Key Recommendations for Asset Owners

Asset Owners nearly universally identify the energy transition as a secular trend, still in process, but set to impact asset valuations and business models in the coming years. AOs believe capital allocations in nearly all industries will undergo major shifts. They are leveraging longstanding approaches to investment decision making (i.e., risk/return tradeoffs) to navigate this trend within portfolios.

Their approaches to these changes may differ, but the challenges Asset Owners face are shared. Asset Owners clearly identified a knowledge gathering period – initially, and then in an ongoing manner – followed by implementation and investment. We share some best practices related to each of these below.

1. Knowledge

Given the global and multi-disciplinary nature of the energy transition, Asset Owners would benefit from enhanced knowledge in the below areas:

- **Develop Policy Expertise & Deeper Understanding of How Policy Impacts Asset Value**
  Given the critical role policy has played in shaping some of the exponential shifts involved in energy transition (as acknowledged by asset owners), we believe AOs would benefit from dedicated resources on this topic and deeper ongoing dialogue with policymakers. We believe a gap exists in understanding how policy developments may impact upon learning and scaling curves for key net zero technologies.

- **Increase Scientific & Technical Expertise**
  The AO community today has a high degree of literacy on the fundamentals of net zero and the energy transition. As the global marketplace moves towards implementation and deployment, AOs will need to develop deeper in-house climate expertise (e.g., scientists, modelers, geographers, demographers, etc.) to overlay their existing approaches with additional insights and upgrades.

- **Engage Deeply with The Sell-Side**
  There is a particular role for sell-side institutions to play as a convener across corporates, Asset Managers and Asset Owners as part of the energy transition. The investor community as a whole would benefit from deeper engagement between Asset Owners and the sell-side.

2. Investment and Allocation

As allocators of capital, there are 4 main recommendations we propose to AO, based on our conversations:

- **Increase Allocations to Private Energy Transition Companies**
  Very simply, the public market opportunity set for energy transition companies as of 2023 is limited (only ~200 companies), many of which are in the small or mid-cap space. One can also question the merits of delivering on the energy transition via secondary markets. Private companies present opportunities for both asymmetric return profiles and advancing progress towards clean energy targets. Given their time horizons, AOs could benefit from greater allocations to growth equity & venture opportunities.

- **Introduce Greater Flexibility in Overall Asset Allocation**
  AOs' asset allocation decisions will heavily influence the extent to which they are able to participate in the transition. Deciding the appropriate weight of private vs public assets or debt vs equity, real assets, and growth vs early-stage equity, among others are a crucial input in determining the extent to which AOs are exposed to various themes within the transition. A less rigid asset allocation approach may afford AOs flexibility and new opportunities in allocating towards the transition.

- **Reconcile Long Term Time Horizons with The Pace of The Transition**
  Although the change brought about by the transition may be exponential in nature, these trends are likely to play out over the medium-long term. Given the time horizons of many allocators, we believe greater patience will be needed on their part — performance will be uneven and at times down. In the long term, the collapse of certain industries and emergence of new ones should outweigh short term losses.

- **Develop Performance Measurement Aligned with A Transition**
  It is clear to Jefferies that product innovation is hampered by an obsession with measuring performance vs traditional benchmarks. Given the seismic shift the energy transition entails, traditional benchmarks do not accurately capture the ongoing transformation. Even those benchmarks focused on transition are unlikely to contain cutting edge companies and sector approaches to net zero, in an ever-evolving space. Penalizing managers when deviating from said benchmarks, even in the short term, inhibits the creation of innovative products with cross asset exposure.