Capital markets at the crossroads

Sustainable investing: Environmental focus

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Abby Joseph Cohen, CFA
Goldman, Sachs & Co.

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Sustainable investing

Environmental focus

Goldman Sachs' environmental, social and governance (ESG) research works to integrate ESG issues with industrial analysis and valuation on a sector-by-sector basis, and to identify investment themes related to alternative energy, water, and other emerging ESG issues.

Main themes for discussion

- Socially Responsible Investing (SRI) is gaining both momentum and a new acronym; "ESG" incorporates Environmental, Social and Governance issues

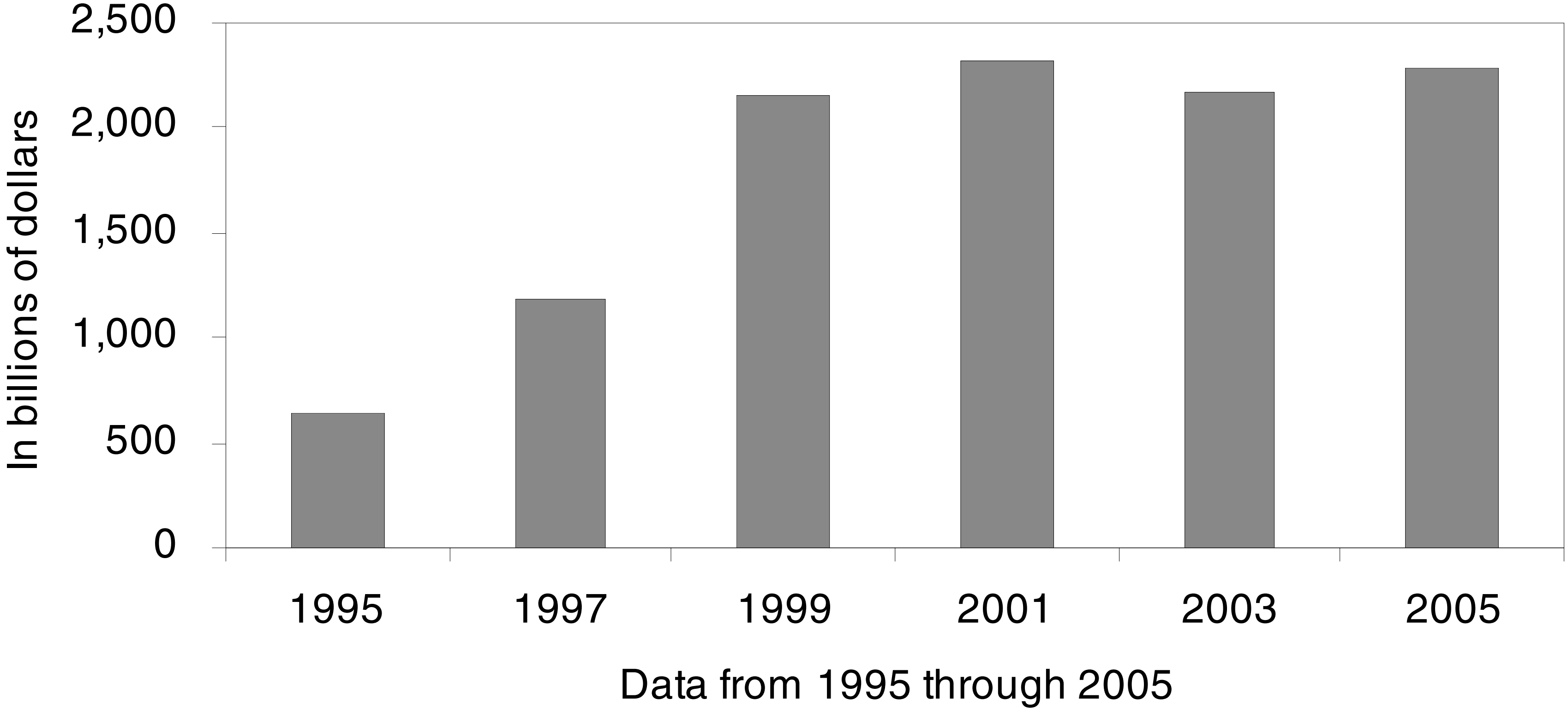
- For investors, it's not just about the environment, but also concern about fiduciary responsibilities

- Environmentally sensitive investing is cognizant of both risks and opportunities

- There can be dramatic impact from ongoing technological change and structural adjustments in the economy

Socially responsible investing strategies

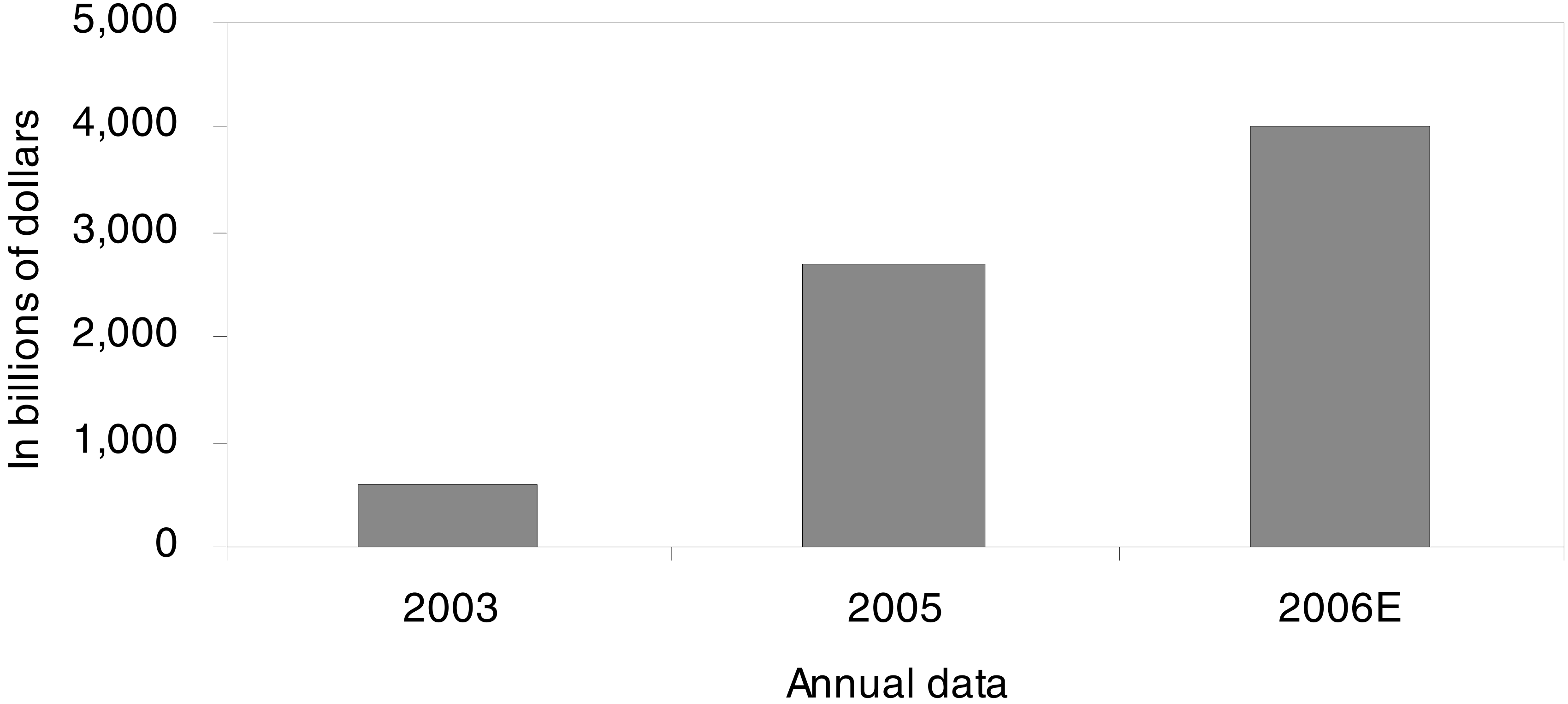
$2.29 trillion in total assets for 2005



Source: Social Investment Forum Foundation.

Assets controlled by INCR participants

$4.0 trillion in total assets for 2006E



Source: Investor Network on Climate Risk; CERES.

Examples of Exchange Traded Funds

Ticker	Name	Description
KLD	iShares KLD Select Social Index Fund	Uses an optimization technique to overweight and underweight companies based on social and environmental performance.
PBW	PowerShares WilderHill Clean Energy Portfolio	Comprised of companies that promote renewable and alternative energy.
CALVIN	Calvert Social Index	Broad-based, benchmark for measuring the performance of large US-based socially responsible companies.
KLD BMSI	KLD Broad Market Social Index	Socially screened companies within the Russell 3000. These companies are also included in KLD Broad Market Social Index.
DJSI STOXX	Dow Jones STOXX Sustainability Indexes	Consists of a pan-European and a Eurozone index, the DJSI STOXX and the DJSI EURO STOXX.

Source: SRI World Group, Inc.

Fiduciary responsibilities come first

- Pension fund managers must focus on providing strong returns for plan participants

- Until recently, there was scant evidence that environmentally sensitive investing generated favorable returns

- The “Eco-Efficiency Premium” may be increasing as more investors focus on these characteristics and they are more appropriately priced in the financial markets (Derwall, et al, 2005)

Climate change and investing

New opportunities will likely continue to develop

Investment vehicle	Commentary
Mutual Funds	According to the Social Investment Forum, there were 200 SRI dedicated mutual funds as of 2003. We anticipate that additional professional managers, although not necessarily adopting a pure SRI mandate, will increasingly incorporate environmental issues into their fundamental analysis.
ETFs	Several socially conscious and/or environmentally oriented funds have been developed in the past year.
Company-specific relative advantage	Companies that are better positioned for a carbon-constrained world could have a relative advantage vis-à-vis other companies in the same industry (i.e., potential factor in pair trade ideas).
Insurance	Demand for protection from weather-related property damage, health-related risks due to pollution, and D&O liability for inadequately addressing climate change threats will likely all increase.
Reinsurance	The ability to transfer and share the risk of loss from weather-related incidents will likely gain in importance
Carbon-emissions trading	In a cap and trade environment, carbon has a value placed on it by the emissions trading market. Investors with views on the price of carbon have a direct way of approaching this theme.

Source: Goldman Sachs Portfolio Strategy.

Goldman Sachs

Companies consider risks and opportunities

- Earlier focus was on participants in at-risk industries; the “usual suspects”
- More sophisticated approach considers environmental sensitivity in all industries and activities, including those that are affected
- Opportunities to “make green by being green”

Climate change risks and opportunities

The list will likely grow

Topic	Risk	Opportunity	Commentary
Reputation	X	X	Companies viewed as environmentally "friendly", even within troubled industries, likely to see their reputation enhanced as opposed to those companies that are viewed as being environmentally "unfriendly."
Regulation	X		Uncertainty surrounding potential future regulation at the Federal and/or State level introduces uncertainty for companies that are heavy emitters of GHG.
Litigation	X		As with Asbestos, the potential for liabilities to be realized at a future date is a real issue, especially for potential acquirers.
Competitive Position	X	X	Companies that are better able to adapt to a "greener" world will have a competitive advantage over those companies that can not, or will not, adapt.
New product development		X	Business opportunity for any company that can develop new "green" products or technology to reduce the emission of GHG by existing products or processes.
Impact on business operations	X		The unpredictable element in planning, but shifts in weather patterns due to climate change could impact any business, i.e., insurance, travel, tourism, construction, etc.

Source: Goldman Sachs Portfolio Strategy.

Company-specific environmental actions

Striving to meet targets

Company	Sector	Policy Initiatives: Targets	Policy Initiatives: Achieved
Gap Inc.	Consumer Discretionary	Reduce GHG emissions by 11% per square foot from 2003 to 2008.	Increased energy efficiency of stores in the US by 27% per square foot between 2001 and 2004.
General Motors Corp.	Consumer Discretionary	Reduce global CO_2 emission by 8% from 2000-2005.	Reduced CO_2 emissions by 7.1% between 2000 and 2003.
BP PLC	Energy	Reduce GHG emissions by 10% to 1990 levels by 2010. Have flat net emissions from 2002 to 2012. Invest $350 million in energy efficiency programs over 5 years starting from 2004.	Met GHG reduction target in 2001, nine years ahead of schedule. Reduced GHG by 4 million tonnes through energy and flare reduction projects between 2001 and 2004. Reduced absolute emissions by 14% between 1998 and 2004.
Johnson & Johnson	Health Care	Reduce absolute worldwide $C0_2$ emissions by 7% by 2010 to 1990 baseline. Reduce CO_2 emissions per km driven from worldwide vehicle fleet by 30% by 2010 to 2003 baseline.	Reduced absolute CO_2 emissions by 3% between 1990 and 2004. Worldwide used 18% of energy from renewable sources.
Caterpillar Inc.	Industrials	Reduce GHG intensity (CO_2e per million $ of sales and revenue) by 20% between 2002 and 2010.	Reduced direct GHG by 35% between 1990 and 2005 in the U.S.
United Parcel Service Inc.	Industrials	Decrease gallons of fuel consumed per package to 0.1008 by 2007.	Reduced CO_2 emissions by 13% per 1,000 packages between 2002 and 2004.

Source: The Climate Group.

Company-specific environmental actions

Striving to meet targets

Company	Sector	Policy Initiatives: Targets	Policy Initiatives: Achieved
International Business Machines Corp.	Information Technology	Reduce absolute 10% PFC emissions from semiconductor manufacturing processes between 2000 and 2005. Reduce CO_2 emissions from electricity and fuel use by 4% each year between 2000 and 2005.	Reduced PFC emissions by 57.6% compared to 2000 baseline. Reduced worldwide CO_2 emissions by 37.8% from energy conservation between 1990 and 2004.
Motorola Inc.	Information Technology	Reduce energy use by 25% to a 2000 baseline by 2010.	Reduced absolute energy use by 78% between 2000 and 2004.
Dow Chemical	Materials	Reduce energy use per pound of production by 20% between 1994 and 2005.	Reduced total direct CO_2 emissions by 28%. Reduced energy intensity by 21% between 1994 and 2005.
Du Pont (E.I.)	Materials	Reduce GHG emission by 65% on 1990 levels by 2010. Source 10% of global energy from renewables by 2010. Hold total energy use flat using 1990 baseline.	Reduced GHG emissions by 72% between 1990 and 2003. Used 4% of energy from renewables sources in 2005. Reduced global energy consumption 7% below 1990 levels.
American Electric Power	Utilities	Reduce GHG emission to 3% below baseline levels (average of 1998 - 2001) by 2005, and by 4% in 2006.	Reduced CO_2e emissions by 13% between 2000 and 2004.
PG&E Corp.	Utilities	Increase power supply from renewable sources to 20% by 2015.	Prevented the release of 25 million tonnes of CO_2 over the past 3 decades. Reduced SF6 emissions by 56% between 1998 and 2004.

Source: The Climate Group.

Technological change and structural adjustments in economies

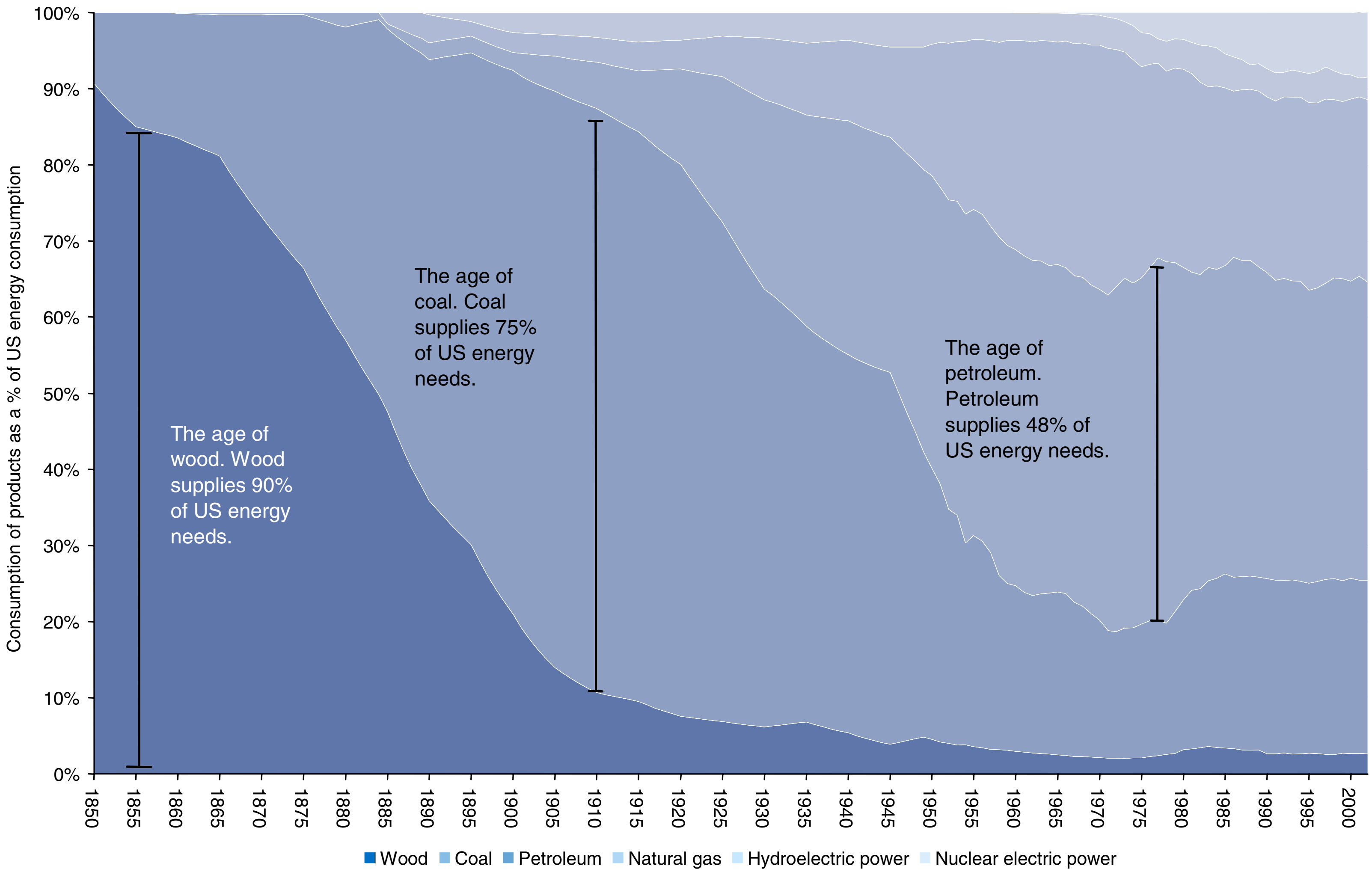
- There can be notable effects from these wide-ranging factors which may not be driven by policy

- Example: there has been a dramatic shift in energy supplies during the last 150 years and a revived focus on new potential sources

- Economic shifts, including outsourcing of energy-intensive activities to developing economies, can affect energy intensity and environmental impact

The ages of wood, coal and oil are leading to the age of gas and renewables

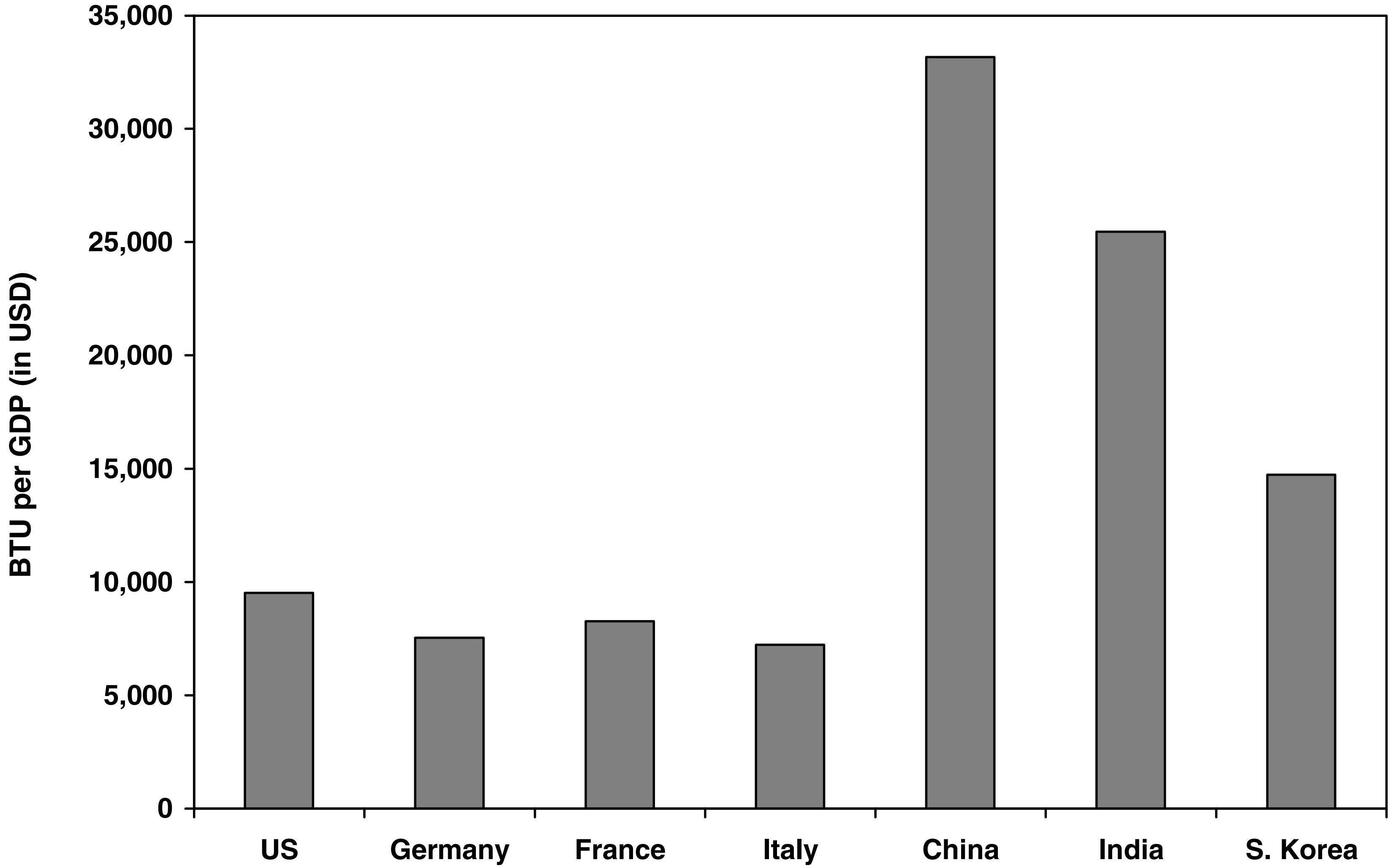
US energy consumption by type



Source: US Department of Energy, Goldman Sachs Research.

Energy intensity gap between developed and developing economies, 2003

Energy-intensive activities are being outsourced



Source: U.S. Department of Energy.

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September 20, 2006

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Price target and rating history chart(s)

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