

Why can investors be enthusiastic about natural resources?

By Benjamin Ergas

Yes. Energy, Food and Water (EFW) resources are generally scarce – and growing scarcer. Unless we come up with 50 percent more energy, 35 percent more food and 40 percent more water by 2030, the world will be rather tapped out. At the very least, it will be unready to meet the growing demand for such essential and irreplaceable resources.

Since they are vital to economic growth, these shortages could short-circuit businesses, and investors. When resources become scarce in market economies with relevant price systems, prices increase. This has been the case over the last 10 years, and the structural drivers are here to stay. The growing issue of EFW scarcity is impacting the economics of traditional business models, and the very context determining how businesses will succeed.

But one should enter this gloomy, perfect storm-scenario with enthusiasm. There are ways to navigate it, beyond the perception that all you could do is stack up water or food supply.

Scarcity is a clear secular trend, an investment framework that can and should be integrated into a traditional stock selection processes.

We have always lived in a world of constraints and limitations. Scarcity defines our environment. The manner in which companies address the challenges and risks of those limitations, with respect to their input costs, is vital to their prosperity. And the manner in which investors take those initiatives into account can be a source of further growth, one with higher resilience.

Historically, companies that have been more efficient in their input costs have been more productive, and have outperformed their peers. Over the last 50 to 60 years, companies have addressed a series of distinct efficiency curves to combat scarcity, improve their productivity and develop structural cost advantages.

This was true with labour and processes in the 1940s, capital in the 1980s, technology and information in the 1990s.

In a context of growing resource shortages, natural resources are the new challenge, the game changer: it is the new frontier – or opportunity – of corporate efficiency.

Still today, there exist inefficiencies or gap in portfolio management and research where natural resources efficiency is often not included. But if you look at your portfolio from the perspective of natural resources efficiency, you will be capturing opportunities for significant cost savings and growth through new products. Efficiency comes in many forms, across business models and value chains, from production to consumption, from the field to the table. In other words, there exists a rich source of economic opportunities!

EFW Producers or Utilities can produce more effectively through higher productive or mechanical efficiency, lower consumption of resources or waste bioconversion. Technology companies can supply innovative or disruptive solutions that help produce or transport EFW resources in a more efficiency manner. Think of the benefits of environmental biotech, precision planting, drip irrigation and/or smart grid. And industrial companies (from consumer products to mining) can optimize their processes through resource recovery and recycling, streamlined distribution, supply chain management. All these measures are sources of growth, and greater resiliency.

Companies that incorporate Energy, Food and Water (EFW) efficiency as an economic and industrial vision in their business models are most likely either to capture new growth opportunities or mitigate their financial and operational risks, in both cases generating higher risk-adjusted, long-term shareholder value creation for investors.

Our EFW Efficiency Index (www.efwcapital.ch) captures all these three business models, tracking 150 best-in-class companies. It recognizes and empowers companies that are doing something about scarcity. The Index is outperforming the MSCI World by more than 5 percent in 2014, YTD.

By focusing on efficiency to tackle issues of scarcity, one brings the analysis of natural resources consumption in the mainstream of financial analysis. Importantly, it allows investors to incorporate one more layer of risk in their financial analysis of companies, and protect themselves from potential scarcity shocks.

Is natural resources efficiency the only criteria on which investors can base their decisions? Of course not. But could the quantified efficiency of those companies help generate investment opportunities? It certainly could.