CIO believes investors should take advantage of the rapid evolution of the sustainable investing universe. (UBS)

US-China climate talks highlight opportunity for investors

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Climate negotiators from the US and China have reached "understandings and agreements" that should result in progress at the COP28 talks later this month, according to US climate envoy John Kerry.

Kerry hosted China's Xie Zhenhua in California last week for four days of negotiations. Heading into the COP28 summit in Dubai, the market focus will likely be on any reduction in coal power production plans, higher spending, or support for renewable energy infrastructure, and efforts to fund countries most at risk of climate change, such as low-lying islands.

Alignment between the world's two largest carbon emitters is key to ensuring a meaningful consensus emerges from COP28 talks. As the focus intensifies on addressing climate risks, along with other sustainability issues, we see investment opportunities across asset classes and regions.

Investors can incorporate sustainability into both fixed income and equity parts of their portfolios. As a higher-quality credit segment, we expect thematic sustainable fixed income to continue to display a good degree of resilience in a growth slowdown, while current yields provide a buffer against the risk of a further rise in rates volatility. Multilateral development bank bonds provide slightly higher yields than US Treasuries (by 5–30 basis points across the curve), compensating for the slightly lower liquidity. This liquidity premium has historically led to a steady outperformance over the cycle.

"ESG leaders" strategies within equities focus on companies with top metrics across environmental, social, and governance criteria. Some empirical research supports a link between companies with better sustainability management and financial performance, and ESG leaders portfolios correlate strongly with "quality" factors, and typically enjoy valuation premiums.

With many innovative companies in key areas of sustainability not listed on public markets, investors can consider alternatives. We continue to think that education and biotechnologies (e.g., within virology) represent targeted opportunities in venture capital and growth equity. Investing in these technologies and early-stage innovative treatments also presents an opportunity for investors to engage in impact investing and drive positive, measurable change. As always with venture capital, we remain selective and focus on early-stage companies with credible financials and a clear path to exit. Of course, investors need to be willing and able to accept the risks entailed in locking up capital for longer.

We also see further opportunities for diversification with allocations to sustainable hedge funds, particularly within equity long-short along the energy transition theme, and with innovative uncorrelated strategies such as carbon trading. Manager selection remains key to sustainability and financial objectives within this space.

Together with innovative technologies, infrastructure is a critical enabler of the energy transition, food, and water security themes. According to the American Clean Power Association, over USD 240bn has been invested since the passage of the US Inflation Reduction Act in August 2022 (through June 2023). The size of this capital deployment is about the same as the past seven years' worth of US clean-energy investments alone. We think this development points to the significant capital that is likely to be deployed into infrastructure as part of the energy transition, including grid infrastructure and electricity transmission, and energy storage. The US Infrastructure Development Index has outperformed the broader US equity market by 1.7 percentage points year-to-date. We expect similar developments in Europe to accelerate following the EU Green Deal Industrial Plan for the Net-Zero Age (GDIP), which was introduced earlier this year.

So, we believe investors should take advantage of the rapid evolution of the sustainable investing universe. Sustainability can now be incorporated into investing across the full range of asset classes.

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