SUSTAINABLE INVESTING

The ESG sector encompasses $40 trillion in assets globally, and the label can be found on anything from an exchange-traded fund to a credit default swap. While it's a little more difficult to quantify private sector flows related to ESG, fund flows into ESG-labeled public market funds across equity and fixed income markets provide an interesting indicator of investor appetite for the sector. While there is still potential for greenwashing to impact these numbers, the direction of flows has continued to be positive.

Flows into fixed income ESG funds were flat in March after experiencing their first month of outflows in two years in February. A potential negative reaction to ESG may reflect the robust price action in commodity- and particularly hydrocarbon-linked investments over the past few quarters. Similarly, on the equity side, while broad market equity inflows slowed across the board by the end of the first quarter, the decline in ESG specific fund inflows was much more pronounced. These flows fell to their lowest levels since the pandemic began. Even markets that have seen steady interest, such as European ESG equity funds, saw outflows for the first time this quarter. We view these developments as temporary.

Geopolitical events in Q1, and the resulting impact across the commodity complex, have made it clearer than ever that fossil fuel dependence has created or exacerbated geopolitical instability. It's proving to be unsustainable in the long term – not just environmentally but socially, politically, and economically, as Germany is witnessing. Investors and policymakers alike are navigating a period of transition, with increasing renewable energy but also moves away from politically less reliable sources of hydrocarbons to more reliable energy sources in the US, Europe, and Asia.

For investors, tailwinds in energy transition and ongoing development and investment in adaptive technologies will continue to accelerate, providing more attractive investment opportunities and a boost to existing and ongoing advancements in the space. Longer term energy efficiency, renewable energy, and related sectors are the biggest beneficiaries from the aftermath of Russia's invasion of Ukraine, as this terrible tragedy has shed a light on the implications of fossil fuel dependence in a way that climate summits – including COP 26 – did not.

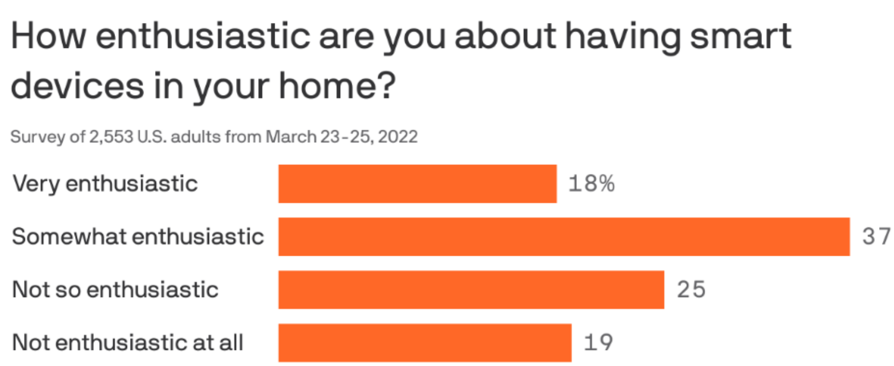
Interim solutions and paths to reducing fossil fuel reliance that were previously shunned by policymakers, stakeholders, and climate activists are coming back and now seem necessary for a faster transition. For example, discussions on the appropriate use of natural gas and nuclear power – always sources of complex debate – are returning to the forefront. A March 2022 Nikkei poll in Japan found that a narrow majority of citizens now support restarting idled nuclear reactors. The survey marks the first time in the decade since the 2011 Fukushima disaster that an increasing role for nuclear energy has been favored.

Some 53% said nuclear reactors should restart if safety can be assured, while 38% said they should remain shut. That's up from 44% support for nuclear restarts in a similar survey late last year. The opinion shift is likely a direct result of events in the first quarter that have negatively affected the energy complex, and it's no surprise that it comes amid surging power prices and warnings of electricity shortages in Tokyo.

Similarly, Germany has had to wrestle with the implications of diversifying away from Russian gas, which last year accounted for half of the gas the Germany used to heat homes and power factories and a third of the oil. The Green Party has been increasingly supportive of the possibility of extending the lifespans of coal and even nuclear plants to cut dependency on Russia. While this puts Germany's ambitious plans to exit from coal by 2030 in jeopardy, the country needs an immediate solution to the energy crisis that cannot be solved entirely by wind and solar. Germany has had a longstanding aim to shift entirely to renewable power sources by 2045, but given recent events, the Green Party has also promised to stockpile coal and gas reserves and build two new terminals to import liquefied natural gas from countries other than Russia.

Such shifts by major countries have made LNG projects more interesting. Carbon capture, together with increased natural gas production, may also increase in the short term. There are more opportunities in companies focused on the transition to green energy such as wind and solar power. Energy security, as well as food and water security, continue to be growing themes across RockCreek investments.

Interestingly, there is significant coordination between US and European government entities to help implement short term energy efficiency across everyday life. Smart homes have been a rapidly growing investment theme, including everything from devices to let households know how much energy they are consuming to technologies that encourage consumers to reduce their energy needs. Existing smart home devices such as programmable thermostats, energy monitors, eco chargers, and smart sockets are all the future of potential investment returns for smart devices. The transition to smart homes, as well as electric vehicles and other related areas, is proceeding quickly, with consumers slowly starting to digest the magnitude of the opportunity.



Source: Momentive; Chart: Thomas Oide/Axios