Water: an essential and investable asset

by Andreas Fruschki | 28/08/2018

Summary

The exceptionally hot summer afflicting large parts of the planet has highlighted the precariousness of a finite resource – clean, consumable water – that we too often take for granted. By helping to bridge the gap between water supply and demand, investors can help address a critical structural problem while adding growth potential to their portfolios.

Key takeaways

- After decades of warnings, many of the world's most critical investments in water infrastructure and technology still haven't been made
- The structural imbalance between water supply and demand – and the pressure to close the gap – make water particularly attractive for investors
- Water can be a defensive investment theme with prospects for high growth – a helpful combination under today's uncertain market conditions

Amid global concerns about rising temperatures and a changing climate, recent news headlines have featured a steady stream of stories about water worries.

- In South Africa, Cape Town has been fighting the rapid approach of "Day Zero" – a point when this drought-stricken city's taps could run dry.
- The US state of California is grappling with a multi-year drought that has fuelled a summer of devastating wildfires.
- London is experiencing lower-than-usual rainfall, forcing it to draw much of its water from key rivers and raising fears that the United Kingdom's capital could soon experience water-supply problems.

While clean water has always been an issue in developing nations, the fact that major cities and prosperous states are struggling to secure their water supplies illustrates the magnitude of the world's water infrastructure problem.

Tracing water issues to their source

For decades, experts have warned about the growing risk of water shortages even as scientists and engineers developed new solutions that connect water-rich with water-scarce regions, and that improve water-usage efficiency.

Urbanisation and population growth, the rising water intensity of industrial processes, high-output farming practices and consumer lifestyle changes are all stressing the water system. While these may be slow-moving individual factors, they have combined into a powerful overall trend – one that could result in severe disruptions to farming, industry and everyday life if left unaddressed.

So what is impeding investment? One issue is that fixing the world's water infrastructure is a costly long-term commitment, yet most parts of the water network are invisible to the average citizen. As long as water comes out of the tap, people are less inclined to worry about the hidden parts of the water cycle.

Politicians are also afraid to push for taxes or levies that could finance the construction or repair of waste-water treatment plants, or the implementation of new sewage-filtration technologies. As a result, upgrades to the water system can be all too easily pushed down the road.

Yet while this overall lack of investment is problematic, it makes water an under-appreciated and under-addressed theme that can be attractive for investors who know how to approach it.

How to invest in water

Investing in water is different from investing in other commodities, as water itself is not a tradeable asset. While rainfall is "free", clean water out of the tap is a commodity with high social value, and one that is extremely sensitive to environmental factors.

As a result, major investments along the entire water supply chain are needed to provide cities and farming regions with clean water – and this is where the value for investors can be generated. Collection wells, pumping stations, filtration solutions and the treatment of sewage are all critical parts of the complex system of fresh and waste water. Also critical are technologies that reduce water loss and further improve its quality in the delivery chain.

Companies that offer these solutions stand to benefit from the growing need to improve the world's water infrastructure, and they will likely enjoy ongoing social and political support for their products and services.

A good way to approach water investing is with a concentrated, high-conviction portfolio of stocks of companies with the highest exposure to the most stable areas of the water industry. Integrating environmental, social and governance (ESG) factors into the investment process can also add the improved performance potential associated with socially responsible investing. In addition, actively picking stocks of water-related companies could also help reduce cyclicality and volatility.

The future of water investing

Only a few countries have achieved the level of sophistication where water is routinely safe to drink, or can be safely and easily released back into the environment. Yet securing a steady supply of clean water is a goal shared by every nation around the world, making water an investment theme worth pursuing.

Adding to the solid outlook for water investing is the fact that the societal need for water tends to provide protection from political uncertainty, and it can strengthen the regulatory support needed for continued investment.

Water-related investments are also less dependent than others on the broader economic cycle. Consolidated markets and the technological leadership shown by major water-market players allow for stronger pricing power and the potential for more stable profits.

Given this combination of drivers – including a supply/demand imbalance and protection against wider political and economic volatility – water can be a defensive investment theme with prospects for high growth. That could make water an even more attractive option for investors under today's uncertain market conditions.

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The US economy remains strong, but tail risks are rising

by Mona Mahajan | 29/08/2018

Summary

Tax reform has given the US economy a second wind and widened its divergence from the global economy, which has faltered amid fears of trade wars and emerging-market uncertainty. Sector rotation in US equities could make tech and consumer discretionary attractive; energy and industrials may also benefit.

Key takeaways

- The Fed will continue on its normalisation path as we move later in the cycle, but we don't foresee a recession in the next 12-18 months
- Tail risks are emerging – including trade wars and geopolitical uncertainty – but US equities could still outperform global peers, albeit with higher volatility and some sector rotation
- It's too early to move completely away from the tech sector, which has still delivered strong year-to-date returns; in the overall markets, we believe mid to high single-digit returns are still feasible this year
- Investment opportunities could also be found in energy and industrials, short-duration fixed income, Asia and alternatives

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