Three reasons for private investments in renewables

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Explore why CIO thinks private renewable energy infrastructure is key to achieving net-zero goals and offers potential portfolio benefits as an investment.

When it comes to supporting the transition to a low-carbon economy, investors need to be discerning. Renewable energy investments in listed stock markets have faced several recent challenges that may have dissuaded some investors from investing in the decarbonization theme. The MSCI Alternative Energy Index has fallen 32% over the five quarters to end March 2024, compared to an 8.2% climb in the MSCI World Energy index, as concerns about higher-for-longer rates and cost pressures have taken their toll.

But CIO thinks unlisted investments in renewable energy infrastructure—where investors use patient capital to gain exposure to long-term physical assets directly and with less sensitive to daily market swings—look increasingly appealing for investors. Here are three reasons why:

Renewables are crucial to achieving net-zero goals. We think private investments in renewable infrastructure will be pivotal in closing the infrastructure investment gap and meeting the ambitious net-zero objectives by 2050. With an estimated annual investment requirement of USD 2.6 trillion in green infrastructure, renewables such as solar, wind, and hydropower are essential for decarbonizing electricity generation, transportation, and heating/cooling processes. These investments directly contribute to global efforts in combating climate change and align with several United Nations' Sustainable Development Goals, including SDG 7 (Affordable and Clean Energy) and SDG 13 (Climate Action).

Government support remains a tailwind. The current market environment, bolstered by supportive government policies such as the Inflation Reduction Act in the US and the European Green Deal, creates a favorable landscape for private investments in renewables. These policies are designed to spur capacity expansions and enhance the economics and competitiveness of renewable projects. Despite challenges like inflation and rising capital costs, the sector continues to experience record annual spending and capacity additions, presenting a potential investment opportunity for far-sighted investors seeking financial returns alongside environmental impact. An additional catalyst for these assets may come from the AI revolution. For example, the International Energy Agency estimates that global energy consumption of AI and data centers could exceed 1,000 TWh by 2026—about the same amount of energy that Japan consumes today.

Private renewables infrastructure can provide potential portfolio benefits. Renewable infrastructure investments offer attractive diversification benefits within private markets allocations, exhibiting low correlation to other asset classes. We think these investments can act as a return enhancer and provide a stable source of income, with return estimates for renewable power assets ranging between 8% and 13% according to GSAM data. What's more, renewable infrastructure assets have shown resilience in the current macroeconomic environment. We think they can benefit from higher barriers to entry and stable cash flows often linked to inflation that appeal to long-term investors looking to put money to work across economic and business cycles.

So, CIO believes private infrastructure investments in renewables can help diversify sources of return, support long-term financial goals, and provide alternative, stable income streams that are often tied to inflation. This approach may also help investors achieve their sustainability and impact goals. However, investors should consider the risks inherent to private markets before investing, including illiquidity, long lockup periods, leverage, and over-concentration.

For more details, please see *Private markets: Investing in renewable energy infrastructure* (22 April, 2024).

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Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.