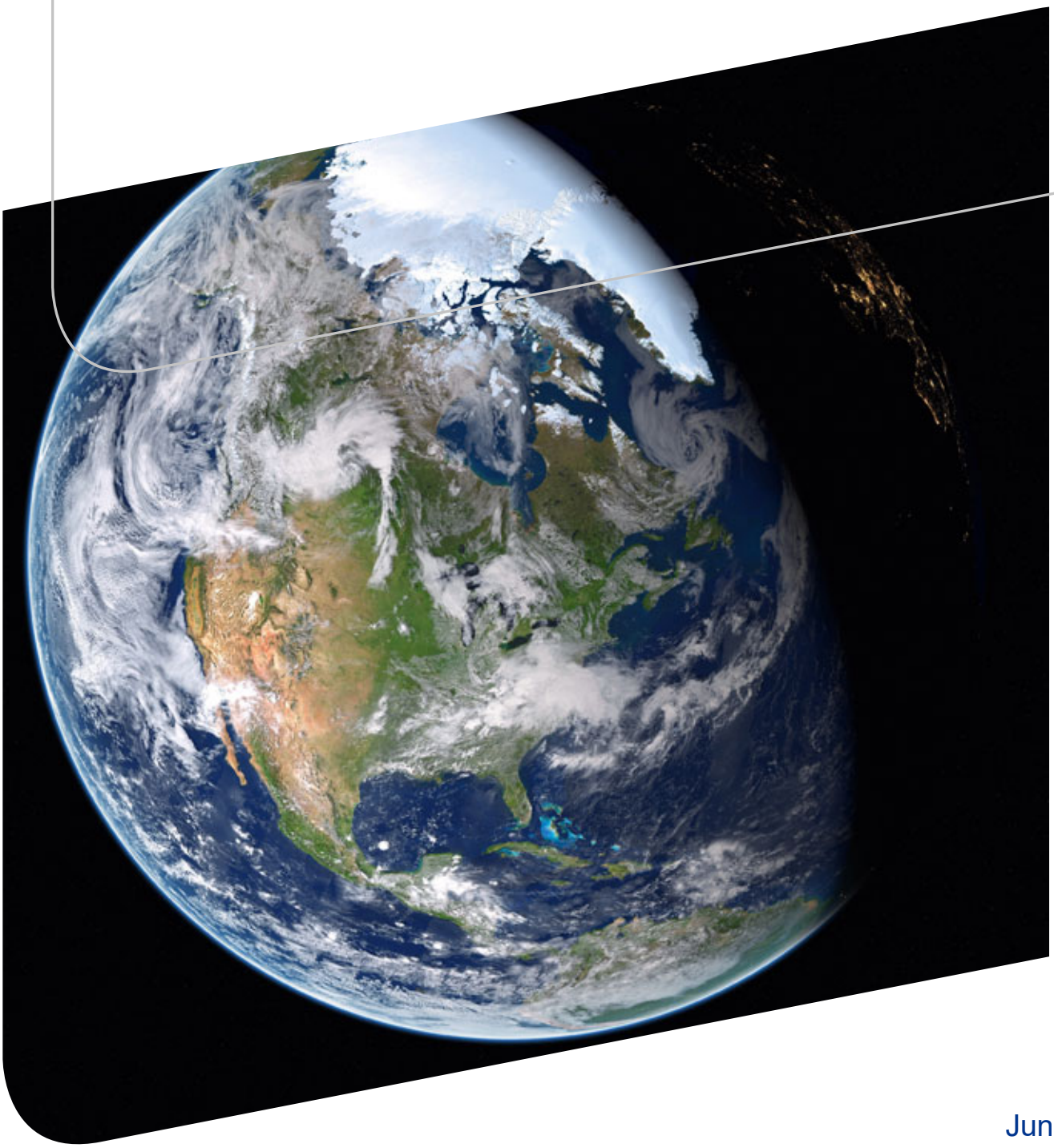
Union Investment

ESG post coronavirus – What will change in the environmental, social and political spheres?

Twelve propositions



June 2020

At first glance and in the short term, almost everything has changed for many people. Will coronavirus really have a lasting impact on society, the environment and politics?

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Introduction

Sometimes there are signs that herald an imminent shock, but ultimately, every shock comes as a surprise. **Coronavirus has been a global shock**. Now, we are slowly coming to terms with what has happened.

At first glance and **in the short term**, **almost everything has changed** for many people. But what about the **medium- and long-term outlook**? Will **coronavirus** really have a **lasting impact on society, the environment and politics?**

We have decided to **look ahead** and play out potential future trajectories of relevant trends. **Our analysis shows:**

- The pandemic is **accelerating trends** that were already apparent long before the first coronavirus cases were reported.
- This applies as much to **digitalisation** as it does to changes in **travel and transport habits**.
- Nor were the trends toward **deglobalisation** and the **revival of stronger nation states** originally sparked by the virus.
- But the **pandemic** and its indisputably tragic consequences **detract attention from other problems: Climate change, social injustice and species extinction** all remain key challenges.
- Coronavirus is having a **mitigating effect** on climate change as many people work from home and air travel has reduced to a minimum.
- **What areas of the economy** are most affected by coronavirus and how does this relate to **sustainability**?

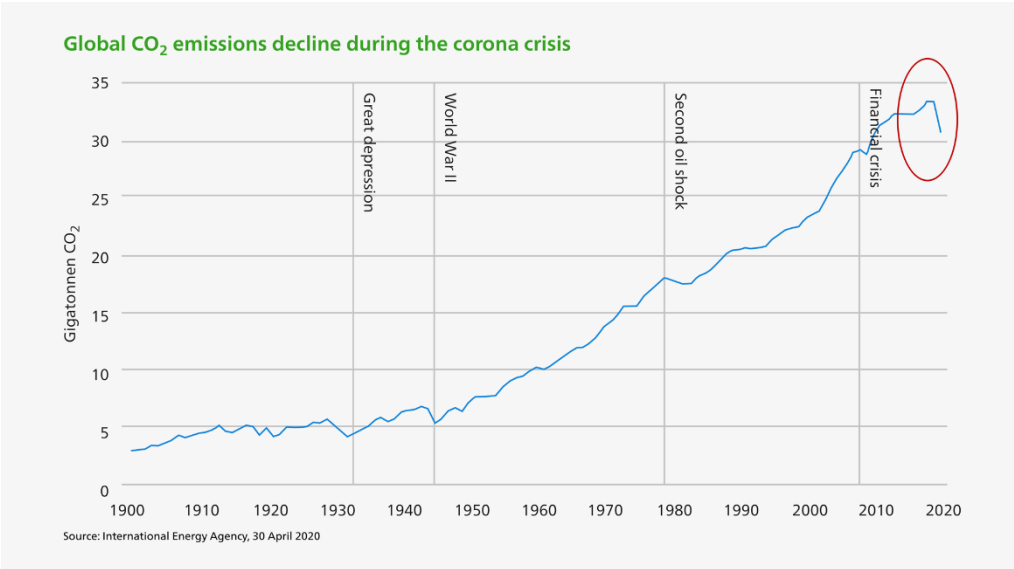
You will find the answers below in our **Twelve propositions on the topic of ESG post coronavirus: What will change in the environmental, social and political spheres?**

Proposition 1. A historic crossroads: Climate protection remains the most pressing political issue, but the coronavirus crisis is changing the parameters

The coronavirus crisis will have certain predictable short-term effects on global warming. But this does not constitute a systemic change.

Over the year as a whole, the total reduction in CO2 released into the atmosphere worldwide could amount to as much as 8 per cent.

- The pandemic has led to a sharp short-term fall in carbon emissions. Over the year as a whole, the total reduction in CO_2 released into the atmosphere worldwide could amount to as much as 8 per cent. While energy prices have collapsed, the price of CO_2 has remained relatively stable.
- At the same time, both the general public and policymakers are paying significantly less attention to climate change in the short and medium term as the pandemic is at the forefront of people's minds. The planned climate summit (COP26), which was intended as a platform for the announcement of important new climate targets, has been postponed to 2021. And a range of other political measures have also been pushed back.

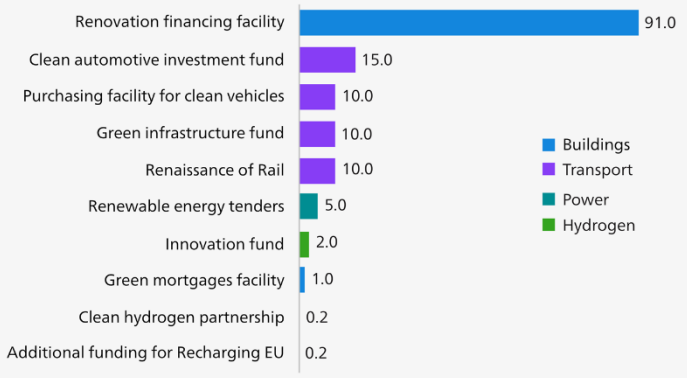


BUT: The decisions that determine what will happen at a systemic level in the medium to long term are being taken here and now!

- The fiscal and monetary policy programmes that have been adopted so far aim to mitigate the immediate consequences of the coronavirus crisis, but the need to take action to protect the climate is still just as urgent as before the crisis.
- However, certain new opportunities have been opened up. For example the of use industrial policy in order to achieve climate goals (e.g. with governments acquiring stakes in Air France and Lufthansa) and the design of economic stimulus packages.

- This means that we are now at a historic crossroads: Either we decide to use the coronavirus crisis as an opportunity to also tackle the climate crisis ('acceleration' scenario), or we miss this opportunity and lose the race to keep global warming below the critical threshold of 1.5°C and probably even 2°C.
- Now is the moment when we decide which path we want to take.
- The latest economic stimulus packages in the EU show that politicians have not forgotten about climate change. At least 25 per cent of the funding – i.e. a total of €463 billion between now and 2027 – is earmarked for green capital expenditure (source: Bloomberg, 8 June 2020).

Green money from the EU economic stimulus package. Anticipated annual green capital investment
Euros, billion



Source: Bloomberg 8 Juni 2020 „How green is t he EU's Trillion Euro Recovery Plan" (based on leaked Working Dokument of European Commission on Euroactiv)

Worst-case scenario: going into reverse

- The pandemic detracts public attention away from climate change. At the same time, unsustainable business models and practices are being reinforced by the coronavirus crisis while green innovation is obstructed.
- Economic stimulus packages introduced after the coronavirus crisis do nothing to transform the economy but exhaust the available medium-term fiscal headroom. Financial support is poured into the fossil fuel sector, internal combustion engines and aviation. The Paris climate goals become less and less attainable and global warming spirals out of control
- Sudden knock-on effects trigger tipping elements and parts of the planet become uninhabitable. As a result, hundreds of millions of lives are at risk.

Best-case scenario: acceleration

- Climate change is brought back into the spotlight and the structural upheaval caused by the coronavirus crisis is used as an opportunity to change unsustainable business models and practices. As a result, economic stimulus measures support the green transformation.
- Investment is used to bring about a sustainable transformation in the automotive industry, aviation and the energy sector. Carbon pricing is expanded and CO2 emissions thus become increasingly costly. As a result, companies focus more on reducing their transport and supply chains.

- The impact of climate change is minimised and global warming maintained at no more than 1.5–2°C. The threat to large coastal cities posed by rising sea levels is contained, famines are averted and many hundreds of millions of lives are saved.

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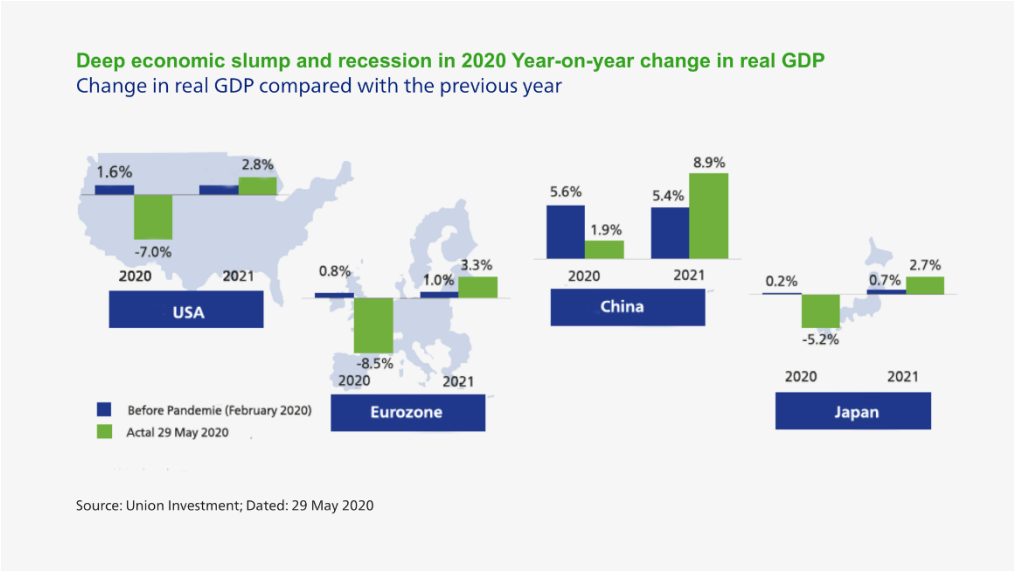
Proposition 2. Deep divides: coronavirus exacerbates social inequality both within and between countries

Unfair conditions: no equal access to healthcare

- The coronavirus pandemic has seriously overwhelmed the healthcare systems of many countries. Even in western industrialised economies, many people do not have sufficient access to basic protective equipment such as masks and disinfectant.Especially in the US, disadvantaged groups in society have very limited access to essential healthcare – many citizens do not have health insurance and are thus particularly vulnerable. The distribution of coronavirus-related deaths is also uneven. In New York, the death rates in low-income boroughs such as the Bronx or Brooklyn are a multiple of those recorded in affluent areas like Manhattan or Greenwich Village (source: New York City Health Department / https://www1.nyc.gov/site/doh/covid/covid-19-data.page)
- The risk of infection is particularly high in low-wage sectors of the labour market, where people frequently work together in confined spaces and compliance with safety standards can be poor (e.g. factories, abattoirs, mines).
- In some cases, healthcare systems in developing countries cannot provide essential healthcare (such as hospital beds with ventilators) at all. Only those who have the necessary financial means can get access to medical care.

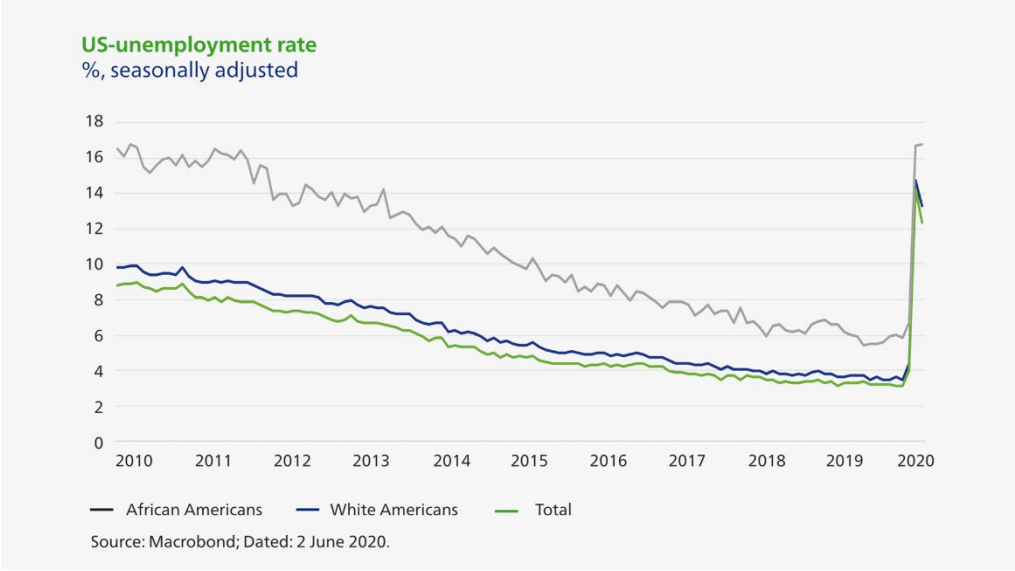


According to a study by the United Nations, half a billion people are at risk of being pushed below the poverty threshold of US$ 5.50 per day if household incomes fall by 20 per cent..

Vulnerable groups of society are hit hardest by coronavirus

- The global recession caused by the coronavirus crisis will have a severe social impact. According to a study by the United Nations, half a billion people are at risk of being pushed below the poverty threshold of US$ 5.50 per day if household incomes fall by 20 per cent. A fall in incomes by 10 per cent would still see 250 million people slip into poverty (source: UNU, Sumner et al 2020).

- Unemployment figures are shooting up at an unprecedented rate. In the US alone, 41 million people filed for unemployed within just two months (source: Macrobond, 2020). Globally, more than 200 million people are expected to lose their jobs (source: ILO 2020 in Furceri 2020 https://voxeu.org/article/covid-19-will-raise-inequality-if-past-pandemics-are-guide).



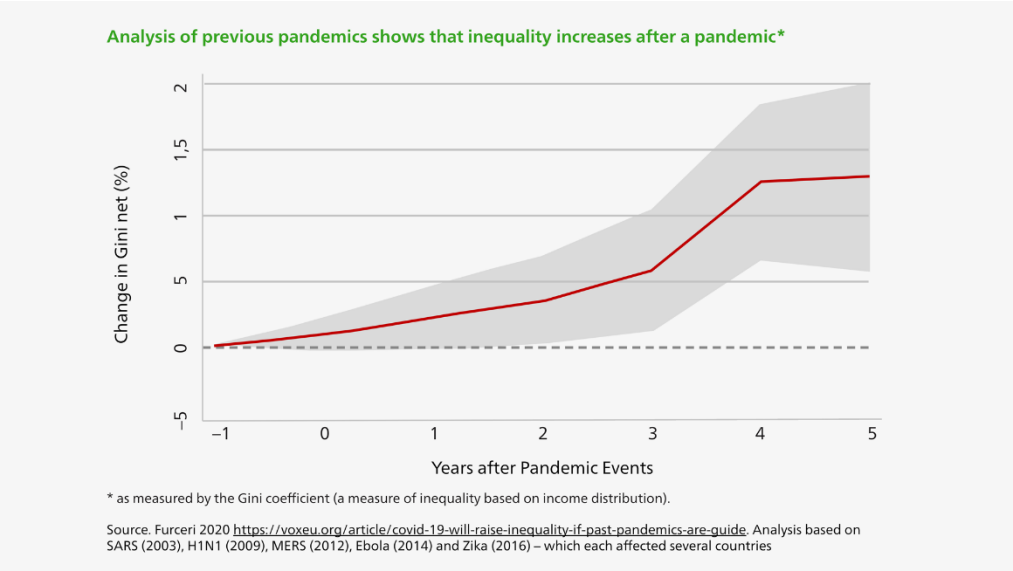
- For many workers in low-paying sectors (e.g. hospitality, factories, retail), working from home is not an option.

Coronavirus intensifies the intergenerational conflict

- The fight against coronavirus is fought primarily to protect older, at-risk groups of society – at the expense of the younger generation. Spiralling sovereign debt levels, demographic change and stagnating real wages are coming together in a perfect storm that the next generation will have to weather.
- US and eurozone debt ratios for 2020 are expected to be at least 10–15 percentage points up on the figures recorded at the end of 2019. In Italy, the debt ratio could grow to around 165 per cent of GDP by the end of 2020.This huge burden of debt means that many countries will lack the means to put funding into public services such as education and healthcare systems for quite a long time.
- The dissatisfaction of younger people with this intergenerational injustice is growing and resulting in political demands. Fridays for Future was only the beginning

The votes will be cast at the end

- During the coronavirus crisis, many people are experiencing a new sense of social solidarity. But on the other hand, many will emerge from the crisis frustrated. New cracks are emerging in the social fabric.
- As a result of the containment measures imposed by governments, millions of people have lost their jobs, have had operations cancelled or have been socially isolated for months. The heroes of the crisis (hospital and care workers, emergency services, supermarket staff) have not been forgotten and are now calling for appreciation to be shown in the form of better pay. But due to the crisis, there is very little financial headroom available and the potential for disappointment is very high.



- The ‘losers’ of the coronavirus crisis will seek a political outlet to vent their anger. This means that the pandemic increases political risk, especially in countries where the government is deemed to have managed the crisis poorly. Uncertainty regarding the likely outcome of upcoming elections has thus increased compared with pre-crisis levels.

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Proposition 3. New appetite for solo action: The coronavirus crisis has increased the role of the state and strengthened the focus on action at the national level

Greater state power – a new experience

This is the moment of truth for those in power, while opposition parties initially play only a marginal role.

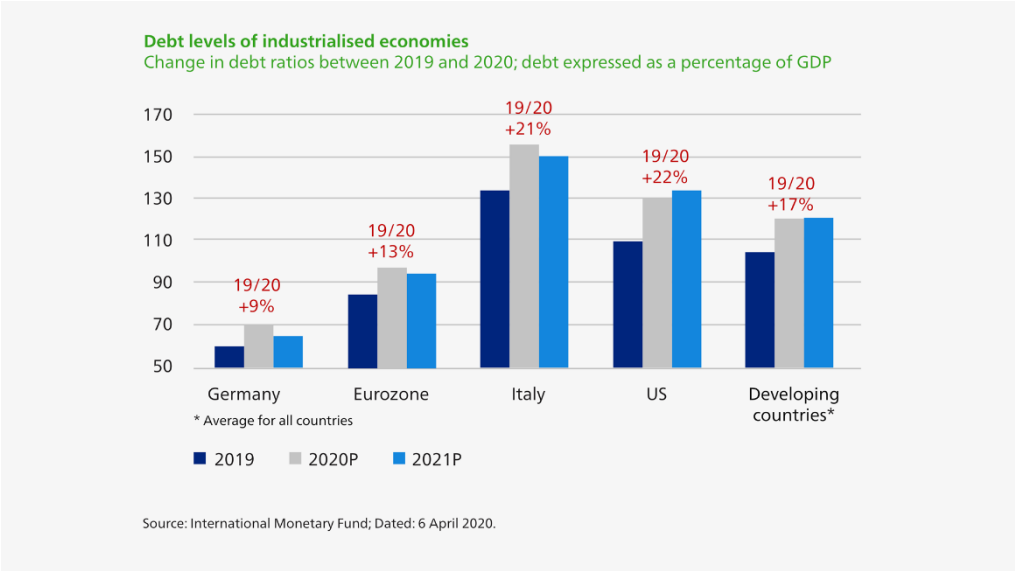
- To fight the pandemic, government needs to be strong and effective. Restrictive measures such as lockdowns, social distancing and border closures, which would have seemed unthinkable not long ago, have suddenly been imposed by governments and largely tolerated by their populations. Democratic societies are experiencing something completely new to them during this crisis, i.e. a powerful state taking radical cation.
- Parties that are able to convey a sense of safety, stability and competence have been gaining support during the crisis. This is the moment of truth for those in power, while opposition parties initially play only a marginal role. Within society, virtues such as discipline, solidarity and obedience are key to success in the battle against coronavirus.

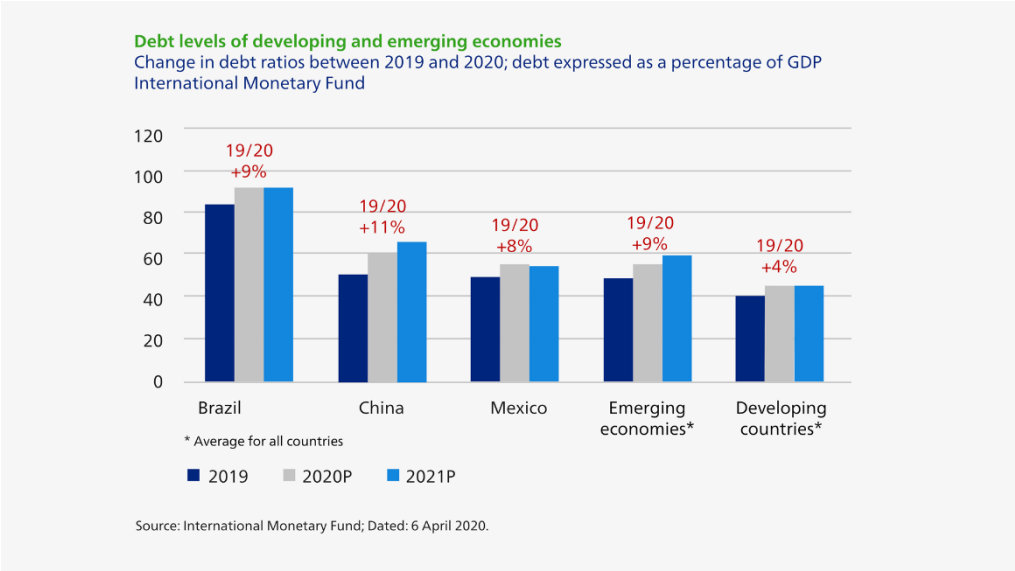
Inward perspective accelerates trade disputes

- America first', Brexit and an upsurge of right-wing populist parties across Europe – the shift in focus towards national agendas is not a new trend.
- In the crisis, the overriding mentality has been 'every state for itself'. Governments are clearly prioritising national interests. Borders have been closed and solidarity with other countries appears to be subject to available resources. National governments are the main actors while international institutions are taking a back seat. At the same time, the crisis seems to be bringing countries closer together. In Europe, this is clear from the efforts to establish a joint recovery fund. At global level, it is demonstrated by the many countries expressing their commitment to the World Health Organization.
- The coronavirus crisis is providing fresh ammunition to governments pursuing protectionist economic policy agendas. US President Trump is looking for a scapegoat and thereby exacerbating the US-China trade dispute.

Governments are expanding and strengthening their influence

- In the wake of the coronavirus crisis, government institutions are facing challenges of almost unprecedented dimensions. Debt ratios are skyrocketing, the central banks' balance sheets are ballooning and economic stimulus packages worth hundreds of billions are being adopted. The battle against this crisis is bestowing a more prominent and powerful role on governments. Some sectors are seeing direct government intervention. Nationalisation is another instrument available to states in their fight against the crisis.





- Governments are also deploying new technologies. More than 30 countries are using coronavirus apps to track the movements of their population. Especially in Asian countries, the rigorous tracing of people's movements is playing a crucial part in containing the virus. Acceptance for such measures is also growing in western democracies. 'Red lines' are being challenged and new technologies are being deployed.
- The growing level of indebtedness is raising the issue of intergenerational equity. There is a growing risk that populists will exploit the impotence of governments faced with having to solve these momentous challenges. And if populists manage to gain a position of power, sustainability will go to the bottom of the agenda. It is therefore all the more important to adopt an integrated approach that addresses both the economic challenges of the current crisis and the challenge of climate change. There is no other way of resolving the issues on hand whilst also retaining the ability to develop further solutions in the future.

Global issues require global collaboration

- In the early days, the response to the coronavirus threat was inward looking and focused on action at the national level. But overcoming this crisis also requires countries to collaborate closely at an international level. It is important that national governments strengthen and use international partnerships and institutions such as the EU and the UN. Therein lies our only chance of successfully resolving issues such as coronavirus, climate change and species extinction.

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Proposition 4: Prudent management – companies with good corporate governance are more resilient and will emerge stronger from the crisis

Clear quality criteria in the crisis

- Agile companies with a motivated workforce are able to assert their position in the market, adapt their production and gain competitive advantages that will continue to benefit them over the longer term.
- Flat hierarchies and good organisational structures enable companies to react faster and get ahead in terms of costs and productivity.
- Companies that have a close and fair relationship with suppliers are able to bounce back more quickly, benefit from improved availability of materials and enjoy exclusive partnerships – another benefit that will last beyond the current crisis.
- By reducing working hours instead of making staff redundant, companies avoid losing know-how. Employees on reduced hours do not become formally unemployed and can return more quickly to a position in which they can contribute to the company's economic recovery.
- Forward-looking companies are bringing maintenance work forward. Low demand during the crisis makes it easier to upgrade and service industrial facilities.
- Good crisis management has a positive effect on management remuneration. Well-designed management remuneration schemes that set the right incentives can help to make good governance financially rewarding even in a crisis (e.g. in a peer group comparison).

Attention is drawn to the working conditions of workers in the gig economy

- Workers who are not on a company payroll have had no income and no health insurance cover during the coronavirus crisis. In the US, 33 per cent of the working population are self-employed contractors, low-paid staff or zero-hour contract workers (gig economy workers) for larger online platforms such as delivery services, courier companies and transport service providers.
- Governments have stepped into the breach: In some countries, freelancers and self-employed workers have been given temporary public health insurance cover during the crisis (e.g. the US).

Regulation is going to tighten

- Canada, France, California and New York City have announced plans to improve working conditions in the gig economy, which will drive up prices for the affected online platforms.

Investors are increasing the pressure on companies to take better care of their self-employed contractors and to be more transparent about their working conditions

- Dividend payments and share repurchase programmes of companies that receive state aid are being challenged. Restructuring programmes will become more difficult to implement if planned dividend payments go ahead.

- Tax avoidance increases insolvency risk: Companies based in tax havens (shipping companies, financial holding companies) are not eligible for state aid.

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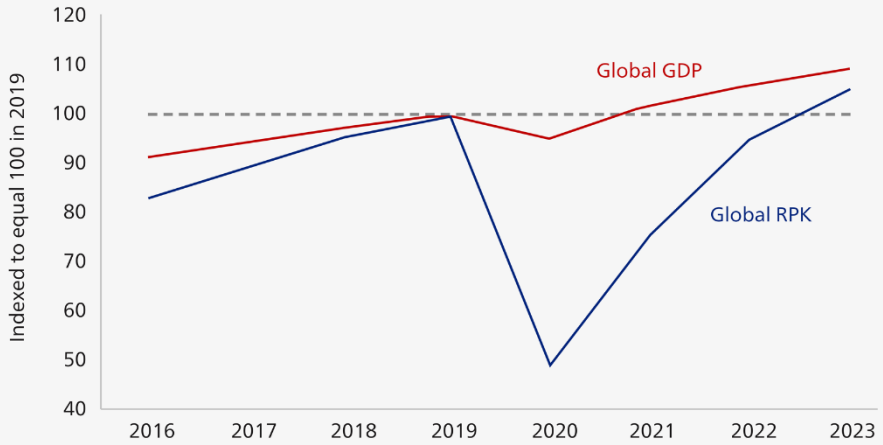
Proposition 5. A hard landing – coronavirus is hitting airlines just as hard as the financial crisis hit the banks. Only this time it's better for the climate

Everything has changed

The biggest collapse in travel since the dawn of commercial aviation is going to have many and varied long-term implications and will result in structural changes in the industry..

- Much like the banks during the financial crisis of 2008/2009, now the airlines are fighting for survival and calling on their governments for support. Nothing is the way it was before. In the first half of 2020, international air travel virtually came to a halt due to the coronavirus crisis. The biggest collapse in travel since the dawn of commercial aviation is going to have many and varied long-term implications and will result in structural changes in the industry.
- The current crisis combines a supply-side shock with a crisis in demand in 2021. Radical changes in holiday and business travel habits can be expected. Medium-term growth in the aviation sector will therefore be below the historical average. It will take the sector at least until 2023 to return to 2019 levels.

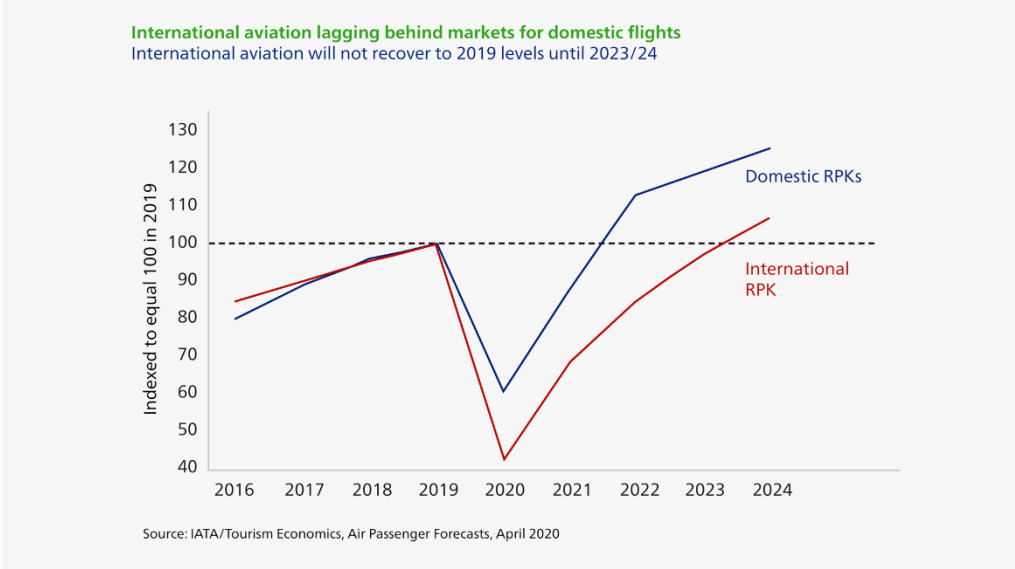
Airlines have sunk much deeper into crisis and will take longer to recover



Source: IATA/Tourism Economics, Air Passenger Forecast, April 2020

The global climate stands to benefit in the short and medium term

- Global passenger kilometres in 2021 are expected to be between 32 per cent and 41 per cent below the previously estimated levels. Less air travel also means fewer emissions. And the fleets of those airlines that manage to stay in operation will not return to their pre-crisis size. Older and more environmentally harmful aircraft in particular will not return to service. This will improve the carbon footprint of airline fleets.



- At the same time, there will be a shortage of money to fund green innovation – e.g. in the fields of alternative fuels and propulsion technologies – which will be needed in the longer term to bring about a green transformation in the industry.
- State aid will, to some extent, be linked to investment in climate protection and the reduction of emissions. The French government, for example, is making it a condition of its multi-billion-euro support package for Air France that the airline will no longer be permitted to offer domestic flights on any route that can be covered by train in two and a half hours or less. In addition, the company will be required to cover 2 per cent of its fuel consumption from renewable sources by 2025.

Short-haul and holiday flights will recover more quickly than business and long-haul travel

- Consumer confidence in air travel generally remains a crucial factor and may take some time to rebuild, even when borders have been reopened and travel restrictions eased.
- Leisure and short-haul travel will bounce back first. Over the longer term, the impact will be greater on

- international long-haul flights, due to the complexity created by different entry requirements of individual countries and the implementation of new health and safety measures.
- business travel. This segment is adversely affected by the severe economic impact of the crisis, the duty of care of employers towards their employees, the growing number of people working from home and the digital interconnectedness of the world of business.

Further consolidation highly likely

- To ensure access to liquidity during this period of lockdowns around the world, some companies took on substantial amounts of debt. Smaller airlines and those with a weaker balance sheet will be facing a battle for survival – if not yet, then certainly when air travel begins to resume. It is highly likely that the sector as a whole will contract. Once the crisis has been weathered and the market has consolidated, at least to an extent, there will be opportunities for companies with strong balance sheets.
- Low-cost carriers are proving more resilient in this crisis than network operators. They have lower fixed costs, do not require government support and are using the lockdown period to further optimise their costs. They also have a stronger focus on domestic and regional flights and generate most of their business from leisure travel. Historically, these carriers have been more able to generate traffic during periods of declining economic output thanks to their lower cost base.
- COVID-19 will fundamentally change air travel: Like 9/11, COVID-19 is going to have a lasting impact on the travel sector as rules and procedures will change in line with efforts to contain the spread of the virus and prevent further waves of infection. Measures currently being discussed include the wearing of face masks, more pre- and post-flight health checks (body temperature measurements), health passports, changes to catering services and more extensive aircraft cleaning.

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Proposition 6. Health comes first – coronavirus is accelerating the digital transformation in the healthcare sector, but governments remain in control

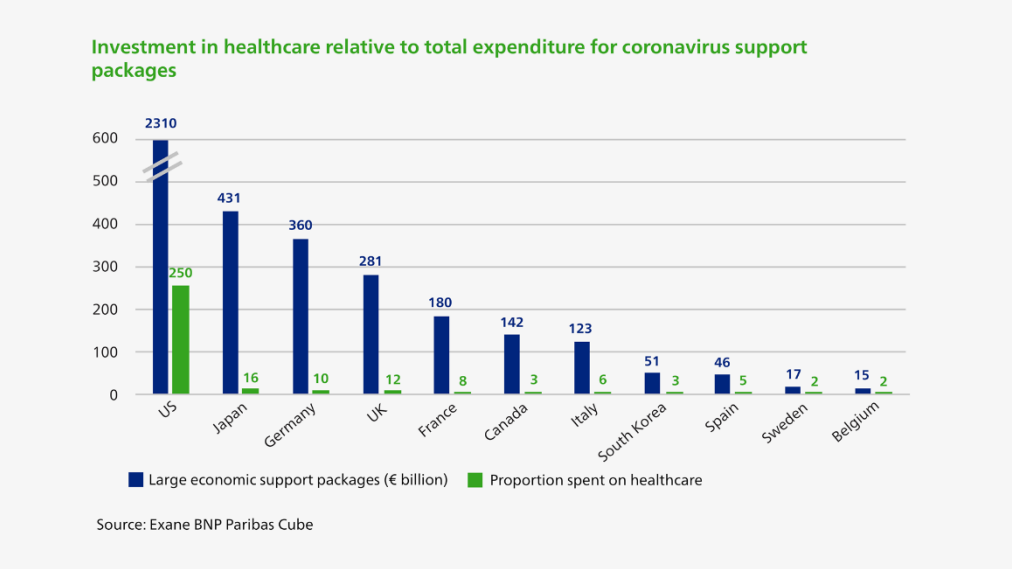
Health is currently the topic at the forefront of everyone's mind

- 'Coronavirus' and 'viral diseases' are dominating the news: According to Bloomberg, these two buzzwords of the current crisis appeared in approx. 6.5 million headlines in May 2020 alone.
- Warnings from doctors and experts have triggered a debate about a 'healthcare supercycle'. The Royal College of Radiologists warned that the field of radiology has been 'woefully underfunded'. In response, the UK government has committed to funding an investment package of around £200 million for imaging technology in hospitals across England. This could be the first small part of a much more comprehensive government investment programme in the UK's healthcare system. But in light of soaring expenses for measures to support the economy through the coronavirus crisis, the chances of a real supercycle seem slim. It appears more likely that there will be lots of smaller, targeted investments in digitalisation for the healthcare sector, in improved information management and in hospital equipment.
- The pandemic has put the healthcare sector in the spotlight. As a result, companies and governments are likely to attach greater importance to health aspects in their future decisions. Health-related key figures will be reported in addition to traditional indicators such as GDP and unemployment statistics.

The pandemic has put the healthcare sector in the spotlight.

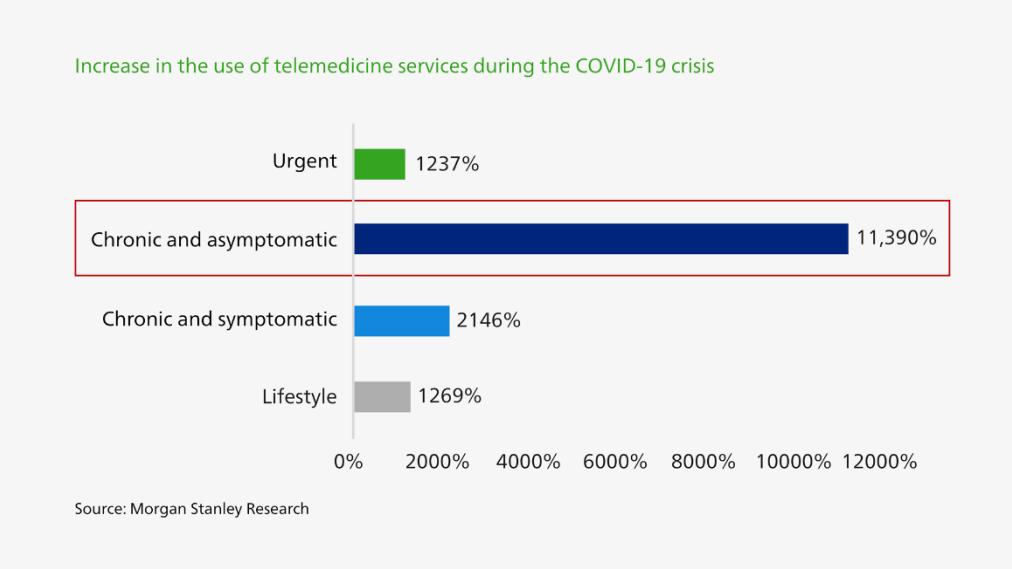
The coronavirus pandemic is highlighting inefficiencies at the interface between politics and healthcare systems

- More is not always better: The proportion of healthcare spending relative to GDP is particularly high in the US. Nevertheless, people in the US do not enjoy a higher life expectancy than those in countries that spend less on healthcare. The WHO estimates that 20–40 per cent of all healthcare spending is wasted as a result of inefficiencies. It has, for example, been suggested that the US healthcare system could save up to US$ 213 billion per year by applying treatments more efficiently and appropriately.
- Countries will have to prepare their healthcare systems better for future crises: According to the WHO, making a healthcare system more resilient only requires limited investment and also helps to fight poverty, as poor people are often more affected by health crises.
- A resilient healthcare system is a worthwhile investment. The WHO estimates that the economic benefit would amount to at least US$ 6.7 billion per year and thus clearly exceed the required investment of around US$ 3.4 billion.



Coronavirus is acting as a catalyst for the acceleration of digitalisation in the healthcare sector.

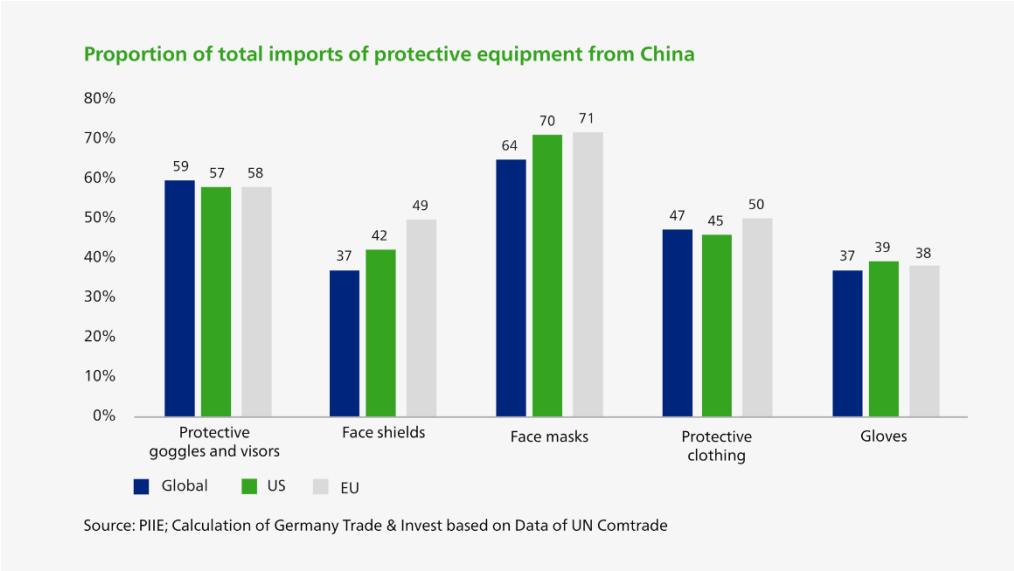
- Public acceptance of medical monitoring and digital services has increased and new standards are being set. During the lockdown, many patients have had to resort to telemedicine services. These are now being offered by more than 50 per cent of doctors – up from less than 10 per cent just one year ago. Many companies have used the coronavirus pandemic as an opportunity to expand their digital offering. In the medium term, around 25 per cent of patient interactions will take place via digital channels. This will reduce the strain on doctors and hospitals. In the long run, digital services will have a positive effect on costs and access to medical care and could also reduce carbon emissions.



- Digitalisation, big data and artificial intelligence facilitate faster and more precise diagnostics for a growing number of patients. One third of all globally available data is connected to health. At present, this pool of information is not being leveraged to the full extent. The use of big data holds potential for more precise treatment approaches and better prevention, which would improve efficiency in the healthcare sector and tackle the challenge of high demand at the source. Imaging diagnostics, dialysis and radiotherapy are areas that could benefit particularly strongly from the use of artificial intelligence, because treatments related to these areas have so far not been personalised to a significant extent.

National governments will have a greater influence in the healthcare sector

- Supply chain dependency will be reduced. Shortages of components for technical equipment, personal protective equipment and testing equipment during the coronavirus crisis have highlighted the extent to which some countries are dependent on supplies from others. EU countries procure 60–70 per cent of their medical protective equipment from China. In order to be better prepared for future crises, some parts of the supply chain are going to be brought closer to home.



- In systemically critical sectors such as healthcare, governments are going to scrutinise investors more closely and intervene where they deem it necessary. To protect the health of the nation, the involvement of foreign investors will be examined more carefully and may be prohibited in some cases.

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Proposition 7. Staying in – after the pandemic, working from home will be part of the 'new normal' and present opportunities for climate protection

In the short term, smaller companies and tenants constitute the main sources of risk in the office segment of the real-estate sector

- Due to widespread lockdowns, a significant proportion of employees have been working from home during this crisis. Many prospective tenants have postponed decisions about new leases for the time being amidst substantial economic uncertainty. New offices leases have consequently fallen over the course of the pandemic. However, at the start of the current crisis, conditions in the office segment of the real-estate sector were upbeat.
- In the early stages of the crisis, many governments in Europe introduced rules to facilitate deferrals of rent payments. While measures to protect market participants have already started to take effect, actual rent defaults have been a rare occurrence so far. In future, smaller companies and private tenants with lower creditworthiness will pose the highest default risk. Providers of coworking spaces are currently among those most adversely affected by this crisis.

Demand for office space will change

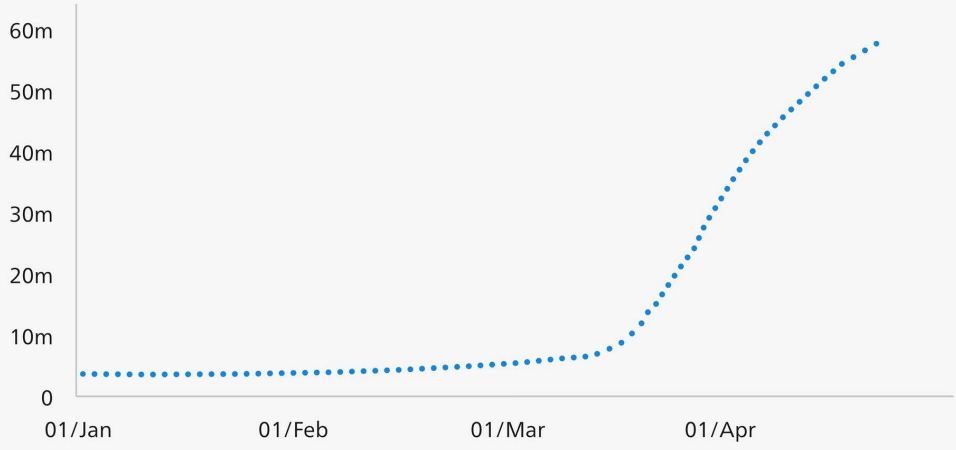
- Going forward, the need for office space will change in line with shifts in demand..
- On the one hand, there will be a general trend towards fewer employees being present in the office at the same time. But on the other hand, more space for meeting rooms will be required. Personal interaction will remain an important element.
- All in all, however, it seems likely that the importance of conventional office facilities will diminish somewhat. Traditional providers of physical office space will have to adapt to this shift in demand.

All in all, it seems likely that the importance of conventional office facilities will diminish somewhat.

Potential for climate protection

- The coronavirus crisis has boosted the trend towards flexible working. Adaptable office use concepts that combine a range of possible meeting formats, the option to work from home and flexible solutions for working in the office are becoming increasingly important. When we emerge from the crisis, a higher proportion of employees will use options such as working from home at least as an occasional alternative. This means that the number of commuter journeys will fall in the future.

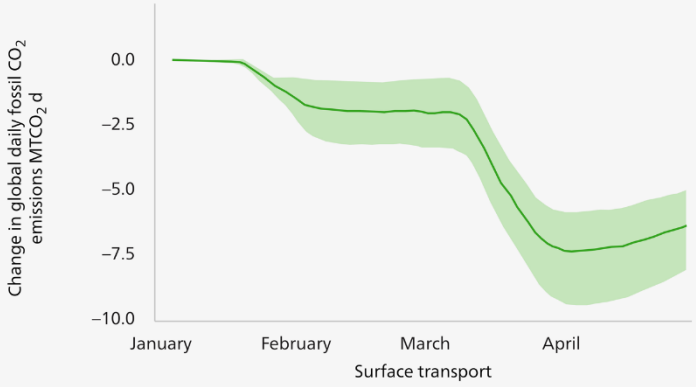
The current environment created by the COVID-19 crisis is giving a tremendous boost to remote working



Source: Apptopia Worldwide Daily average users of ZOOM Cloud Meetings. JPM Report; Dated: 30 April 2020

- The way in which we work in offices is also going to change fundamentally. During the pandemic, it has become clear that work tasks and meetings can be carried out very effectively by virtual means. With lockdowns and travel restrictions in place, international companies have had no choice but to convene their meetings via video link or conference call. As a result, it seems likely that decentralised working will become much more prevalent.

Significant reduction in CO2 emissions due to reduced levels of traffic since the coronavirus outbreak



Source: Nature Climate Change, Dated: 19 May 2020

- The associated reduction in travel is going to benefit the environment. In addition, this trend is also good news for providers of digital office solutions prevalent.

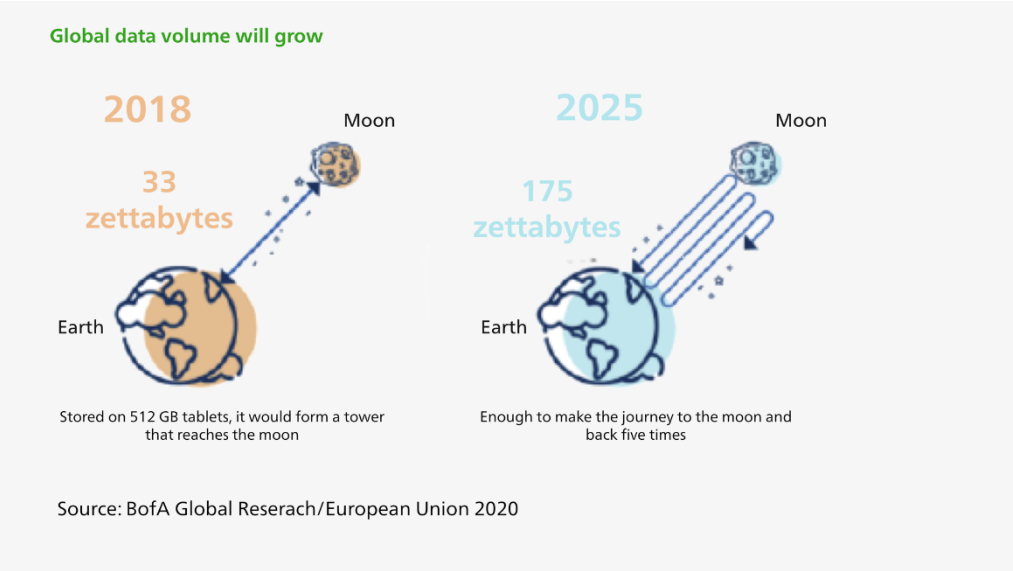
- One of the initiatives that make up the EU's Green Deal is an upgrade and renovation programme. In the real-estate segment, this could translate into more investment in sustainable, low-carbon energy generation, building refurbishment, climate protection solutions and digital technologies. It can be expected that the coronavirus crisis will prompt additional efforts towards greater sustainability in the real-estate sector with the aim of equipping properties for future needs and requirements.

Author:
Johannes Böhm, ESG Analyst at Union Investment

Proposition 8: Surfing safely – coronavirus is accelerating digitalisation and increasing demand for data protection and data security

Trend towards greater interconnectedness and growing data volumes

- The coronavirus crisis is forcing people to use alternative digital solutions – be it in order to work from home, study from home, hold a virtual AGM, have a Zoom party or use a virtual gym. All of these changes in behaviour are accelerating a trend that was already very noticeable before the pandemic: digitalisation. Within just one week, Microsoft gained twelve million new users for its software application Teams. In addition, the general acceptance and use of apps for health-related data collection and monitoring is growing rapidly.

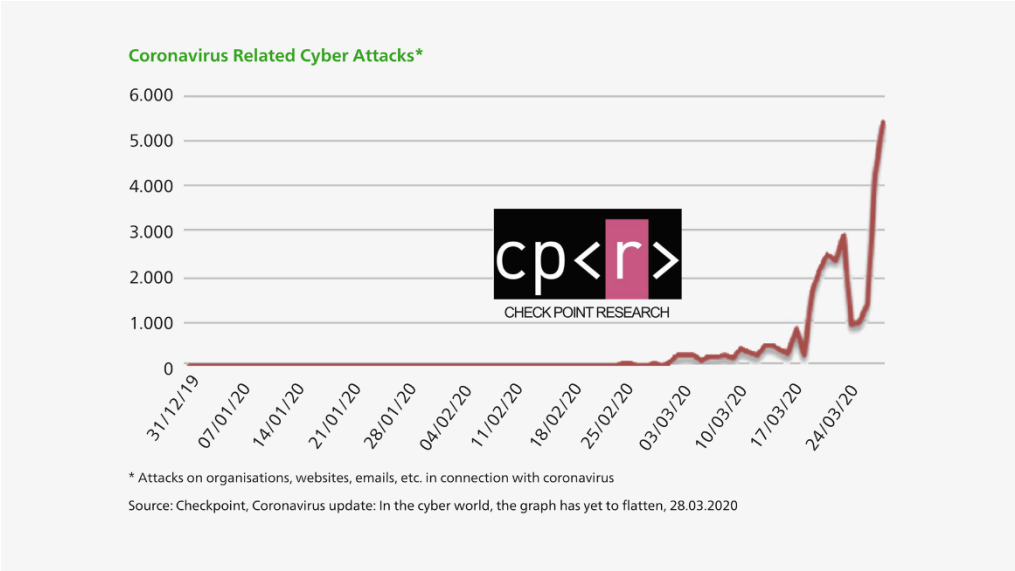


- The global volume of available data is expected to increase about fivefold over the next five years. But most importantly, the amount of sensitive data such as health metrics and data on political opinions or personal preferences is going to increase substantially. This makes cybercrime attractive and lucrative. In addition to the financial damage, a successful hacker attack usually causes reputational damage for a company and can result in a violation of the rights of individuals to their privacy.

The global volume of available data is expected to increase about fivefold over the next five years..

Increase in cybercrime during coronavirus

- The number of cyberattacks, for example on healthcare and financial institutions, has risen by up to 20 per cent during the pandemic. This means that demand for data protection and data security is also rising. Especially when people are working from home, their computers are less well-protected than within the company's optimised IT infrastructure. This means that employees need to be made aware of potential risks and trained appropriately, which – in turn – benefits companies that specialise in IT consultancy and cybersecurity.



- Consequently, companies with good social welfare standards and human capital management and strong corporate governance (including risk management) are more resilient to cyberattacks.

The impact of coronavirus on digitalisation has implications for the performance of investment strategies

- Coronavirus is accelerating further growth in investment in IT infrastructure and IT security for both office-based and mobile work environments. Certain institutions such as schools, universities and public authorities will therefore be forced to increase their IT investment.
- Against the backdrop of this rise in IT spending, specialist providers of cybersecurity solutions are among the beneficiaries of the coronavirus crisis. Services such as single sign-on solutions and multi-factor authentication, which facilitate flexible and secure working, will be in demand. Areas like network security (firewalls) and cloud-based product solutions also hold potential. In addition, VPN connections will be replaced by ZTNA (zero trust network access) within the next few years. This new technology is regarded as more cost-efficient, faster and more secure.
- For IT consultancy companies, there are substantial opportunities to capitalise on the strong demand for advice and training in relation to data protection and data security (especially with regard to regulatory requirements).

Risks resulting from poor corporate governance

- Deficiencies in a company's human capital management or corporate governance (including risk management) such as a lack of IT security expertise at management or supervisory board level can be an indicator of increased cyber risk for investors. This should be taken into account in the analysis of the company.

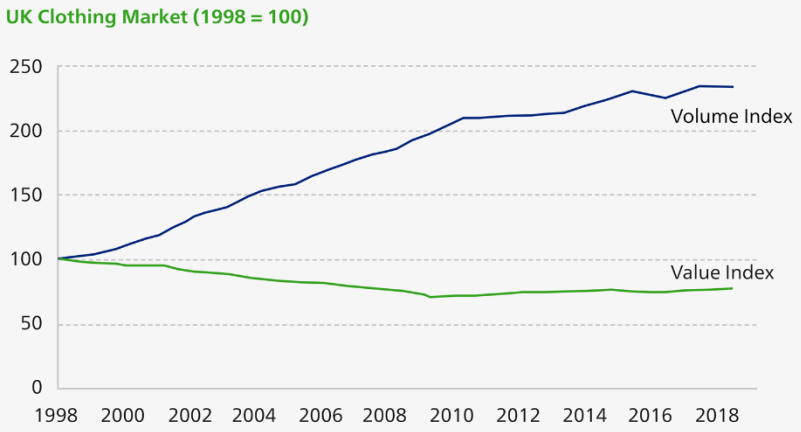
Author:
Duy Ton, Senior Portfoliomanager ESG at Union Investment

Proposition 9. Fast fashion is out – the coronavirus crisis is changing consumer behaviour and challenging global supply chains

Less is more: coronavirus has slowed consumption and revealed the downsides of globalisation

Die Corona-Krise offenbart die Schwächen einer globalisierten Welt: zunehmende Abhängigkeit und fehlende Agilität, wenn der Welthandel stillsteht..

- Consumer spending has plunged as a result of the implementation of lockdowns. And although shops are now beginning to reopen, social distancing is diminishing the appeal of high street shopping. In addition, demand for new clothing has declined due to a lack of special occasions such as weddings, parties and holidays. Aside from these temporary effects, consumers have been questioning for some time the deeply engrained notion of ever-greater consumption as a path to contentment. During the pandemic, we have seen that more moderate consumption does not require us to compromise our happiness.
- For a long time, globalisation was associated with falling prices and a wider choice of goods. Especially in Germany, a country that owes much of its prosperity to a sizeable trade surplus, this has been perceived as favourable in almost all respects. The coronavirus crisis has highlighted the weak points of our globalised world – increasing interdependency and a lack of agility when global trade comes to a halt. The pandemic could therefore trigger a shift towards relocating production closer to home.



Source: Morgan Stanley Research

- For the future of the fashion industry, this means farewell to dumping prices and excessive consumption.
- Clothing prices have been falling for more than 20 years as companies shifted more and more of their production to low-cost countries. In the UK, for example, prices were lowered by more than 60 per cent (cumulatively) between 1992 and 2009, in spite of moderate inflation.
- Consumers have been responding to this trend by buying more and more items. Over the past 20 years, unit sales tripled in the UK. In 2015, more than 100 billion items of clothing were produced – twice as many as in 2000. The lifespan of items of clothing, on the other hand, has reduced drastically. In China, the average number of times that an item was worn before it was disposed of fell from more than 200 times in 2002 to just 62 times in 2016.

New rules for clothing manufacturers

- A trend reversal triggered by the coronavirus crisis would have implications for producers because clothing is a good deemed to be subject to the principle of diminishing marginal utility. It is assumed that each additional item of clothing purchased provides an incrementally smaller amount of additional utility than the previous one. This means that fashion companies will not be able to rely exclusively on rising unit sales in the future. Fashion companies that focus on durable, high-quality products and clearly set their business models apart from 'fast fashion' will be successful in the long run.

Durable textiles are good for the environment

- In 2015, the textile industry generated a total of 1.2 billion tonnes of carbon emissions. This exceeds even the volume of emissions attributable to international aviation and shipping. If fashion chains continue to encourage overconsumption at the current rate, the textile industry will be responsible for approximately 25 per cent of global CO_2 emissions by 2050.
- Even if consumers replaced any items of clothing they dispose of with new items made of recycled materials using resource-efficient production methods, the ecological footprint would still be bigger than if existing clothing was worn for longer.

Shifts in supply chains reduce reputational risk

- Inadequate working conditions in low-cost countries have been a topic of discussion for years, but fierce price competition is obstructing meaningful progress. During the coronavirus crisis, fashion companies have been cancelling more and more orders from suppliers based in Bangladesh, Myanmar and Cambodia.
- For companies in this sector, a trend towards more local production would eliminate reputational risks in the supply chain.

Author:
Dijana Bogdanovic, ESG Analyst at Union Investment

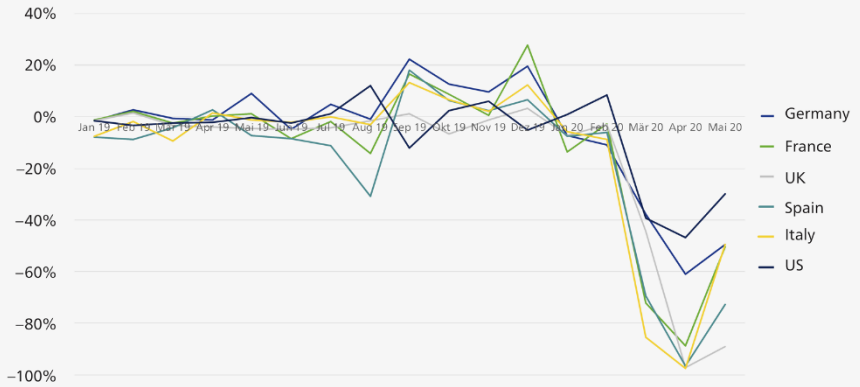
Proposition 10. Slow going for petrol cars – coronavirus is holding the automotive sector back, but the green transformation continues to gain momentum

Tough times ahead for Germany's flagship industry

Some 20 per cent of global production capacity had already become obsolete before the pandemic.

- Companies in the automotive sector are going to ramp up job cuts after the coronavirus crisis. Some 20 per cent of global production capacity had already become obsolete before the pandemic. After the crisis, companies will accelerate the process of plant closures and staff reduction.
- Capacities in the compact car segment will be slashed first. The trend in demand towards SUVs still persists and compact cars are not profitable. For some manufacturers, the road ahead could hold significant potential for conflict with trade unions.

Automotive industry plunges into crisis
Collapse in new passenger car registrations in Europe and the US



Source: Car Associations and Bloomberg

New mobility concepts in the pipeline

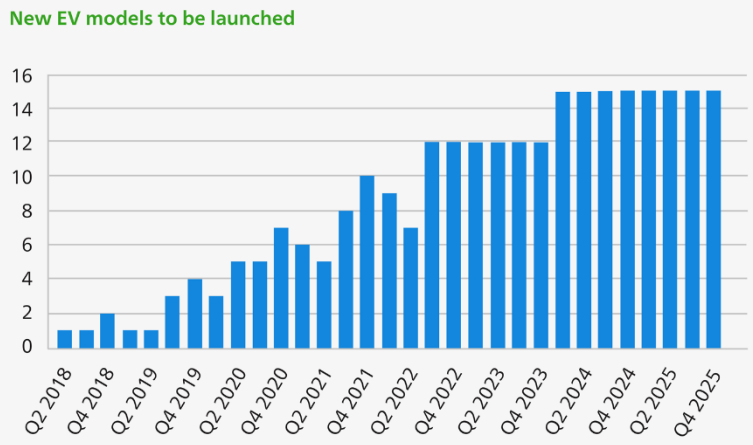
- The concept of shared mobility is losing traction. Consumers are avoiding public transport and transport service providers (e.g. taxi or car-sharing services) due to the increased risk of infection. Providers are adversely affected by additional costs for new disinfection regimes.
- The topic of self-driving vehicles is also being put on the back burner, if not abandoned. Moreover, investment in cutting-edge technology whose production readiness is uncertain, such as self-driving vehicles, is usually the first to be cut back..

Governments are stepping in

- Governments have been offering funding guarantees in the current crisis, but they have linked these to conditions regarding production sites, dividend payments and remuneration.
- In the current environment, Chinese companies are on the lookout for acquisition opportunities in Europe.

Subsidies for clean vehicles will be ramped up

- Substantial increase in funding: Over the next two years, the EU is planning to launch programmes worth €20 billion to incentivise purchases of clean vehicles. The number of filling stations offering alternative fuels will be doubled across Europe to a total of two million facilities by 2025.



Source: Company data, Morgan Stanley research

- Further plans include an automotive investment fund worth €40–60 billion for more research and investment in zero-carbon drive technologies. The focus is on moving towards low-carbon battery production and away from manufacturing methods that rely heavily on coal and nuclear power, which are common in Asia. The introduction of manufacturing certificates for CO_2 emissions would be ideal.

Opportunities for genuine innovation

- The crisis is creating opportunities for companies in Europe to develop genuine alternatives to existing drive technologies. The automotive investment fund is non-discriminating and open to many alternative drive concepts, not just from the field of electric propulsion but also from areas such as fuel cell technology and efficient diesel or gas combustion.
- Investment in alternative fuels will be stepped up. Biomethane and second-generation bioethanol and biodiesel cold make a significant contribution to reducing carbon emissions in the transport sector. This applies to passenger cars as well as to heavy goods vehicles, ships and aircraft.
- In addition, there could be opportunities to promote and intensify partnerships. European funding programmes could strengthen the collaboration between the automotive industry and upstream supply sectors (especially the chemical industry and electrical engineering) in order to develop pioneering technologies and gain competitive advantages.

Author:
Katja Filzek, Senior ESG Strategist at Union Investment

Proposition 11. Rediscovering local gems – the pandemic is changing travel behaviour

Regional tourism is gaining market share

- In light of the risk of a second wave of coronavirus infections, ‘staycations’ are going to remain the preferred holiday option this year even when travel restrictions have been eased or lifted.
- The temporary abstinence from long-haul travel could boost the appeal of local alternatives in the medium and long term: People might come to appreciate the benefits of nearby destinations, such as shorter travel times and a lower price tag.

People might come to appreciate the benefits of nearby destinations, such as shorter travel times and a lower price tag.

Going on holiday by motorhome, car or bike is more popular than ever

- In the current environment, going on holiday by motorhome, car or bike is very popular. Flexibility and independence at the planning stage are obvious benefits of these forms of travel and they also make it relatively easy to adhere to social distancing rules and maintain good hygiene.
- Motorhome and bicycle manufacturers are therefore clear winners of the coronavirus crisis.

Long-distance tourism and cruise holidays have come under pressure

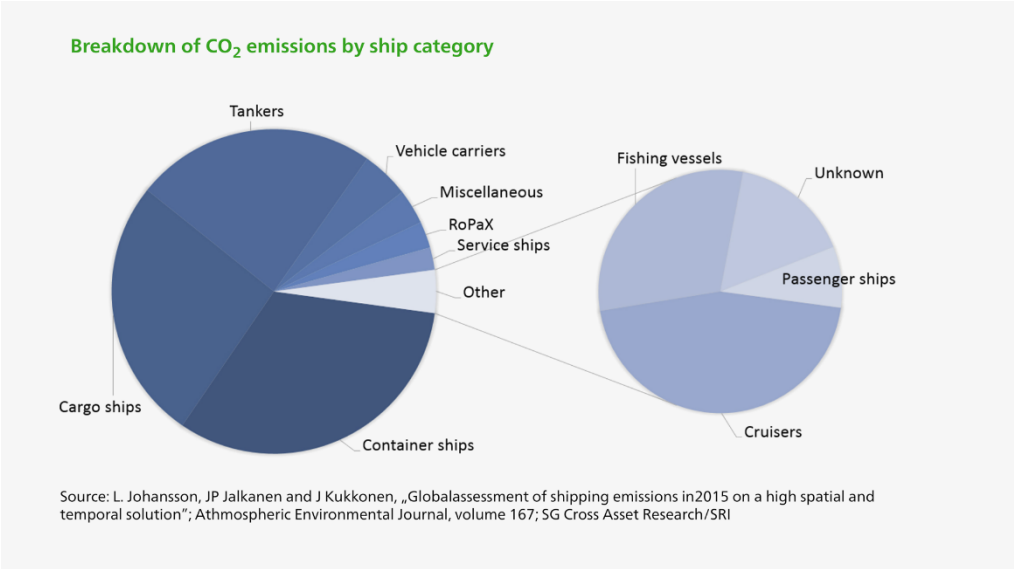
- Travelling to other continents where good healthcare is often harder to come by and holidaying on a crowded ship together with thousands of fellow passengers will not be viable options until a coronavirus vaccine becomes available.
- The cruise industry has been hit particularly hard. It will take several years for the sector to return to its 2019 revenue levels.

Bleak outlook

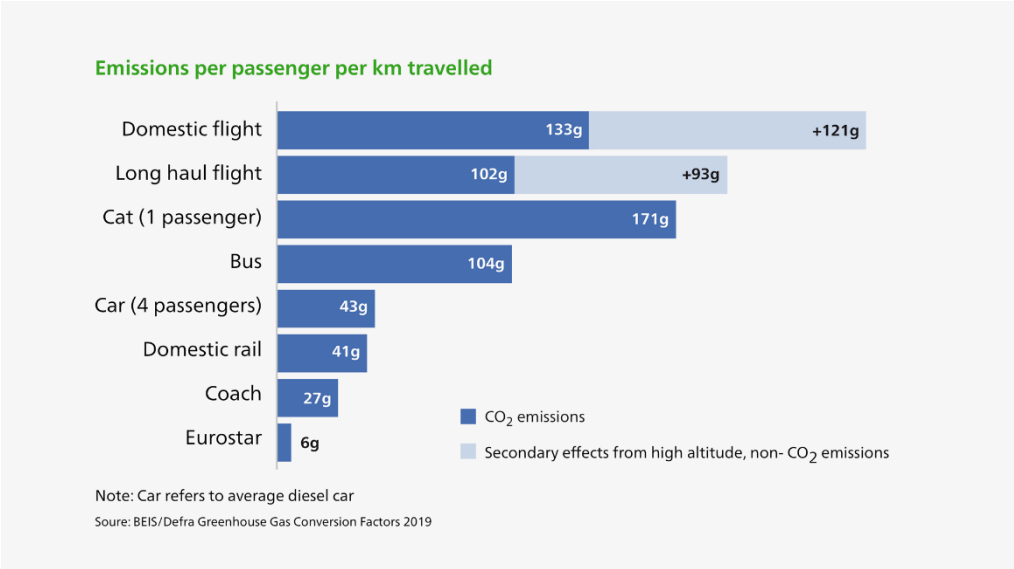
- In light of extremely high debt levels and a collapse in revenue, a second wave of coronavirus infections would be disastrous for cruise operators and could bring the entire industry to its knees.
- The fact that share prices in cruise companies have already crashed by up to 75 per cent speaks for itself. Even if share prices rally intermittently, there is no denying the fact that the industry’s prospects for the coming years are bleak.

Less (long-haul) travel is good for the environment

- Emission-intensive travel is declining during the coronavirus pandemic, meaning that less greenhouse gases are being released into the atmosphere.
- While holiday travel by car has the biggest impact on air quality, air travel still accounts for the largest proportion of tourism-related greenhouse gas emissions in the eurozone.
- Cruise ships are the most emission-intensive means of transport per kilometre travelled. In addition, most cruises require passengers to use air travel to get to the port of departure and back home. According to the European Environment Agency, these flights contribute 10–30 per cent of the total volume of emissions caused by a cruise holiday.



- However, the decisive factor in the medium term will be whether people actually change their travel and consumption behaviour in favour of more sustainable options. The objective should not be to curb consumption to the detriment of economic growth, but to strive for a better quality of growth that does not come with ever-higher levels of CO_2 emissions. A shift towards more regional tourism could be a good solution to this problem.



Author:
Dijana Bogdanovic, ESG Analyst at Union Investment

Proposition 12. Fresh momentum – after the crisis, sustainability will be even more relevant than before

The pandemic is not a catalyst for a fundamental regime change

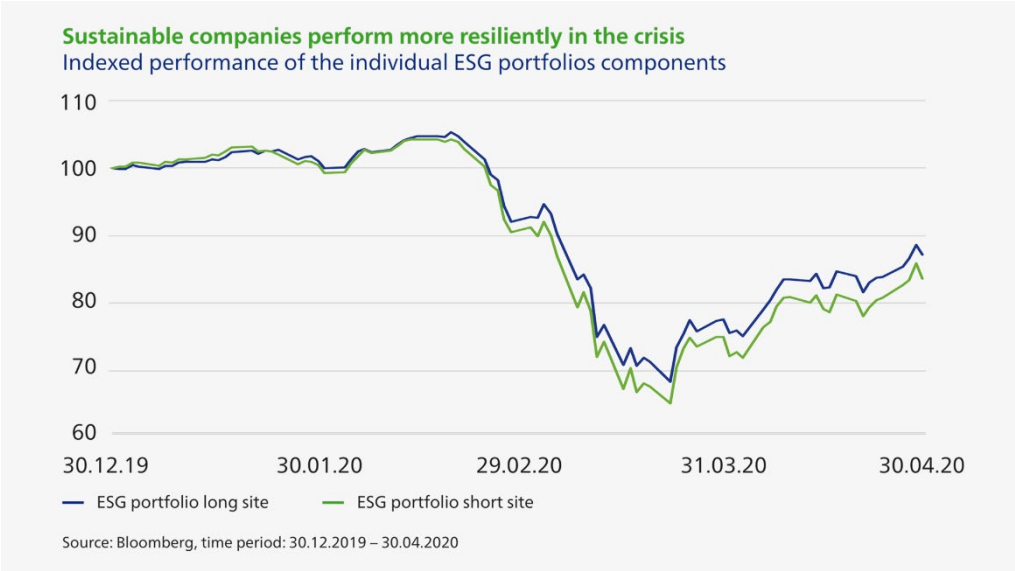
- Notwithstanding the great number of tragic personal stories of physical and economic suffering, coronavirus does not mark the beginning of a new era. The crisis is not stopping key trends such as digitalisation and sustainability in their tracks but rather accelerating them.
- Even supposedly new phenomena such as deglobalisation, which are being attributed to the pandemic, are actually not new at all. Here too, we are seeing an acceleration of a trend that began long before the first coronavirus cases were reported.
- Previously dominant issues such as climate change, inequality and species extinction are still there and are still waiting to be resolved in the coming years.

Severe consequences for entire industries, but no change in mindsets

- The crisis and its impact should certainly not be played down. In addition to countless personal tragedies, entire companies and even industries, for example in the tourism sector, are suffering severely.
- But it remains to be seen if and to what extent this shock will result in a long-term change in behaviours and mindsets.
- This crisis has been a stroke of misfortune rather than a self-inflicted disaster. As a result, no one might stop to draw more far-reaching consequences once the worst of the damage has been mitigated and the world begins to return to a new normal.
- However, a fundamental change in thinking as a starting point for a critical assessment of our current economic practices would be more than welcome in the present situation. But studies of previous crises provide limited cause for optimism in this respect.

Sustainable companies are more resilient to crises

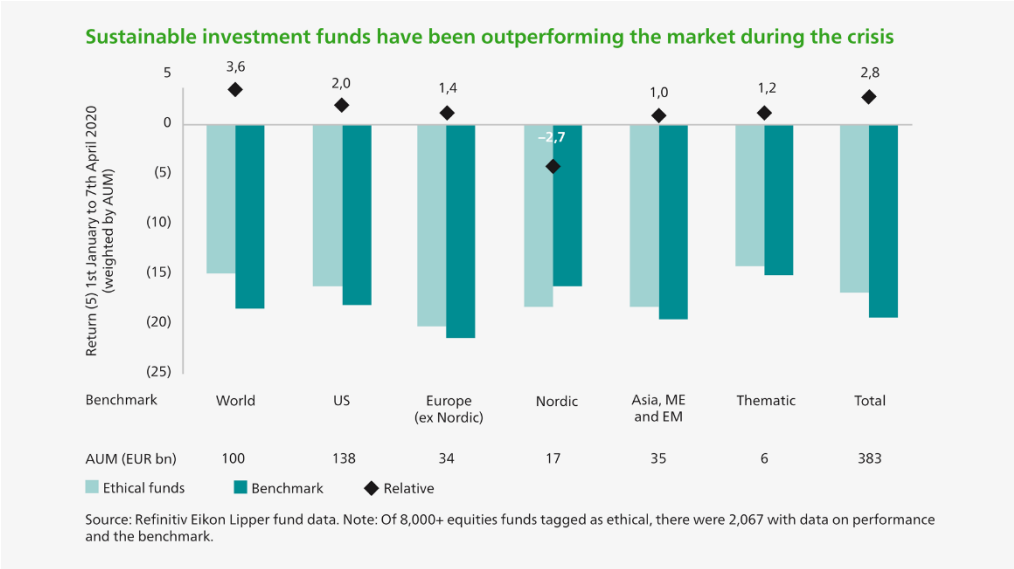
- The pandemic has exposed vulnerable business models. As a result, the crisis holds opportunities for companies and investors with a sustainability-oriented, long-term focus.



- Companies that have a fast-acting, assertive and responsible management team, value their employees as people and promote the compatibility of work and family life are particularly well positioned to draw on the strength of a motivated, high-performing and flexible workforce and to adapt quickly to changing production conditions during times of crisis.
- High-quality companies with a strong ESG profile are still generating relatively steady levels of income in the current circumstances (depending on their respective sector), will emerge from the crisis sooner and will be better placed to cope with its fallout.

Sustainable portfolios are more stable

- The coronavirus crisis is highlighting the benefits of sustainable portfolios. It has become clear that portfolios with a sustainable focus are generating higher returns than conventional portfolios and suffered much smaller losses in the temporary market crash at the start of the lockdown period. This indicates that sustainable portfolios are less susceptible to volatility and underscores their superior stability and resilience to crises.
- Another striking observation is that actively managed sustainability funds have proved more robust than their passively managed counterparts, especially in Europe. This first successful ‘stress test’ will lead to greater demand for funds that pursue an actively managed sustainable investment strategy.



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