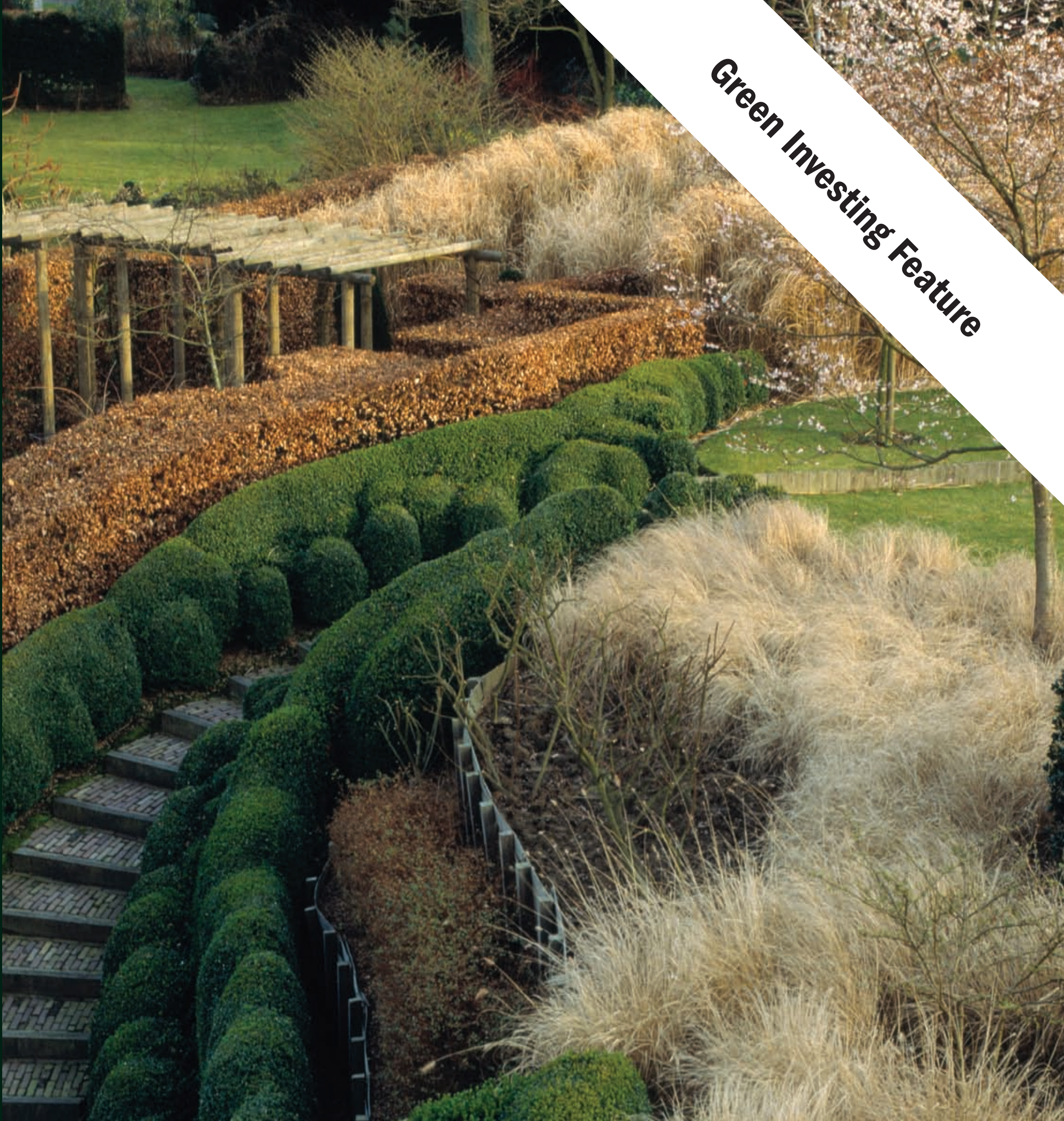
Green Investing Feature



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Merrill Lynch

# World Wealth Report

2008

## Green Investing Gains Traction in 2007

As the world community has grown more attentive to environmental concerns, such as global warming and climate change, the presence of related investment opportunities has greatly increased, driving robust growth of green investing in 2007. Whether perceived as an investment opportunity or a responsibility of global citizenship, overall participation in green initiatives has risen rapidly in recent years due to the fundamental need for sustainable development, and, as a result, the undeniable growth potential of the green sector. Furthermore, it seems the era of economically viable green power has finally arrived, as the impact of soaring oil prices on consumer attitudes and the widespread acceptance of global warming implications converge. Individuals, businesses and governments alike are actively pursuing the integration of green initiatives into everyday systems and investment strategies, adapting to and preparing for what is quickly becoming the way of the future. Capitalizing on the fundamental strength of demand for green initiatives, the investment community has been particularly invigorated by the attractive financial returns of green investments that have accompanied the already appealing environmental and social benefits generated.

### More Investors Bet on Green

In much greater size and proportion than in recent years, investors have been supporting innovative research and development initiatives in search of alternative fuels, renewable energy and other advanced technologies. Today, investors are presented with many vehicles through which to back green initiatives, such as mutual funds, ETFs and other pooled products or alternative investments. In 2007, these investment vehicles drove robust growth in green sectors. For example, total investment in the clean technology sector increased to US$117 billion in 2007, up 41% from 2005,[114] with particular strength in the wind and solar segments. In fact, in the three years ending November 2007, gains in the wind segment exceeded 300%, while solar posted the highest growth in 2007, roughly 150%.[115] Furthermore, the solar segment produced the highest proportion of IPOs of any green sector over the course of last year, including the Merrill Lynch-led US$6.5 billion issuance of Iberdrola Renovables, the world's largest renewable energy company.[116] Despite being burdened by poor overall market conditions in late 2007 and early 2008, green investing trends have been driven by an underlying commitment to sustainable development, which takes profit incentives into consideration alongside social responsibilities. As a result, the sector will likely weather short-term fluctuations and deliver strong returns in the long run.

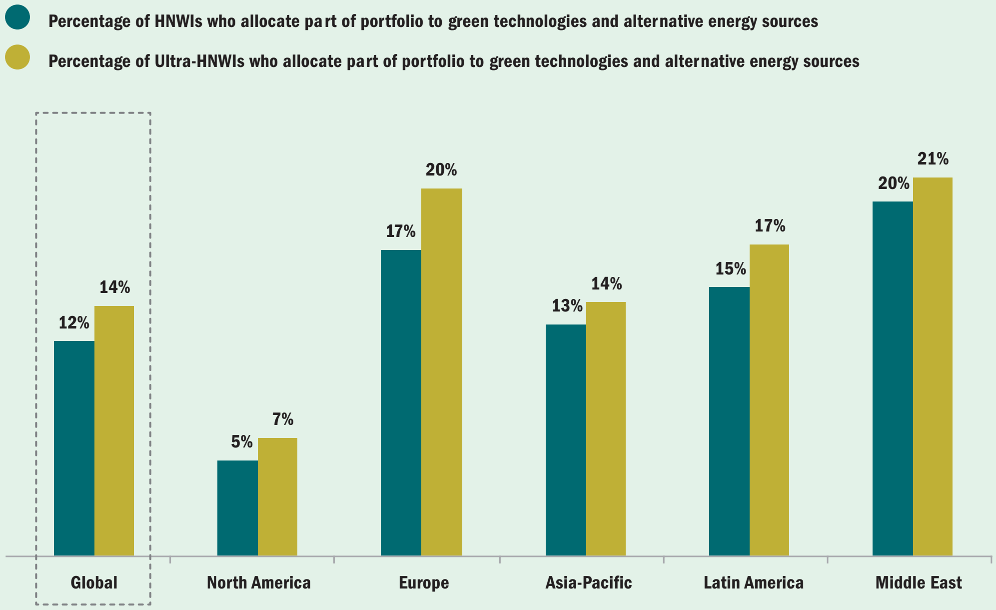
Venture capital has played a leading role in green investing throughout North America and Europe, as investments in the sector reached nearly US$5.2 billion in 2007, up from US$3.6 billion in 2006 and only US$714 million in 2001.[117] In 2007, US$3.9 billion of venture capital was invested in the United States in green technology, of which roughly US$1.8 billion was invested in California alone—accounting for approximately 45% of all green investments in North America.[118] Given the greater freedom with which individuals, relative to institutions, can allocate their assets, venture capital has flowed largely from wealthy private clients as opposed to stringently controlled institutional investors. In addition, private equity firms will likely play an increasingly active role and represent another important investing outlet as innovative technologies continue to emerge. Also, many top-tier banks showed heightened involvement in green stock market listings in 2007—Credit Suisse, Merrill Lynch and Morgan Stanley set the pace, handling deals worth US$2.8 billion, US$2.4 billion and US$2.3 billion, respectively.[119] Financial institutions of all classes are quickly realizing the growth potential of the green sector and are acting accordingly to secure an early stake in the market.

### Heightened Interest Drives New Market Opportunities

Scientific evidence today overwhelmingly points to a massive expansion in greenhouse gases as the foremost consequence of rapid industrialization and driver of climate change. The widespread acceptance of such theories has warmed the international political climate to broader environmental issues and, as a result, has encouraged the general public to integrate green standards into their personal and professional lives. Informational broadcasts by the mass media and documentaries, such as Al Gore's *An Inconvenient Truth*, have raised public awareness of the global impact of everyday activities and habits and driven greater appreciation of the need for green initiatives. As a result, heightened public awareness has reshaped business dynamics and raised expectations for government and business endeavors, creating significant opportunities for future growth.

[114] "Folding green: the investment boom," *The Observer*, February 24, 2008
[115] "Green Light for Renewable Energy," *Davy Research Report*, November 2007
[116] "Is 'green' power money misguided? Market is booming, but dot-com memories make some worry business of green," *International Herald Tribune*, March 1, 2008
[117] "Green tech investments growing fast," *The San Francisco Chronicle*, January 17, 2008
[118] Ibid.
[119] "Is 'green' power money misguided? Market is booming, but dot-com memories make some worry business of green," *International Herald Tribune*, March 1, 2008

*Figure 10.* | **HNWIs' and Ultra-HNWIs' Interest in Green Investing, 2007 (by Region)**




Source: Capgemini/Merrill Lynch Financial Advisor Survey, April 2008

Governments across the globe have played an active role in stimulating the growth of green initiatives, paving the way for lucrative market opportunities. Depleting fossil fuel reserves, volatile fuel prices, energy security worries and emission concerns are some of the key factors that convey the international nature of the issues at hand and, to date, have driven aggressive government advocacy of green initiatives.[120] European powers have been long-standing leaders and pioneers of green initiatives. In January 2008, Norway made an extraordinary pledge to be "carbon neutral" by 2030, such that it would generate no net greenhouse gases into the air.[121] Despite concerns regarding carbon neutrality and the practice of offsetting domestic emissions with contributions to emission-reduction schemes abroad, Norway represents the high ambition necessary to bring about meaningful change. Britain may become the first country in the world to introduce legally binding $CO_2$ reduction targets if a climate change bill, aimed at reducing the country's emissions 20% by 2010, is passed, as expected, in summer 2008.[122] In the United States, state-level policies, tax credits and cost-recovery systems are among the incentives that have been offered to encourage innovation. However, Abu Dhabi is exploring, arguably, the most ambitious plan of all: to create the world's first carbon-neutral metropolis.[123] Intended to host 100,000 inhabitants and likely to absorb billions of investment dollars in clean technology initiatives, this futuristic project illustrates Abu Dhabi's resolve to be a pioneer of post-oil alternatives, and is drawing significant global media attention. As climate change and other environmental concerns take center stage in the global arena, government bodies have demonstrated a keen interest in advancing even the most daring green initiatives in order to induce meaningful change and secure future economic and political stability.

Businesses "go green" in an effort to adapt to changing market dynamics and capitalize on growth opportunities, as heightened public interest redefines the rubrics by which companies are evaluated and governments raise the incentives to participate in environmentally conscious endeavors. A flurry of start-ups has sprouted in search of innovative technologies and other alternative solutions they hope will meet the fundamental needs critical for sustainable economic growth. Developing anything from online dashboards that monitor environmental activity in buildings (e.g., energy and water usage) to real-time tracking of transportation systems through GPS and mobile phone networks to improve efficiency and cut fuel costs, to thin-film solar panels that boast longer lifetimes at lower costs,[124] businesses are devoting resources to bring about improvements in all facets of daily life. Even the construction industry has fostered pioneering green initiatives that have altered the landscape of international building standards. For instance, the Leadership in Energy and Environmental Design (LEED) Green Building Rating System is a third-party certification program that has become an international benchmark for high-performance green building standards; it is currently being utilized in 41 countries, representing both mature and emerging ations.[125]

[120] HSBC, "The US Market, Global Natural Resources & Energy," December 3, 2007
[121] "Lofty pledge to cut emissions comes with caveat in Norway," *The New York Times*, March 22, 2008
[122] Heather Green and Kerry Capell, "Carbon Confusion," *BusinessWeek*, March 17, 2008
[123] Stanley Reed, "Guess who's building a green city," *BusinessWeek*, December 24, 2007
[124] "The most promising green tech startups," *Green Wombat*, October 30, 2007
[125] U.S. Green Building Council, "LEED Rating Systems," www.usgbc.org, accessed April 28, 2008

Around the world, scientists and entrepreneurs have been fusing creativity with abundant resources to extend green initiatives beyond their current reach. Business mogul and social activist Richard Branson hosted a private conference in early 2008 on his remote Caribbean island, Necker Island, to discuss with world leaders and other business executives possible green initiatives that would bring about both meaningful change and lucrative returns.[126] Efforts aimed at expanding the scope of alternative solutions are quickly increasing in number as individuals and companies of all backgrounds have been converting environmental and social concerns into actionable business opportunities in new and innovative ways.

Globally, consumers increasingly favor "environmentally friendly" products and more prudent green standards, putting pressure on businesses to meet new market demands. Even traditional industries have realigned their strategies to incorporate green initiatives in recognition of more sophisticated consumer expectations. Among others, the likes of Siemens, Wal-Mart and GE have executed mergers and acquisitions of green pure-plays to augment their own internal environmental-sustainability initiatives. Introducing environmental considerations to business decision processes has become increasingly important and, as a result, businesses across the globe have demonstrated concerted efforts to adapt to a changing global environment.

## HNWIs Attracted to Growth in Green Investing

Green investing encompasses a wide range of industries, making the classification of applicable investment products quite subjective. Furthermore, green investments often match very different criteria and include anything from "best-in-class" oil rigs to true pioneers of clean technology. As a result, the green investing market is difficult to size. However, trends evident in the broader Socially Responsible Investing (SRI) category—which encompasses environmentally and socially screened assets—provide useful insight into the narrower green universe. Institutional investors and HNWIs held more than 70% of the US$2.71 trillion SRI assets under management in 2007, representing an increasingly attractive target for financial institutions and advisors. Given the high development risk associated with the sector, green investing caters largely to institutions and HNWIs—more sophisticated investors willing to assume greater financial risk in hopes of high returns.

Roughly 12% of HNWIs and 14% of Ultra-HNWIs around the world allocate part of their investment portfolio to green technologies and alternative energy sources.[127] Regionally, the most environmentally attuned HNWI and Ultra-HNWI populations, as measured by the percentage of affluent investors allocating to green investing, were found in the Middle East and Europe—with participation rates ranging from around 17% to 21% in 2007, all exceeding global averages. By comparison, only 5% of HNWIs and 7% of Ultra-HNWIs in North America allocated part of their portfolio holdings to green investing. It is interesting to note that North America was the only region in which social responsibility was the primary driver of HNWIs' green investing. Among all HNWIs worldwide, approximately half pointed to financial returns as the primary reason for their allocations to green investing. The combination of lucrative returns and social responsibility underpin the rising popularity of green investing among HNWIs across the globe.

## With Future Sustainability at Stake, Green Investing Will Grow

Investors, businesses and governments can no longer ignore the realities of climate change and other environmental risks. Therefore, all are looking for ways to systematically integrate eco- and sustainable investing into their moneymaking decisions.[128] Amid government efforts to promote and reward the pursuit of green initiatives, and the increasing dependence of corporate profitability on sustainable development, green products will be more commonly incorporated in households and businesses on the premise of practicality and efficiency gains. Furthermore, the sheer size of the energy market, estimated at US$6 trillion,[129] coupled with the fundamental need for energy to drive economic growth, underpins the long-term, global security of green investing, even though higher levels of risk are often associated with nascent marketplaces, such as the green sector. Ultimately, the unilateral pursuit of economic progress against a backdrop of sustainability will be driven by consciously aligning investment choices with values and concern for the environment.

[126] "On an island paradise, talking about global warming's silver lining," *The New York Times*, March 22, 2008
[127] 2008 Capgemini/Merrill Lynch Financial Advisor Survey, April 2008
[128] "Personal wealth: Profiting from climate change," *The Edge—Singapore*, July 16, 2007
[129] "Environment—Where the money is," *The Wall Street Journal*, March 24, 2008

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