The Future of Investing in Environmental Markets

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The impact of climate change is set to alter the shape of the global economy over the coming years and, as a result, there is an expectation that the environmental technologies sector will benefit and grow, providing attractive long-term investment opportunities for global investors.

It is important to note, however, that it is not only the renewable energy sector that will benefit from the changes required to deliver a low-carbon economy. Companies emerging in sectors such as energy efficiency, water infrastructure, and pollution and waste control also have important contributions to make in addressing not only climate change, but the interrelated wider environmental threats facing society as well. Growth in this sector will be partly dependent on access to capital and we are already seeing the start of this evolutionary phase with several governments across the globe pledging high proportions of their economic stimulus packages towards environmental technology investment.

The focus on climate change and its implications in terms of assessing economic cost and investment portfolio risks is increasing. This is highlighted by the United States and Chinese pledges to address the impacts of climate change on economic growth and prosperity despite current market conditions. Incentives derived from economic stimulus packages are expected to play an increasing role in this growth over the coming months and years. Therefore, global investors and their advisors should now be examining these investment opportunities as part of their asset allocation strategies.

Climate Change and the Birth of Environmental Markets
Although environmental technology businesses have existed for decades, it is in the last few years that they have begun to attract increased investor interest. In Sir Nicholas Stern's report on the economic impacts of climate change, the former Chief Economist of the World Bank argued radical and rapid cuts in emissions are needed to limit the effects of increasing the world's "stock" of atmospheric greenhouse gases. Following his report, the Group of Eight (G8) recently stated its call for a reduction in global emissions of 50% by 2050, which will require an 80% cut by developed countries.

In order to achieve such drastic cuts, investment capital will be required to develop, scale up, and bring down the cost of the key environmental technologies. In addition, public policy-derived market mechanisms such as carbon trading are likely to play a larger role. Running parallel are numbers of initiatives, trade organizations, and alliances that seek to facilitate the flow of investment capital (for example, the Carbon Disclosure Project and the United Nations Principles of Responsible Investment).

Oulton, William. "The Future of Investing in Environmental Markets." *Journal of Environmental Investing* 1, no. 1 (2010)

Investing in Environmental Technology

A decade ago, very few environmental technology investment opportunities were available outside of those from a small number of pioneers specializing in this area. These opportunities tended to be strategies that focused on pure-play technology companies (which derive the majority of their business from environmental technology) and have primarily been in the private equity, venture capital, or small-cap investment space. There has been little in the way of products and services that provide investors access to larger listed equities that are adapting and transitioning their business models to exploit the path to a de-carbonized economy.

Today, this is rapidly changing. Index providers have entered the field to provide investors with much-needed visibility to the performance of environmental markets through both tradable and benchmark indices. Environmental indices such as the FTSE Environmental Technology 50 (ET50) Index have successfully provided index funds and exchange-traded funds with low-cost exposure to this exciting sector, while also providing transparent benchmarks and a framework of reference for investors.

In addition, such indices also define the environmental opportunity set because they attempt to remove a major hurdle: identifying or classifying activities of companies in environmental markets on a global scale. FTSE Group has developed a taxonomy for these emerging low-carbon sectors and services that can be used by investors to accurately identify, analyze, and measure the performance of homogenous groups of environmental technology and service businesses. This new Environmental Markets Classification System is used to create the FTSE Environmental Opportunities Index Series, which includes both sectoral and regional breakdowns. This increased transparency of the performance of sectors will enhance the ability for institutional investors to implement climate change-related investment strategies.

Today, with the advent of such methodologies and benchmarks, institutional and retail investors have access to a broad and expanding range of environmental and climate change investment options, with many billions of dollars invested into these funds.

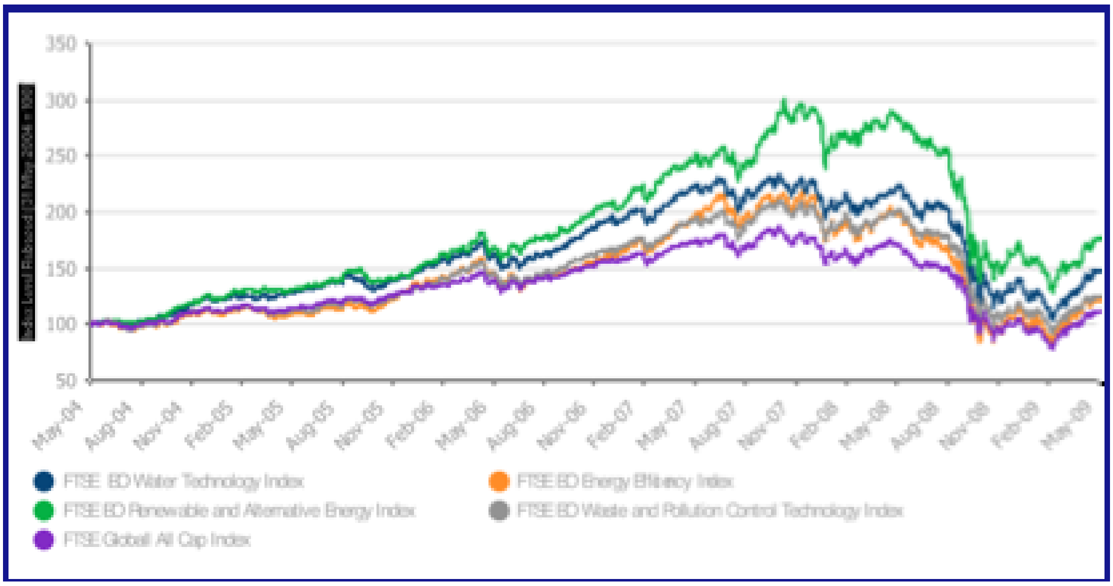
The Future of Environmental Markets Investment

As many of the drivers of environmental markets continue to catch political and public attention—such as energy security and supply, water scarcity, and disruptive weather patterns from a changing climate, the interest in those companies and sectors providing solutions to these issues will attract the interest of global investors. It will become increasingly clear that attractive returns may be achieved from the investment opportunities emerging from the leading companies in these sectors.

This increased investor interest will challenge the global financial services industry and, indeed, index providers, to develop a range of investment tools to reflect this growth and suit the needs of a variety of investment strategies. The challenge for the next decade, against a backdrop of recent recession in many developed markets and a contracting financial services sector, is to continue to build on these many successes. Global investors will have a key role to play in de-carbonizing economies, rewarding companies that adopt sustainable and responsible business practices, and creating a sustainable global financial market system—the latter being the biggest challenge of all.

Supplemental Data

Five-Year Performance of the FTSE Environmental Opportunities Index Series versus the FTSE Global All Cap Index



Source: FTSE Group data as of May 29, 2009

Biography

Will is the Director of Responsible Investment at FTSE tasked with leading the development of FTSE's responsible investment services which include the highly acclaimed FTSE4Good indices. He has also led the development of FTSE's award winning Environmental Markets Indices and the FTSE Environmental Markets low carbon industry sector classification system. He is widely recognised as a leading thinker in the sustainable and responsible investment world and is a regular commentator in the media. He is also the Editor of <u>Investment Opportunities for a Low Carbon World</u> published in June 2009.