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Investing in the Green Space Today

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The third year of sustained higher energy prices has finally convinced investors that higher energy prices are here to stay. This acknowledgement is igniting the clean technology sector as environmental issues are also pushing forward. In fact, energy and environment are now fused as an emerging investment sector. Its outcomes cannot be charted, but it is helpful to understand the investment parameters and dynamics of this new sector.

As stock market analysts like to say, there are many ways to play this theme. The most traditional has been called social responsible investing (SRI); however, today the dynamics are that investors want returns as well as goodwill. So, stocks and bonds of environmental companies or companies that pass through an environmental screen are one way to play it. There is also a growth of index-like products and several ETFs (Exchange Traded Funds). There are also insurance and reinsurance products particularly as weather and climate risk rises.

So, there is a lot of talk about sustainability and sustainable development. This is usually linked to climate change and greenhouse gas returns. But once again, this does not get us to return on investment (ROI) criteria that many investors need to make the plunge.

There are three main groups of investment that can be followed: institutional investment grade market caps (with some environmental component, however diluted), smaller companies that are usually undercapitalized and under heavy research and development funding (i.e. looking for breakthrough technologies), and venture capital/private equity/ hedge fund (see IssueAlert from July 11, 2005, "The New Business Model for the Green Space"). This group is high risk and usually reserved for high net worth individuals i.e. those that can afford to lose their money.

There is another economic argument that is beginning to emerge forcefully in the investment community this year. That is, energy and environment are starting to be perceived as a new asset class for investment diversification. It is a means to diversify risk for investors. It is also starting to flow into the agricultural field, the second leading source of global pollution, and water, which is emerging as a commodity market. Some equity and hedge funds are now pursuing this strategy, and expect more to surface this year.

The green sector includes companies involved in solar, wind, water, and biomass energy, distributed energy (for that matter distributed water), fuel cells, microturbines, battery storage, metering and information technology. Ethanol and biofuels excite many people today but agricultural waste (read cellulosic ethanol) or fast growing benign fuels such as switch grass, is not exciting nor particularly environmentally benign. Corn-based ethanol gives off government subsidies particularly from the Energy Policy Act of 2005. In fact, this bill does little to invest in this emerging sector at all except for some coal gasification and hydrogen incentives. The recent state of the union was the usual smoke and mirrors of the Bush Administration with little money involved. Don't forget an authorization is not an appropriation.

In fact, the biggest corporate environmental announcement last year besides GE's Eco-Imagination was on November 22, 2005, when Goldman Sachs, the premier investment bank in the world, made a corporate statement that it was going green with $1 billion in investment in renewable and energy efficiency, make markets in carbon dioxide emission and establish a Center for Environmental Financial Markets. Wall Street seems the money now, and it is not altruism that drives them. The see return on investment.

Climate Change as an Investment Opportunity

Depletion of the world's natural resources coupled with rising global environmental concerns are creating opportunities are well as risks in the climate change sector. Climate change risk is beginning to have a pronounced impact on financial markets and on corporate performance as shareholder pressure continues (In fact, there are various networks that should be mentioned: the Investor Network on Climate Risk (INCR), the Carbon Disclosure Project with $31 trillion of institutional investor money) . While not only raising a corporate board issue throughout the world, it is presenting many investment opportunities as some companies begin to position themselves to offer green products or services. These green products or technology can reduce GHG emissions and other environmental footprints.

Expect to see more green mutual funds, ETFs, green insurance products, and carbon aggregation schemes. On a larger scale, there are clean technology and carbon funds and carbon finance plays underway. These are usually for big institutional investors and not yet yielding returns although there are several attempts to sell carbon credits on eBay i.e a retail investor play if there was ever one.

Clean Tech Investment Indexes

One passive and usually rewarding way to play a sector that is traditionally been used by investors who are less risk tolerant is to use investment indexes. There are several clean tech investment indexes that are available for today's investors. These include the KLD Global Climate Index, WilderHill Clean Energy Indexes, SAM Group Smart Energy Index, and Light Green Advisers Eco Indexes, and New Energy Finance's indexes to name a few. The problem is once again is to show returns but it is coupled with a long-term investment horizon and a high risk tolerance for volatility.

Get to Know Your Risks

The biggest risk for investors is technology risk in many new equities that are beginning to flood the market particularly the London Stock Exchange's AIM (pink sheets). Can these new devices work? If they pass through the IPO phase to concept stocks. These new companies need to make their numbers. Many are not tracked by anyone, and most are tracked by a few research firms such as Ardour, Jeffries or Piper Jaffray. Thus, fiduciary responsibilities and prudent due diligence of institutional investors such as pension funds that desire to shift into invest this sector may be stymied due to the risk factor; moreover, these new companies must show investment returns.

Despite the confusing global regulatory picture on climate change, renewable energy, and clean technology, many investors now smell the coffee. In recent months, I have met or been contacted by Indian Green Funds and Indonesia Green funds. The effort will be global because the solutions are. Now with the Kyoto Treaty EU Emissions Trading Scheme in place, one more piece of the political puzzle comes into place, and its 2008 when this all starts to go faster (the first Kyoto compliance period). As corporate pressure rises on greenhouse gas mitigation, the United States will not be left out of this equation as it is 25 percent of greenhouse gases and a carbon footprint of 7.2 billion tonnes, which increased 2 percent during 2004 (latest EIA stats). Today, Going Green is Now Good for Business!

Peter C. Fusaro is involved with a nonprofit effort called “Eco-Commerce” with Green Ground Zero to accelerate green trading & financial knowledge transference through the web, and is holding the fifth Wall Street Green Trading Summit at Bloomberg headquarters on April 4 and 5 in New York City (see www.hedgeconnection.com/wsgts).