Rodney's Take

November 1, 2021

The Carbon Trade

The 26th (sort of) annual UN Climate Change Conference of the Parties, dubbed 26 COP UN Climate Change (or COP26), is underway in Glasgow, Scotland. The meeting gives participants a chance to beat the table about how things must change to save us from catastrophe… before they take private jets back to their mansions. It seems that if they were serious about the cause, they would meet virtually, saving their taxpayers the expense and the environment from their carbon emissions. Politicians might not recognize their own hypocrisy, but they surely will demand accountability from others.

Last week I wrote about the Next Big Thing in finance, which will be the cost of companies of all stripes clamoring to reach fuzzy carbon goals. I'm skeptical not because we shouldn't be good stewards of the earth, but because I think politicians, activists, and the media in general continually will move the goalposts. For many, we won't succeed until all energy is renewable and therefore all oil, gas, and coal extraction has ended. Such a time is a long way off, no matter what the talking heads in Scotland claim.

To appease the climate gods between now and then, companies will do their best to offset their climate footprints by retooling their operations and sourcing as much green energy as possible. But no matter what they do, it won't be enough. There will be some level of carbon emission that cannot be exorcised, which is why they will turn, either voluntarily or by requirement, to carbon credits and offsets.

The carbon credit market has been a sleepy corner of the investment world mostly inhabited by companies and brokers in industries that either produce or purchase such credits, but that's changing.

With concerns over climate change gathering steam and governments pledging to crack down on emitters, unrelated parties are getting in on the act. Hedge funds, institutions, and individual investors are piling into the new asset class and driving up prices.

The price of credits in the European Union Emissions Trading System, known as European Union Allowances (EUA), rose from $34 to $58 this year, up 73%, as interest soared. California Carbon Allowances (CCAs) and credits in the Regional Greenhouse Gas Initiative (RGGI) also marched higher. IHS Markit created a global index that tracks the futures prices in these three-carbon cap-and-trade programs, which gives investors a handy way to follow such prices. IHS Markit reported that at the first of the year, the global price of carbon was $24.05 per ton of CO_2, and it would need to be $147 per ton to meet the UN warming limit of 1.5°C.

Seeing the opportunity, KraneShares created the KraneShares Global Carbon ETF (Nasdaq: KRBN) in July 2020. The fund is up just over 50% so far this year and now holds more than $1 billion in investments. Just last month, Krane launched two more carbon offset funds, one that tracks just EUAs and another that tracks just CCAs. That seems like splitting hairs, but they likely will be successful. All three funds give regular investors the chance to step in front of corporate clients who must buy such credits to satisfy current and future emission regulations.

This has been a great market over the past 18 months, but investors should be cautious. What governments give, governments can take away. The authorities that developed the cap-and-trade systems can expand the number of credits available or change how they are priced with the stroke of a pen. IF EUAs consistently trade over $75, the European Union will issue more automatically. It's something to think about before jumping on the bandwagon.

I'm not yet ready to buy KRBN, but this space is likely to be a steady asset class for years to come.

Rodney

Got a question or comment? You can contact us at info@hsdent.com.