The Great Mining Paradox

Take a sustainable portfolio at random and look at the underlying sector exposure- what do you see? Clean energy? Technology? Other sustainable themes such as clean transport, environmental services, and resource efficiency? All of these have one thing in common – a reliance on metal, be it common industrials (like copper), exotic rare earths with unpronounceable names, or precious metals such as platinum, silver and gold. Despite this, the average sustainable portfolio will probably have no mining or direct metal exposure.

Excluding miners and metals whilst investing in all the technologies on which they depend seems something of a paradox. But invested or not, a decarbonising society is going to require a huge amount of these materials.

Take cobalt – this hard, silvery grey metal is an essential component in electric vehicle batteries. According to data compiled by S&P Global, demand for cobalt from the EV industry is set to increase from c.45,000 tonnes in 2021 to over 110,000 in 2026.

Lithium, in many ways the elemental poster child for net zero, is needed to produce virtually all EV batteries, as well as the vast majority used in consumer electronics. According to research by Mckinsey, batteries accounted for less than 30% of global lithium demand in 2015 – by 2030, it will be 95%. Unsurprisingly then, demand for lithium is also expected to skyrocket. In 2020, global lithium-ion battery demand was roughly 300 GWh – by 2030, this is expected to be 4000 GWh, growing at an annual compound rate of 30%.

We are going to need a lot of metal - our ability to wean ourselves off the coal, oil and gas which have fuelled western economies for centuries depends on it.

So why aren't sustainable portfolios chock-full of miners? There are several important considerations. Firstly, it's no secret that the mining sector as a whole has a poor track record when it comes to upholding environmental and social standards. The cobalt industry is a classic example - for decades, the vast majority has been mined from the extraordinarily rich deposits of the Democratic Republic of Congo (DRC). But the DRC is notorious for its lack of political stability, and miners operating in the country have long been dogged by accusations of human rights abuses and the exploitation of child labour. It's one of several reasons why EV giants such as Tesla are reducing the amount of cobalt used in their products, or substituting for different metals all together. Of course, it's not just cobalt – be it lithium brine extraction in Chile, or gold mining in the Amazon rainforest, material extraction often has a negative impact on the local environment and the people that live/work there.

The second reason speaks to the nature of investing in the mining sector. In general, miners are asset-heavy businesses often (but not always) trading at a discount to the wider market, and profits are inevitably tied to the price of the underlying commodity. Not a great combination for your typical 'quality growth' skewed sustainable portfolio.

As a result, we have created a somewhat strange situation whereby the average sustainable fund manager will actively seek investments in green technology while simultaneously avoiding/overlooking the facilitators - the miners that form the base of the value chain. Is this really in the best interests of sustainably minded investors? Promoting more sustainable business practices is much easier for those with a seat at the table. If enough investors exclude a company (Bloomberg estimates there were $35tn in ESG assets by 2020) that company risks being starved of capital, increasing the cost of borrowing and hindering their ability to improve business practices.

How might investors go about introducing these miners to their portfolios? One might start with a best-in-class approach, accepting that any mine will have some impact on the local

environment, but seeking those companies which have a track record of environmental and social best practice. This might be achieved using an ESG score, though investors should exercise caution when relying entirely on third-party data.

Engagement is another tool used extensively by sustainable mandate managers. Successful engagement attempts to initiate and sustain a dialogue with company management, often in collaboration with other shareholders, in order to enact change and create better outcomes for stakeholders. Critics of this approach argue that successful engagement outcomes can take many years and in the meantime, progress is very difficult to measure. In theory, this could lead to managers holding a company with very poor environmental and/or social performance under the guise of 'engagement'. As wealth managers, our role is to hold our fund managers to account, ensuring that any engagement activities are carried out effectively and with well-defined performance indicators.

Global efforts to reduce greenhouse gas emissions are driving mass adoption of new technologies that are part, or entirely dependent on metals such as lithium, cobalt and nickel. But while much of this technology might feature in a typical sustainable portfolio, the miners at the base of the value chain are often ignored, excluded, or don't fit the investment style. We shouldn't ignore the potentially detrimental environmental and social impact miners can have – many miners are rightly blacklisted from exclusion-based portfolios due to recent past controversies – but we should also acknowledge the vital role these companies play. Using a combination of ESG screening and targeted engagement, investors could help to shape these essential players, whilst enjoying the diversification benefits such companies can potentially bring to portfolios.

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