Decarbonisation: investing in the transition to a cleaner world

Revisiting the case for an allocation to global listed infrastructure

The investment case for an allocation to listed global infrastructure in well-diversified portfolios is becoming increasingly well-understood as investors look for solutions to meet the challenge of persistently high inflation, slowing growth and a period of tightening financial conditions.

An allocation to listed infrastructure also exposes portfolios to potential long-term sources of growth in the form of some of the most important structural trends playing out in the global economy. These include climate change, the rise of the digital economy and the modernisation of global supply chains, an increasingly important theme in the Covid aftermath and as the war in Ukraine continues to play out.

By far the most urgent of these is the race to decarbonise the worlds energy sources as the effects of climate change become increasingly obvious through extreme weather events and wildfires.

IRA: the most significant piece of climate change policy passed in the US

That urgency is being increasingly felt by politicians. In the United States, President Joe Biden signed the Inflation Reduction Act (IRA), a slimmed-down version of his Build Back Better proposal, into law in August. While the IRA will likely have little meaningful direct impact on inflation, it is nonetheless the most significant piece of climate change policy ever passed in the United States.

The IRA will see US$369 billion of investment into energy security and climate change programs over the next ten years. Our global listed infrastructure manager Cohen and Steers (C&S) sees the IRA as a net positive for listed infrastructure with favourable tax credits providing a significant tailwind for utilities and renewable energy.

This will likely speed up the necessary transition from fossil-fuels to renewable energy. C&S believes that while US infrastructure companies have already been ramping up their decarbonization efforts, they believe these additional incentives should facilitate and accelerate further the reduction of carbon emission levels.

But despite growing broad political and regulatory support for the renewable transition, this transition will still take several decades to achieve.

Defining an investment approach to decarbonisation: exclude or engage?

Given rising awareness of and client demand for greater integration of principles of sustainability (ESG) into portfolios, we have had to think long and hard about our investment approach to energy and how we best support the transition to a greener world within our portfolios.

That question inevitably boils down to two approaches: to engage with companies to influence meaningful change, or to exclude them from the portfolios.

Many investors are choosing a divestment and exclusion approach to climate change (and indeed other "bad" sectors or firms) by avoiding investment in carbon-intense firms. The theory is divestment and exclusion will raise the cost, and ultimately starve them of capital, thus speeding up their demise.

We think about it differently. We believe we need to continue to invest in energy to support the necessary energy transition. By excluding companies based on their current carbon footprint, you deprive those companies or industries the opportunity to transition to a more sustainable business model. Investors then miss out of potential returns.

Divestment may do nothing more than shift the ownership of carbon intensive assets from one owner to another. While your portfolio may be less carbon intensive, but you have achieved nothing in the real economy.

Exclusion also means losing the opportunity to engage and influence change. This is especially the case if starving a company of capital forces them into private hands without the scrutiny and need for transparency that comes with being a publicly-listed company.

Active investment with meaningful engagement

In our view, the best approach to supporting the energy transition is to remain active investors, employing a high engagement model with an underlying manager of sufficient scale for that engagement to be meaningful.

Our philosophy is in line with many international investment experts and sustainable benchmark providers, who counsel that there is little value in "missing the transition" by taking an exclusions-only approach, and that participating through carefully placed capital provision to sustainability-aware businesses is far superior both in terms of environmental efficacy and investment strategy.

In that way we aim to help allocate capital to support the development of new technologies and industries, for the benefit of our clients and the planet.

Salt Sustainable Global Listed Infrastructure: Stock Stories

NextEra Energy is one of the largest positions in the portfolio. NextEra is the largest developer of renewable assets in North America, with more than 20GWs of operating capacity and a backlog of 18GWs in wind, solar and battery storage projects. NextEra's generation fleet has 47% lower CO2 emissions per MWh than the average for the US utility sector. NextEra is also a pioneer in hydrogen projects including Monolith Nebraska and Infinium.

Clearway Energy is an example of a pure play renewable energy investment within our portfolio. Clearway is one of the leading US-based renewable energy operators with a top 10 position in both wind and solar ownership in the US. Clearway has access to one of the largest renewable energy development pipelines in the world through its parent, Clearway Group, with over 19GW of projects in queue. Clearway has committed to 100% of its future growth coming from renewables and has recently sold a fleet of thermal energy facilities in order to redeploy the proceeds into renewable development. According to the July 2020 Ceres Report, Clearway has one of the lowest carbon emission rates amongst the top 100 electric power producers in the US (13th lowest out of 100). In 2021, 91% of the electricity Clearway generated was produced from emission-free resources. Total generation amounted to more than 12.5 million MWh of clean, carbon-free power – enough to power more than 1.7 million homes.

Norfolk Southern Corporation is one of the US' premier transportation companies. They connect customers to markets and communities, to drive economic opportunities, with a focus on safe, reliable and sustainable solutions. Earlier this year they received two Sustainability awards for their efforts in carbon reduction. The first award recognised the launch of a next generation carbon calculator to support customer efforts to account, measure and mitigate carbon emissions in their supply chain decisions. It is recognised that Rail is the most efficient way to transport freight across the US landscape. Their second award was for their issuance of a $500m green bond. Funded projects include locomotive fuel efficiency improvements and investing in intermodal terminals to further promote the shift of freight from trucks to trains. Not only does the green bond fund investments help customers reduce their supply-chain emissions, it also contributes to their company's science-based emissions targets.