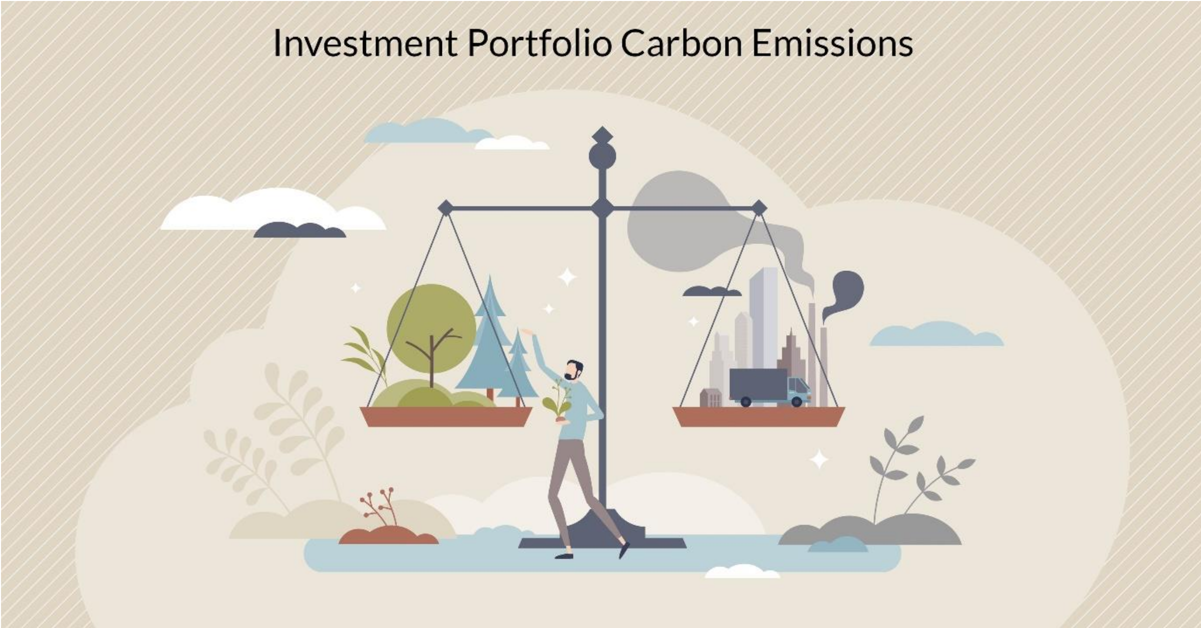

Impact Cubed

BEING SHORT (CARBON) WITH THE FAMILY

It's estimated that family offices represent more than $400bn in assets under management globally. That's a significant amount of capital that can potentially be deployed to sustainable investments that have a positive impact.

Of course, if investors aren't willing to explore sustainable investing, then the size of their collective AUM is moot. Fortunately, CIOs at family offices can be agile and have shown themselves to be innovators. This is a cohort that was an early adopter of hedge funds and traditionally hasn't been afraid of seeding up-and-coming managers or innovative investment strategies.

Put these ingredients together, and it's clear that family offices have tremendous power, and this influence could well be used to invest for a low-carbon future.

Climate change is a top impact theme for family offices

One of the top impact themes favoured by family offices is climate change, with over half of those surveyed saying that climate change has already influenced their investment choices. Families may not wish to see their wealth financing high-polluting companies – particularly if the desire is for younger generations to be more involved and engaged in wealth planning and succession.

Portfolio carbon emissions

Family offices typically invest in a diverse set of strategies. When it comes to climate, each of these portfolios will have carbon emissions from the companies that are being financed. Tally these together and you get the overall portfolio's financed carbon emissions.

Lowering a portfolio's financed carbon emissions - or at least measuring and understanding them – can have a positive impact and it's also good risk management. As carbon taxes and policies become more commonplace, high carbon emitting companies will be faced with increased costs and regulatory constraints. So too does sovereign debt issued by countries with large oil reserves. The world's economy is transitioning to new low carbon technologies where companies will either be winners or survivors as this transition plays out. CIOs at family offices who understand these implications will be better positioned.

Another trend is that asset managers are committing to reduce portfolio emissions, with over 200 set to achieve net-zero portfolios by at least 2050. A net-zero portfolio means it has zero financed carbon emissions.

How do investors get to net zero?

Investing in companies that are reducing real economy emissions and investing in climate solutions are great options.

But carbon offsets - for example preserving a forest so that it can't be cleared - are often floated as a solution to getting to net zero. These, however, can be expensive. Let's say a portfolio has 300 tonnes of carbon per million dollars of market capitalization. The price of a voluntary carbon offsets varies, but for argument's sake we'll use a cost of $5 per tonne. Doing the maths, a manager would have to pay 1.5 bps every year in fees to offset emissions for a $100m portfolio.

Other ways to get to net zero portfolio emissions are with a low carbon overlay to an equity index or a long/short strategy. In other words, buy the "green" companies providing climate solutions and short the "brown" highly carbon polluting ones.

This long/short approach to reducing financed emissions has growing support. For example, Harvard University's endowment has put forward its rationale, explaining that they subtract the carbon from stocks they are shorting from their long positions. In such a trade, two parties have exposure to the shorted company's carbon emissions: the original owner and the party the short seller offloads the borrowed security to. The stock's overall carbon emissions won't have changed. But the carbon accounting is correct when the long positions and short positions are tallied this way.

Of course, getting to a low carbon economy will require real world cuts in carbon emissions from companies' operations – not just net zero portfolios. But adding short selling in the impact investing toolkit makes sense because it increases the cost of capital for companies that have high carbon emissions. Family offices, with their history of being influencers and innovators, can adopt such a strategy to reduce climate risks in their portfolios and help sway the cost of capital towards red for polluters.

ABOUT IMPACT CUBED

Impact Cubed provides ESG analytics and investment solutions for building more sustainable portfolios with greater impact. It combines an award-winning approach to integrating impact into risk and return with technology-enhanced portfolio design and management. The outcome is a seamless approach to customised sustainable investing.

You can find out more about our data and portfolio models at www.impact-cubed.com and if you would like to contact us at info@impact-cubed.com we would be happy to hear from you.