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Funds Say Climate Change Is Now Part of Their Investing Equation

Investing with climate change in mind is increasingly seen as a way to earn the highest returns and avoid risks

Brian Deese, above, is global head of sustainable investing at BlackRock, which has launched an array of sustainable equity ETFs. **PHOTO:** DAVID PAUL MORRIS/BLOOMBERG NEWS

By Georgi Kantchev and Sarah Kent

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Abu Dhabi's $800 billion sovereign-wealth fund recently added a new question to its investment process: How will the Earth's changing climate affect a potential asset's price?

This addition, without fanfare or press release, was driven, fund officials say, by a fiduciary duty to earn the highest returns and avoid risks. It wasn't an attempt to brand the fund as more "green."

From huge sovereign-wealth funds and hedge funds to startup private-equity groups to mutual funds and exchange-traded funds, asset managers and investors increasingly believe there are profits to be made and losses to be avoided by considering how climate change—and government efforts to combat it—might affect companies and industries over the long term.

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Rather than a mere window-dressing exercise conducted for the benefit of conscientious investors, investing with the environment in mind is now seen as a way to gain an edge. Funds are pouring billions of dollars into technologies and industries they think will benefit from a transition to a clean-energy world and avoiding those that are likely to be hurt by it.

“Climate change is the growth story of our lifetime,” says Martina Turner, who four years ago launched the $36 million Accessible Clean Energy Fund, which invests in a basket of around 30 stocks focused on energy efficiency and storage, as well as wind, solar and geothermal energy. “We’re not ideologically driven, we’re not philanthropists. We want to make money,” says Ms. Turner, whose fund is up around 20% this year through April and has returned 22.5% since its inception.

Historic shift

The total value of funds that have integrated environmental, social and governance (ESG) factors into their investment process has more than quadrupled since 2014, rising to $485 billion as of April, according to data provider EPFR Global. That figure includes funds aimed at both individual and institutional investors, but it represents only part of the broader climate-change investing universe, as many funds that aren’t labeled ESG also are investing with the climate in mind, analysts say.

Climate investing is essentially a bet on a major repricing in markets due to historic shifts in how we drive, heat our homes and regulate our industries. Areas that stand to prosper span a broad swath of industries from renewable energy to transport, and from green architecture to agriculture.

Oil and coal companies, on the other hand, could lose out as investors fear the risk of “stranded” assets if electric cars pick up pace or governments crack down on fossil fuels. And some big investors are looking at which industries will be most affected by new rules and regulations, betting, among other things, against plastic-bag makers.

Of course, climate investing isn’t without risk. Investing propositions often hinge on political will and global action, which can be difficult to predict. After some governments started cutting subsidies for renewable energy earlier this decade, for example, shares of renewable-energy companies fell.

Still, funds big and small are jumping on the climate-investing bandwagon.

BlackRock Inc., the world's largest asset manager, with more than $6 trillion under management, has in recent years launched an array of sustainable equity exchange-traded funds. It also is working with clients to build a portfolio focused on companies that are likely to be winners in a transition to a cleaner-energy future.

WHEB Asset Management, a London-based fund manager focused on sustainability, invests in themes such as water management, sustainable transport and cleaner energy. An early win included an investment in LED lighting. Now the fund is focusing on technology that digitizes manufacturing, aiming to improve energy efficiency.

The fund avoids sectors such as oil, gas and coal that are likely to suffer or face severe disruption as a result of efforts to curb climate change.

"This isn't an ethical framing," says Seb Beloe, a partner at WHEB. "These industries are fundamentally at risk and looking at a future with capital destruction. We want to see cash and returns," he says.

Climate-related investing also is getting a boost from activist investors.

Jana Partners LLC is best-known for heckling management over board composition and business structure. It made waves in 2017 by helping to prompt Amazon.com Inc.'s roughly $13.4 billion acquisition of Whole Foods Market Inc.

Now Jana is looking to set up a fund to pressure companies on issues such as climate change, betting it can add value for shareholders by doing so.

"The bet we're making is that we can find companies that aren't doing everything they should be doing, buy them and get them to do better," says Charles Penner, a Jana partner involved with the new fund. "We think we can show you can generate outperformance by doing that."

Who has an edge?

Reima Rytsölä, chief investment officer of Finnish pension fund Varma, is looking for climate opportunities inside traditional industries—such as paint.

Varma, which manages €45.4 billion ($51.1 billion), has invested in a big paint company that created a new type of coating that makes marine vessels more energy efficient. Mr. Rytsölä bets that as the shipping industry faces intense government pressure to reduce its carbon footprint —if it was a country, it would rank as the sixth-largest greenhouse-gas emitter world-wide— demand for efficiency-enabling technologies will grow.

"We're trying to pick companies that have an edge inside more traditional sectors," he says. "We might be a bit boring that way...but climate change is affecting every industry."

Varma says it has cut the carbon footprint of its portfolio 27% in the past two years by withdrawing from oil and coal.

"We don't consider it a trade-off with returns," Mr. Rytsölä says, adding that while such strategies sometimes take time to come to fruition, "in the long-run, this is the only way to generate returns."

With climate, like any other investing opportunity, it comes down to basics.

"You still have to be very careful about the business models, about the fundamentals," says Lucas White, portfolio manager of the $117 million GMO Climate Change fund. The fund, launched in 2017, invests in companies that either help mitigate climate change—like clean energy or smart grids—or firms that aim to help the world adapt. "I can't guarantee that we're going to be the ones who get it right. But someone is gonna get it right and make a lot of money."

— Bradley Hope, a reporter for The Wall Street Journal in London, contributed to this article

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