A broader view of environmental investing

Tokenistic investments in clean-tech funds are not enough – pension funds should urgently address environmental risk and opportunities across their entire portfolios, says Matthew Kiernan

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The good news is that environmental investing is enjoying an unprecedented level of investor interest and even legitimacy, not only within the 'socially responsible investment ghetto', but from living, breathing, mainstream investors as well. The bad news, however, is that up until now, the field has been defined operationally in an excessively narrow fashion, to the detriment of both risk-adjusted investor returns and the planet.

Allow me to illustrate with a simple example: clean-tech. It has always struck me as exceedingly curious that there are a number of major pension funds in Europe, Asia, and even North America which have cheerfully invested (albeit not without some trepidation) in a variety of dedicated clean-tech funds, whether of the publicly traded or private equity variety.

So far, so good. Yet these very same investors would (and do) reject out of hand the apparently heretical proposition that all of their investments should be subjected to a rigorous and systematic analysis of both the downside risks and the upside opportunities created by precisely the same global environmental megatrends that are catalysing the clean-tech investment opportunity in the first place.

> *Environmental investing ought to be essentially synonymous with all investing*

As a result of this double standard, I would contend that, in practice, 'environmental investing' currently boils down to just two areas: clean-tech and carbon finance and trading. For the record, I believe that, as a general matter, both activities are eminently worth pursuing. But they do not, in my humble opinion, constitute environmental investing as it should properly be understood. I would argue, for example, that environmental risks and opportunities are just as central to the profitability and even survival of oil and gas majors (which would rarely if ever be found in a clean-tech portfolio) as they are to a 'pure play' clean-tech company such as Denmark's Vestas, a leading player in the wind energy space. (Sceptics on this point are invited to ponder the spectre of BP's loss of more than 40% of its entire market value over its recent environmental travails in the Gulf of Mexico.)

We know from our own research at Inflection Point Capital Management that, if one uses a robust, multi-factorial definition of 'climate risk', for example, there are many industrial sectors in the MSCI World stock universe where the total climate-related risk exposures of the least and most exposed companies varies by a factor of 30.

So how come the very same institutional investors who feel quite comfortable investing several hundred million dollars – of somebody else's money, mind you – in a clean-tech fund or two have no apparent interest in systematically assessing the climate risks to which the other 99%-plus of their investments are simultaneously exposed? As a result of this seeming indifference, virtually 100% of the climate-savvy investment capital is chasing less than 1% of the true opportunity set!

To be fair, a growing number of institutional investors (most of them undoubtedly signatories of the Principles of Responsible Investment) are claiming today that they do indeed, as a matter of course, integrate environmental and even social considerations into their everyday portfolio management decisions. But it has long puzzled me as to precisely how they could possibly be doing this, given that the vast majority continue to have no access to sophisticated, systematic, institutional-quality research on the risk exposures of the large universes of companies in which they routinely invest, and little if any in-house expertise with which to assess it. But perhaps I quibble…

At the end of the day, my argument here is really quite simple: environmental investing ought to be essentially synonymous with all investing; as the world's population urbanises and grows inexorably from 6.8 billion to 9 billion, and finite environmental resources (notably including water, forests, biodiversity and arable land) come under increasing pressure, investors in all asset classes and virtually all geographies ignore environmental imperatives at their financial peril. A growing body of both academic and empirical evidence strongly suggests that, by doing so, they are leaving both financial and environmental returns on the table. **EF**