

Green shoots

Climate change investing is set for a growth spurt as international governments pour money into the sector but both dock leaves and stinging nettles lie in wait for the potential investor, says **Daniel McAllister**

It's a fertile market for climate change investing. Billions of pounds have been promised by world leaders to be pumped into eco-friendly initiatives in a bid to rein in global carbon emissions.

However, with an industry in its infancy and so little known about the environmental impacts of climate change, huge pitfalls and prizes lie in wait for the potential investor.

Steven Falci, vice president of sustainable investments at fund managers KBCAM, defines climate change investing as investing in solutions to mitigate the effects of climate change or adapt to them.

Investment sectors range across renewable energy, clean energy, energy efficiency, carbon trading and water.

Renewable energy and energy efficiency are the two most important areas for mitigating carbon emissions, with two-thirds of the carbon cuts to come from energy efficiency measures, says Falci.

Global government initiatives to reduce carbon emissions is widely seen in the industry as a key driving force in the push into green investing.

Justin Winter, head of institutional investor insight at New Energy Finance, says \$155 billion of new money entered the sector during 2008.

This investment will be bolstered by \$183 billion pledged by global governments to plug into energy efficiency packages round the world.

US president Obama wants to double renewable energy in the US over the next three years.

The UK aims to cut carbon emissions by 26 per cent of 1990 levels by 2020 and 80 per cent by 2050. In the US, the government has pledged to cut emissions by 14 per cent of 2005 levels by 2020 and 83 per cent by 2050.

"If we're going to hit our renewable targets to reduce carbon emissions then we need large investments in the sector over the next 20 years, which suggests a lot of money will be pumped into climate change firms," says Falci. "In meeting these challenges there are some outstanding investment opportunities, with the chance of stellar returns."

Simon Webber, co-head of Schroders' global climate change fund, says there are three possible outcomes for investors to consider before entering the climate change market.

The first scenario is that the science is wrong, which flies in the face of the overwhelming global scientific consensus. Second, the science is right and we need an 80 per cent reduction in emissions by 2050, which requires radical industrial changes to our economies. Third, we fail in the task of mitigating climate change leading to a violent disruption of markets, economies and societies.

"It's absolutely crucial for investors to consider the second scenario to be right. This requires huge amounts of investing to transform our energy consumption and creates huge growth industries. You don't get that by just building a few wind farms," says Webber.

Cutting emissions and hitting renewable energy targets will lead to a growth spurt in energy efficiency for

transport, housing, manufacturing, and business, says Webber.

Success stories are firms such as Siemens and Philips, which are big players in producing energy efficient light bulbs.

Agroforestry business Oxigen Investments' consultant, Jolyon Bell, says: "Investors are shifting their focus from more traditional investments and are going back to basics to more tangible investments, something they can put their hands on. It's looking attractive."

The firm's agroforestry investment offers a fixed annual return of 8 per cent, while direct investment in trees such as Teak can yield 18-22 per cent over 18 years, Bell says, although there's no guarantee.

The picture is not entirely rosy for climate change investing, however, and there are many concerns for investors and companies alike.

Alex MacGillivray, senior partner at AccountAbility, is sceptical of an explosion in climate change investing, saying that many funds have failed to perform.

He points out Virgin's climate change fund, which has halved in value since its launch last year. Only last week, wind turbine manufacturer Vestas proved that the renewable energy industry is not immune from the challenges that face any business. The Danish firm announced that it planned to lay off 1,900 staff in its northern European operation, citing a lack of governmental initiatives for the cutback.

Yet, MacGillivray says that firms that are looking at ways to adapt to



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climate change will be best placed to succeed.

"Who is making hurricane proof solar panels? No one. Someone is going to have to help when Bangladesh disappears under water, but who is looking at this?" says MacGillivray.

Justin Winter of New Energy Finance says the renewable energy and energy efficiency index, which New Energy finance co-manages, fell 61 per cent in the 2008 calendar year. In 2007 it rose 58 per cent and was up 33 per cent in 2006, when flows of capital into the sector peaked.

"The reality is a lot of the valuations were very frothy. The index has also run very hard for the last several years," says Winter.

"This year will be tough for a lot of marginal players and many won't get through it."

Falci says it's essential when investing in climate change to be selective in the companies and funds you choose. Further climate change investing is a long-term strategy, according to Schroders' Simon Webber, that requires patience.

Nevertheless, Justin Winter is confident. "I don't see any way other than companies on the right side of climate change outperforming. The encouraging thing is climate change investments outperform in both weak and strong stock markets which gives me confidence that the theme is powerful."



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