Environmental Investing Post-Copenhagen

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If we ever needed reminding, Copenhagen certainly calls attention to the fact that the road to dealing with climate change will be far from smooth. Believers in climate change will judge the responses of governments to fall far short of what is required, while the hue and cry over the Intergovernmental Panel on Climate Change report and the University of East Anglia "Climategate" serve to remind us that there remains a strong sceptic camp, in spite of the overwhelming weight of evidence. The price performance of European carbon credits at around €13, down from €30 last summer, also highlights that carbon trading has yet to provide the desired incentives to curb consumption and invest in alternatives. With first-round quotas overly generous, and the recession naturally cutting demand, carbon prices have yet to make a real impact.

All of this could lead one to believe that climate change as an investment theme may have passed its "sell by" date. We believe that that would be a major mistake. The tipping point in public and political opinion has not been reversed—and, in our opinion, is unlikely to be.

We believe we are just at the start of what will prove to be a period of major growth in expenditure associated with mitigating or adapting to climate change. It has gone broadly unnoticed that a major achievement at Copenhagen was wrestling climate change as an issue out of the hands of environment ministries, which was the status quo under the Kyoto Protocol. Governments around the world now realize that the challenge is one of industrial policy, requiring significant investment, and, as a result, must be well-coordinated by central economic and industrial departments. This bodes well for improved effectiveness of public policy in the future.

This is even more important as the main engines of economic growth post-World War II—expansion of global credit in general and of the American consumer in particular—are unlikely to come back any time soon. If we look for reasonably stable, non-cyclical sources of growth for the decades ahead, it is to emerging markets and themes like climate change that we turn. As an investor, it is clearly preferable to position oneself in the fast-flowing part of the river, and growth in climate change-related expenditure still appears to be one of the most reliable and long-term predictable changes in demand out there.

What then is the best way to play this investment theme? We believe that there are two guiding principles that need to be taken into account. First, along with the news flow, environmental investing is likely to move in and out of fashion, with a high probability that some narrow sectors will reach excessive, unjustified valuation levels from time to time. Secondly, when we start to

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think seriously about the breadth of investment opportunities covered by efforts to mitigate and adapt, we should rapidly recognize that the field is incredibly broad. This is not just a story about alternative energy, wind farms, and solar panels. Almost every major area of economic activity (albeit perhaps not diversified financials and pharmaceuticals) will have its winners and losers: building materials/insulation, water in all its dimensions, drought-resistant seeds, agricultural equipment, videoconferencing and providers of bandwidth, nuclear energy and its suppliers…the list goes on. In a period of tight consumer and public spending however, it will be important to remain focused on the technologies that provide solutions in an affordable way, as it will be these industries that are allocated financial, regulatory, and public support.

The messages are simple: investors should cast their nets widely in the search for companies that will have a significant part of their revenues and profits linked to rapidly growing climate change expenditure; moreover, given the breadth of the opportunity set, there is no need to get stuck in over-heated, glamour sectors.

In these particularly uncertain times, environmental investing may, in fact, be more reliable, predictable, and rewarding than most other avenues. This is the first truly predictable industrial revolution. It would be nothing short of a crime to miss it!

Biography

Alan Brown is Group Chief Investment Officer and a Director of Schroders. Alan joined Schroders in 2005 with over 30 years of experience in the Industry

Previously he was Group Chief Investment Officer, Vice Chairman of SSgA and Executive Vice President of State Street. Alan started his career in 1974 with Morgan Grenfell.

He is a Member of the Group Management Committee. Externally he is Chairman and Treasurer of the CERGE-EI US Foundation (Centre for Economic Research and Graduate Education – Economics Institute), Chairman of the CFA Advisory Council for Market Integrity and a Member of the MSCI Barra Editorial Advisory Board, Trustee of the Carbon Disclosure Project, a member of the Board of the IMA (Investment Management Association) and a non-executive director of Pool Reinsurance Company

Alan has an MA degree in Natural Sciences from Cambridge University.