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Debunking Six Myths About Climate Investing

PRIVATE CREDIT & EQUITY | AIP PRIVATE MARKETS TEAM | INVESTMENT INSIGHT | APRIL 2020

By painting climate change with a broad brush, institutional investors are overlooking opportunities to potentially generate compelling market returns and make a meaningful impact on the most pressing issue facing our planet today.

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Investors have come to terms with the reality that climate change is no longer a theoretical threat. The effects of extreme weather, rising sea levels, resource scarcity and pollution are rippling across every continent with dire consequences for individuals, governments and businesses.

Yet, for many investors, climate investing is still an abstract concept that is often lumped in with discussions of risk management, consumer preferences, the conflation of Environmental, Social and Governance (ESG) with impact investing. In fact, the implications of climate change are nuanced—and so are the potential solutions. By looking at the issue of climate change through a broader lens, we believe investors can be better positioned to identify opportunities that meaningfully address a range of climate issues and potentially deliver compelling risk-adjusted returns.

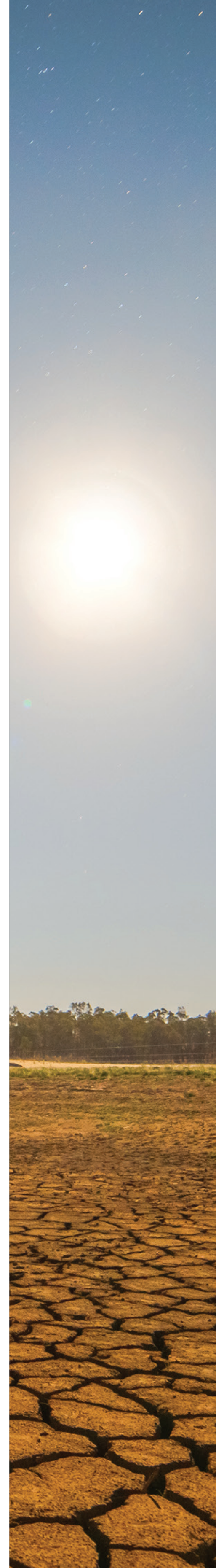
Here are six of the most common myths percolating around climate investing.

Myth #1

The climate problem is all about global warming.

REALITY: Problems are manifold.

For many people, the term "global warming" evokes images of melting icebergs in the Arctic Circle. This is indeed a major



and daunting consequence of climate change. Still, there are many aspects of the climate issue that are more tangible and potentially more manageable. They include, but are not limited to:

- **POLLUTION:** From visible air quality issues in smog-choked Beijing and Delhi to leafy London where nitrogen oxide levels routinely exceed safe norms—pollution is present in our daily lives.
- **RESOURCE SCARCITY:** Drought is a growing problem that affects communities and farmers around the world. Last year, Cape Town nearly ran out of water and introduced the concept of Day Zero which effectively triggers the start of drastic water rationing. California also is dealing with the acute effects of drought and, now, flooding. Lakes in many parts of Africa are shrinking, thus leading to social strife, conflict, migration and refugee crises.
- **WASTE MANAGEMENT:** Many of our cities are running out of landfill and other solutions to dispose waste. Plastics are making their way into the oceans, marine life and our food chain at alarming levels. At the current pace there could be more plastic than fish in the oceans by 2050.[1]
- **ECO-DIVERSITY:** Sections of pristine rainforest in Indonesia are routinely razed for agriculture and timber. This is also true in Brazil where the Amazonian rain forests produce 20% of our planet's oxygen. In 2016 alone, 30% of the coral in the Great Barrier Reef was destroyed.[2]

Myth #2

An ESG strategy addresses climate solutions.

REALITY: ESG is necessary, but not a sufficient condition, for addressing climate change.

ESG, or the incorporation of environmental, social and governance risk factors, is an increasingly core part of any investment strategy. It seeks to limit the operational, financial or reputational risk that could arise from something going wrong in one of these dimensions.

We believe that creating positive climate impact, however, requires more than ESG hygiene. It requires actively investing in businesses, typically putting primary capital to work in a private equity context, whose core activities create new positive effects on the environment, be it a reduction in CO2 emission, pollution or resource consumption.

Myth #3

Renewable energy is the main solution.

REALITY: The investable opportunity set goes far beyond power generation.

Renewables have historically been a cornerstone of climate change investing—but there is a world of opportunity besides windmills and solar panels. A comprehensive climate strategy will look beyond power generation to energy efficiency, housing, transportation, food and recycling.

Here again, some of the most distinctive investment ideas, both from the perspective of returns and impact, focus on solving specific problems, improving existing technology or making broader adoption more feasible.

Minimizing the carbon impact of transportation, for instance, isn't just about funding electric cars and makers of lithium-ion batteries. There are myriad companies in this space that are contributing to more eco-friendly transportation in seemingly small but immensely impactful ways.

One example is a battery-exchange kiosk company in Asia, which makes electric two-wheelers a more viable alternative with a creative answer to charging. Rather than plugging in their vehicles and waiting for them to charge, drivers use the kiosks to swap batteries. The kiosks are technology-agnostic; as new batteries come onto the market, the company simply adds them to its catalog.

Similarly, green chemistry is a category that doesn't get the same attention as alternative energy but offers ample room for reducing the use of fossil fuel derivatives in items of everyday consumption, from packaging materials to paints and furniture polish. The same is true of new business models around recycling, compostable packaging materials, waste-to-energy generation and waste water processing.

There is also a plethora of investment ideas related to food. Demand for meat protein is growing along with the world's population and income levels. Yet, livestock is a major source of emission of the greenhouse gas methane—which is approximately 30 times worse than CO2.[3] As such, sustainable seafood, which has a much smaller carbon footprint, presents a blue ocean of opportunity.

Myth #4

Renewables need subsidies to offer compelling returns.

REALITY: Cost has declined massively since the advent of renewables and pricing is now competitive with traditional energy in many markets.

It was once the case that renewables thrived and died on subsidies, but three major changes make this idea an antiquated one.

[1] Source: https://www.morganstanley.com/ideas/peak-plastic, May 2018

[2] https://www.theguardian.com/environment/2018/apr/19/great-barrier-reef-30-of-coral-died-in-catastrophic-2016-heatwave

[3] https://www.sciencedaily.com/releases/2014/03/140327111724.htm

First, costs have come down substantially while technology has improved; it is now feasible to deploy renewable energy in very small spaces or across remote geographies. Blades on windmills now approach aeroplane wings in terms of size and sophistication, while solar panel prices have declined by more than 60% in the last decade.[4] As this technology reaches critical mass, installation and servicing are also becoming more cost effective and convenient.

Secondly, investors can now target specific projects thus making sure the solution aligns with the problem. Markets are not monoliths, and energy prices, along with solar and wind resources, vary within regions. This makes renewables very competitive in some places and less so in others. It also puts the onus on investors to look at the specific context in which renewable projects operate.

Finally, demand for distributed solutions is on the rise, driven by ageing grid infrastructure in developed markets and, in the case of many emerging markets, because of the absence of grids. A company that focuses on making and selling solar-powered home systems in Southern Africa, for example, is opening doors for environmental and social change. In switching out kerosene or diesel for solar power, consumers are saving money, helping improve air quality in their communities and tapping into a more reliable and sustainable source of power.

Myth #5

Early stage clean-tech investing is a wild goose chase.

REALITY: Savvy investors target low-key solutions rather than moon shots.

Clean-tech investing has been through a few bubble-bust cycles and, like other areas in early-stage investing, there have been some high-profile successes and failures. While a lot of early attention in clean tech investing has been on grand, over-arching solutions, there is a growing and rich universe of companies working behind the scenes to tackle specific causes or effects of climate change.

Indeed, the sector has evolved, as have investors. Instead of looking for a silver bullet for desalination at scale, savvy investors are looking at software that regulates water systems pumps. Rather than banking on the next big thing in electric cars or batteries, smart early-stage investors are backing things like hardware to facilitate data collection and power optimization at charging stations.

These ideas may not make headlines—and that is often a good thing—but they are collectively creating the fabric for meaningful and incremental gains in their respective areas.

Myth #6

Climate investing is highly dependent on political and regulatory changes.

REALITY: Individuals, businesses and local governments can wield as much power.

Media reports focus a lot of government level pronouncements on climate policy, however the underlying trend of climate investing is a steadfast one that, increasingly, transcends politics. Collectively, individuals, corporations and local governments can wield more power.

Consider the United States. While the federal government has taken a different direction on climate initiatives, individual states and cities are rolling out ambitious plans of their own. In March, New Mexico joined California, Hawaii and the District of Columbia in setting a goal for all renewable and carbon-free electricity by 2045, and governors for a dozen other U.S. states are reportedly planning to unveil similar goals. Meanwhile, some of the world's largest companies are taking meaningful steps to reduce their environmental footprints. Not to be underestimated, individuals are taking a stand, as citizens and as consumers.

This is all to say that a comprehensive climate strategy encompasses ideas big and small. It looks to address the broader threat of global warming, as well as to support grassroots initiatives to seek to solve problems related to pollution, resource scarcity, waste management and eco-diversity. Innovation does involve technology and business risk. However, a globally-diversified, active approach across asset classes—from early-stage to infrastructure to agriculture—can offer investors a means by which to achieve meaningful returns and make a real impact in addressing the most pressing issue facing our planet today.

[4] Source: https://news.energysage.com/solar-panel-efficiency-cost-over-time/

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Many countries have experienced outbreaks of infectious illnesses in recent decades, including swine flu, avian influenza, SARS and the 2019-nCoV (the "Coronavirus"). In December 2019, an initial outbreak of the Coronavirus was reported in Hubei, China. Since then, a large and growing number of cases have been confirmed around the world. The Coronavirus outbreak has resulted in numerous deaths and the imposition of both local and more widespread "work from home" and other quarantine measures, border closures and other travel restrictions, causing social unrest and commercial disruption on a global scale and significant volatility in financial markets. In March 2020, the World Health Organization declared the Coronavirus outbreak a pandemic.

The ongoing spread of the Coronavirus has had, and will continue to have, a material adverse impact on local economies in the affected jurisdictions and also on the global economy, as cross border commercial activity and market sentiment are increasingly impacted by the outbreak and government and other measures seeking to contain its spread. The global impact of the outbreak has been rapidly evolving, and many countries have reacted by instituting quarantines and restrictions on travel. These actions are creating disruption in supply chains, and adversely impacting a number of industries, including but not limited to retail, transportation, hospitality, and entertainment.

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CRC 3012130 Exp. 03/25/2021 9824785_KC_0320
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