach.

The most-cited financial reason for fossil-fuel divestment is the concept of "stranded assets." The stranded assets argument is a result of the generally recognized upper threshold of 2°C global warming relative to pre-industrial levels to avoid the potentially more dangerous impacts of climate change. This 2°C limit has been used to calculate a carbon budget for the world and, according to this calculation, we have already consumed over half of the budgeted carbon resources. At current emission rates, society could overshoot the carbon budget in less than 30 years if emissions continue to rise unchecked. The inescapable consequence is that a significant portion of coal, gas and oil reserves will have to be left in the ground to avoid the more serious effects of climate change, which means that any profit from these fossil- fuel products is essentially forfeited. These unusable reserves are referred to as stranded assets.

The stranded asset argument assumes that the market is unaware of or is mispricing the risk of untapped resources and their associated profitability. However, markets are generally efficient in that they incorporate all available information into the price of a security. Fossil- fuel companies are not ignoring the potential impact of climate regulation; rather, they are actively monitoring the risk as it evolves and are incorporating it into their planning and business models. Likewise, investors are aware of stranded asset and climate regulation risks and incorporate these into any decision to buy or sell securities issued by a fossil-fuel company. The general consensus among industry analysts is that there is no indication of a fossil-fuel "bubble" at the moment and it appears that the market is incorporating the appropriate risks into current valuations. The most likely scenario is that regulation will be phased in over time and fossil fuel use will be phased out over time. This will allow the market to gradually adjust supply to meet the changing demand. The likelihood of drastic and unanticipated regulation forcing the widespread write-off of significant fossil-fuel reserves which would impact valuations is unlikely at this time.

However, not all investors see this orderly phasing out of the fossil-fuel industry as beneficial and there are certainly significant risk factors, such as the development and adoption of new technology at a faster-than-anticipated rate, which could dramatically change the demand for fossil fuels in the short and medium term. Uncertainty equals risk and, for investors who see greater risk for the fossil-fuel industry than the consensus suggests, taking a fossil-fuel-free approach will allow them to mitigate that risk in their portfolios.

RBC Vision Fossil Fuel Free Global Equity Fund

As mentioned above, to meet the client demand for fossil- fuel-free portfolios, RBC GAM launched RBC Vision Fossil Fuel Free Global Equity Fund in August 2017. It should be noted that, although the fund has been included in the RBC Vision Fund family, it differs from other RBC Vision Funds in an important way – RBC Vision Funds use a comprehensive exclusionary and qualitative socially responsible investing filter that screens out companies engaged in multiple excluded industries (e.g. alcohol, tobacco, etc.) and companies with poor environmental, social and corporate governance practices; in contrast, RBC Vision Fossil Fuel Free Global Equity Fund uses just one screen for fossil fuels. This fossil-fuel screen uses a sector-based exclusion, complemented by a list of companies with large fossil-fuel reserves provided by an independent third party. For the sector-based exclusion, RBC Vision Fossil Fuel Free Global Equity Fund excludes any company that is directly involved in the extraction (e.g. producers like Exxon Mobil Corporation or BP), processing (e.g. oil refineries, etc.) or transportation (e.g. pipelines) of coal, oil or natural gas. In addition to the sector exclusions, RBC Vision Fossil Fuel Free Global Equity Fund also excludes those companies in the "Carbon Underground 200." The Carbon Underground 200 represents the top publicly traded coal, oil and gas reserve-owning companies globally, ranked by the carbon emission potential of their reported fossil-fuel reserves. Together, these two approaches provide a comprehensive fossil-fuel screen for RBC Vision Fossil Fuel Free Global Equity Fund.

Climate change is a complex problem that will require complex solutions. As the world comes together to address climate change and implement solutions, this will inevitably impact certain facets of the global economy and the capital markets. In response, society will need to adapt aspects to everyday lifestyles, including how to save and how to invest. RBC Vision Fossil Fuel Free Global Equity Fund provides investors with an option which helps them position their portfolios to adapt and grow alongside this changing world.

Which exclusions apply to which funds?

Funds	Exclusions
RBC Vision Bond Fund RBC Vision Balanced Fund RBC Vision Canadian Equity Fund RBC Vision Global Equity Fund	Tobacco, Military Weapons, Alcohol, Adult Entertainment, Gambling
RBC Vision Fossil Fuel Free Global Equity Fund	Fossil Fuel

Please consult your advisor and read the prospectus or Fund Facts document before investing. There may be commissions, trailing commissions, management fees and expenses associated with mutual fund investments. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. RBC Funds, BlueBay Funds and PH&N Funds are offered by RBC Global Asset Management Inc. and distributed through authorized dealers.

This article is not intended to provide individual legal, accounting, tax, investment, financial or other advice and is for informational purposes only. Specific investment strategies should be considered relative to each investor's objectives and risk tolerance. The information contained herein is provided by RBC Global Asset Management Inc. (RBC GAM) and believed to be up-to-date, accurate and reliable. Information obtained from third parties is believed to be reliable but RBC GAM and its affiliates assume no responsibility for any errors or omissions or for any loss or damage suffered.

This document may contain forward-looking statements about general economic factors which are not guarantees of future performance. Forward-looking statements involve inherent risk and uncertainties, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement. All opinions in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

Publication date: October 16, 2017

Global Asset Management