A nuanced approach to building climate aligned portfolios

If it feels like talk about climate change is everywhere – it is. Media mentions in 2021 were three times higher than in 2020[1]. Over the past five years, one fifth of the world's largest companies and 61% of the highest polluting countries in the world made net zero commitments[2]. And investments in climate tech have increased five-fold over the past decade[3].

So, it's not surprising that the topic of climate investing is coming up more often in your meetings with clients.

The process to build a climate focused portfolio has many of the same elements as building a traditional investment portfolio. You work with your clients to establish their goals, develop a strategy to achieve those goals, find the right investment opportunities, and report back on progress over time. However, there are nuances to consider when building a portfolio focused on climate.

Nuance 1: Understand not only the financial goals your clients are seeking, but also the specific climate investing goals

Saying you want to invest in climate solutions is like saying you want to buy a house. Everyone has their own list of must haves, wants, and deal breakers and there are an almost infinite number of ways to achieve that goal. To help you narrow the scope for your clients, we've found that there are three commonly pursued goals for climate investing – **mitigation, resiliency, and alpha.**

Mitigation is investing specifically to reduce, prevent, or remove heat-trapping gas emissions in the atmosphere and includes investments in sectors such as renewable energy, electric vehicles, and biofuels.

Resiliency is investing to help vulnerable communities and economic systems adapt to climate impacts and includes investments in things such as sustainable small-scale agriculture, smart electric grids, and flood resistant water infrastructure.

Alpha is investing primarily to boost returns and reduce volatility from climate-related risks and includes investments such as low carbon intensity portfolios, electric vehicle infrastructure, and carbon credit generation.

Helping your clients identify their specific climate investing goals will help you pinpoint the right types of investment opportunities to explore.

1. https://www.mediamatters.org/broadcast-networks/how-broadcast-tv-networks-covered-climate-change-2021
2. https://eciu.net/analysis/reports/2021/taking-stock-assessment-net-zero-targets
3. https://www.pwc.com/gx/en/services/sustainability/publications/state-of-climate-tech-2020.html

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Nuance 2: Building a climate portfolio can take time and having a plan to help your clients make the transition is key

Many investors interested in climate investing start their journey by aligning their public investments with their climate investing priorities. Investors can pursue strategies such as divesting from fossil fuel companies, purchasing green bonds, and investing with fund managers who have a proven track record of engaging with companies to improve their environmental practices. Taking this first step is a great way to better understand the opportunities and risks presented by climate investments and help your clients understand how their capital can drive change.

Once your clients are comfortable with what they're doing in their public assets, they can pursue more direct impact through private strategies. With private investments, clients can help fund businesses scaling climate solutions, own clean energy assets, or catalyze transformative climate technologies. Private market investments also allow additional layers of diversification, downside protection, and return upside to otherwise public portfolios.

Finding, diligencing, and monitoring opportunities to meet these objectives is often harder for you and your team. Information isn't as widely available and evaluating these opportunities requires specialized expertise. The spread in returns across private equity funds is much larger than public equity funds, putting an increased importance on quality due diligence. Advisors with clients looking to build a fully climate focused portfolio often either hire staff and build solutions and expertise in-house or work with a sub-advisor to support their clients' needs.

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Nuance 3: These are not set it and forget it portfolios – finding the right investments and evaluating impact over time is part of the learning journey

There is no one right way to build a climate focused investment portfolio – every client is going to have their impact goals and their own asset allocation, risk, and liquidity requirements. The good news is that there are investment funds and vehicles in nearly every asset class that allow investors to invest in climate solutions aligned with their impact and financial priorities. Three examples can be found below.

"I want a daily liquid climate portfolio"

- Fossil-fuel-free public equities with active shareholder engagement
- Fixed income contributing to climate solutions

"I want direct climate impact in private markets without sacrificing return"

- Cleantech venture fund
- Sustainable food and agriculture technology venture fund
- Scale sustainable real asset platforms that focus on alternatives to address climate change
- Investing in and managing utility-scale renewable energy and battery storage projects

"I want additional climate impact not reached by market-rate capital"

- Pre-seed fund investing in hard-tech start-ups with major climate potential
- Nonprofit fund providing support to smallholder farmers
- Finance the transition to more sustainable agriculture practices in the United States
- Critical pre-construction financing to clean energy projects
- Community solar fund provides below-market financing to communities of color

When evaluating success, it's important to evaluate both financial returns as well as progress toward your clients' impact goals. Adding impact reporting to your yearly client reporting package is a great way to revisit your client's impact goals and help guide discussions about future portfolio recommendations.

Working with your clients to set up a climate focused portfolio can be a rewarding and engaging journey – one that can help you delight and retain existing clients and position your practice for future success.

CapShift works with financial advisors to source, diligence, and report on impact investments. We have both a technology platform to allow advisors to easily find rigorously researched impact opportunities and a sub-advisory practice to help you build custom impact solutions for your clients. To begin a conversation, reach out to us at hello@capshift.com or check us out at www.capshift.com