

FAST FACTS: CLIMATE CHANGE INVESTMENTS (CCI)



Trading volumes and prices in EU - ETS

Source: Pointcarbon/3C

Focus: a fund that invests in green house gas (GHG) emission credits compliant with the Kyoto Protocol and the EU Emissions Trading Scheme (EU ETS). CCI's aims to balance investment risks and rewards by combining its investment activities in a diversified portfolio of project based emission reduction certificates and, to a lesser extent, trading in carbon allowances.

Strength: 3C as investment advisors to the fund, specialises in providing consulting and risk management services for greenhouse gas emissions reductions. The firm helps more than 200 national and international corporations develop and execute strategies to meet the new needs related to emissions trading.

Weaknesses: suited to those with an investment horizon of 6 years

Opportunities: ETS are evolving - hence has market potential. Annual double digit growth rates in terms of traded volumes are predicted.

Threats: The CO2 markets are sensitive and tend to be influenced by political and legal developments.

Risk Assessment

☐ = low ☐ = low/moderate ☐ = moderate ☐ = moderate to high ☐ = high

The biggest risk: **delivery risk** posed by projects, which is dependent on running time, technological availability etc, but also hinges on approval from authorities. Depending on the initial risk assessment of the projects, CCI, will contract just part of the generated credits but hold the option to buy more in case more credits are generated.

Avg. cost of sourcing allowances and ability to secure the same at attractive levels: ☐☐☐☐☐

(Anticipated purchase price of EUR 7 - 9 /tonne - dependent on project, project developer and other circumstances)

Ability to identify and maintain "deal flow" : ☐☐☐☐☐

Ability to model/forecast GHS market value: ☐☐☐☐☐

Expertise in trading carbon allowances: ☐☐☐☐☐

Diversification achieved at:

Country basis: ☐☐☐☐☐

Primary focus (75 % of sourced credits): Latin America, South East Asia, India. Secondary focus: the CIS, North Africa and the Middle East

Technology basis: ☐☐☐☐☐ Strict Adherence to technology that has proven it self

Leverage and hedging related risk: ☐☐☐☐☐

CCI will hedge its exposure in the credit market through trading in the European Emission Trading Scheme, the most mature emission trading scheme globally

Market risk: ☐☐☐☐☐ The legal circumstances for the European Emission Trading Market and the underlying global Kyoto Protocol are fixed and politically well backed. The European market is designed to exist until 2012 and will most probably continue thereafter. CCI does not take on post- 2012 risk and will be liquidated by early 2013. Analysis for the 2008 - 2012 European Emission Trading market is bullish on prices.

Fine related risk: No physical emissions so fines for non-compliance are not relevant

Performance Parameters

☐ =insufficient ☐ =adequate ☐ = satisfactory ☐ = good ☐ = outstanding

Avg. no of positions to be held: 30 to 35 projects

Average duration of positions held for: long term 3 - 6 years

Allocation:

40% - project-based certificates 40% - in fungible certificates 20% cash - as collateral

Efficiency achieved in allocating capital: ☐☐☐☐☐

Presence of competition: moderate

Correlation to: stocks, bonds, hedge funds, commodities:

CO2 prices do correlate with European power; fossil fuel - coal and gas prices

Outlook

↑ upside potential ↗ upside to range bound ↔ range bound ↘ range bound to down ↓ downside

Fund's outlook on investing in the sector

Ability to deliver targeted performance over the cycle of the project: ↑

Conditions that would lead to an out performance: a surge in CO2 prices

Conditions that would lead to an underperformance: delivery failure of a considerable part of the project portfolio

Barriers to entry: Expertise in the global CO2 market necessary

Current capacity: AuM: EUR 150mn

Investment Insights

Target audience: institutions, private investors

Level of complexity: moderate - basic knowledge of CO2 markets necessary

Fund offers: thematic diversification

Recommended avg. holding period: 6 yrs

Available: globally

Fund and base currency: EUR

Liquidity provided: daily liquidity

Transparency provide: high

Target Returns: 15% pre-tax IRR net of fees, expenses and carried interest

Fee: 2% management; 20% performance over a hurdle rate of 7% rate of return

Regulated by: CSSF (Luxembourg Financial Authorities)

PRACTITIONER'S POINT

Thomas C. Adams, managing principal and founder of Summit Timber Advisors, LLC, has developed a keen understanding of land sale and general divestiture dynamics of companies in the forest products industry... here are his insights on what sort of returns should be expected, investment structures and the challenges that lay ahead.

How has investing in timber as an asset class, evolved over the last decade?

One of the most interesting aspects of the timberland market in recent years, is that it has evolved (at least in the United States) into a 'true' asset class. There has been an enormous land transfer in the US. Paper and forest product companies, under competitive pressure from declining margins, international competition and high debt levels, have been monetising their vast land-holdings. On the receiving end, investors; mainly Timberland Investment Management Organisations (TIMO's), timber Real Estate Investment Trusts (REIT's) and Master Limited Partnerships (MLP's), have sprouted up to take advantage of industry exit from the forest management business. Land that was previously 'locked-up' and unavailable for purchase, is now available to investors. This is probably the single most important dynamic in creating an increasingly active, liquid market for what was previously a 'niche' investment opportunity. Demand for alternative investments, especially those uncorrelated to more mainstream asset classes has also driven interest.

What sort of returns should and can be expected today?

Historically, timberland has been a relatively high return investment with low volatility. Performance has exceeded 12% annually over the past 30 years (NCREIF Timberland Property Index) through a combination of current income and capital gains. Timber returned (again according to the NCREIF index) over 18% in 2005 and approximately 13% in 2006.

Do we expect those returns to continue?

If they do, it won't be from basic forestry. Our investment models, given current pricing, reflect nominal return estimates in the 6-8% range for land managed in the traditional 'forestry' sense. What we think will boost these returns, but are admittedly, difficult to model, is the increasing 'optionality' associated with land ownership. The ancillary income potential in forestry investing is growing rapidly. Income from recreational leases, mineral exploration, cell towers, conservation credits, watershed management, biomass, carbon sequestration, etc., are increasingly adding to forestry returns. Plus the tendency for land to move to higher value categories over time, as urban encroachment and demographic patterns progress, provide potential for long-term, high single digit, low double digit returns. We're targeting 9-11% all in, with an aggressive land management strategy designed to exploit all ancillary revenue opportunities.

What are the different investment vehicles available to an investor planning to invest in timber today?

For direct investments in timberland, Timberland Investment Management Organisations (TIMO's) are the primary vehicles for institutional and high net worth investors. Most manage separate accounts, organised in LLC form in the name of the owner. Alternatives for smaller investors include investing in a timberland 'fund', many of which are sponsored by TIMO's, or by purchasing public shares in a Timber REIT or MLP. The best direct exposure, maximum control and flexibility, but most likely limited to institutions, is the LLC separate account.

What other "investment structures" do you think could and will be applied to making timber a more accessible asset class?

Growing cash flow and generally low capital expenditure, has led to the creation of timber-backed securitised debt vehicles allowing for secured fixed-income exposure for debt buyers, and levered returns for those willing to take the "first loss", or equity position in the capital structure. An example of this is the recent TimberStar deal. International Paper sold most of its timber holdings to investors last summer in a transaction valued at more than USD6 bn. Of this amount, over USD1 bn was securitised and backed by a long-term supply agreement. It resulted in an USD800 mn, multi-tranche Commercial Mortgage Backed Security (CMBS) that saw high demand from investors looking for alternatives to the more typical collateral backing these structures. It is probable that we will see more of these deals. Additionally, look for more 'pooled' equity vehicles of the type that we have already seen from some of the TIMO's referred to earlier.

Why is it interesting to hold timber in a diversified real estate portfolio?

There are some interesting differences between investing in timberland in comparison to the more traditional real estate investment opportunities. Trees grow, land values rise and timber prices have outpaced inflation over any measurable long-term investment period. Biological growth is a primary driver of timberland returns and represents a stable, predictable source of value. More importantly, as trees grow in volume, class changes result in higher values. Saw timber (Lumber for building material) is more valuable on a per ton basis than Chip-N-Saw (small boards, pulp products), which in turn is more valuable than pulpwood (newsprint). Growth is predictable and can be enhanced by applying modern forestry management techniques. Moreover, timber can be 'stored'. If prices are weak in any given year, you can exercise your option not to harvest. Trees will continue to grow and value will continue to build. Contrast that to commercial property. In a weak economy businesses close, rents decline, vacancies rise. Rents lost from a vacant office are lost forever. Timber, by contrast, builds value 'on the stump' and has an excellent history of capital preservation.

What are your concerns and the challenges that lay ahead?

I guess one of the biggest concerns right now is valuation. Capitalisation rates, basically current yields, have declined considerably over the past couple of years. Earning double digit returns from basic forestry is unlikely given recent market pricing, and many timber investment advisors have not sufficiently adjusted their marketing material for that reality. As mentioned earlier, double digit returns are still possible, but they will be earned through more speculative land plays and by capitalising on more of the ancillary revenue sources that have become available through forestland ownership.

INVESTING IN PHOTOGRAPHY

Fiona Lake produces limited edition fine-art quality photographic prints, postcards and is the author of "A Million Acre Masterpiece"

How investible are "photographs" as an asset class?

There is such a wide range available that everyone can find a photographer who specialises in a subject and with a style that appeals to them.

It is important to buy quality, so it is necessary to research and/or seek the advice of experts in the field. Like most visual art, photographs have particular storage requirements. To make sure a photograph stays in good condition it is essential to ensure it has been printed using archival quality materials and methods, and then framed or stored correctly (using acid-free materials and kept within a moderate temperature and humidity range, with minimum exposure to damaging ultra violet rays).

"In February 2006, Sotheby's achieved the highest-ever single-photograph sale price in history, selling Edward Steichen's "The Pond-Moonlight" for USD 2,928,000." Do you believe photography has finally come of age... and people are beginning to better understand and appreciate it? Or do you think it is driven by hype?

These large sales are unusual and as they are dramatic they attract media attention. The "creative industry" is full of hype and is tied to fashion cycles. These big sales do help scale up prices right down to the lower end of the market. However there is always a risk associated with art that achieved record prices as it could be on the crest of a fashion wave. If it is not backed by solid creativity and quality then the only way the price will go is down. Photographs are similar to other forms of investments: if you buy conservatively you may not make dramatic profits but you're unlikely to lose money.

Perceptive people realise that producing quality images involves more than just "pointing and shooting." I think the quality end of the market is seeing prices rise whereas the lower end is experiencing the opposite.

Like any collectible "photography" too can command a "scarcity price." Do you think this price differs because of the medium - i.e. the "risk" that other copies can be made; or that digital photography or modern technology could alter works of photography?

It is natural that a "one-off" will be more valuable than something that has multiple copies. Investors should ensure they know exactly how many copies of the photograph there will be. Prices for limitless or high (1000 or more) editions should be much cheaper compared to the prices payable for a low (10 - 25) edition - however this is not always the case. You don't always get what you pay for. I am sure the prices paid for good quality, low edition photographs have remained lower than they logically should be. There are many photographers producing very large or endless editions that charge low edition prices - this unfortunately undermines public confidence. Investors should be able to sort out which is which by doing some research - ask the photographer exactly how many prints will be made, and make sure it is in writing. Make sure they have a track record and integrity. Signed and numbered certificates of authenticity are often provided by photographers serious about instilling confidence in limited edition runs.

Investors should also determine whether the image they are buying is a straight photograph or one that has been digitally altered in some way, as this may have some bearing on its resale price. In future, it is likely that straight photographs will be viewed as more valuable (particularly if the image is of historical significance) than those that have been digitally manipulated.

If someone were to start a photography collection for "pay sake" (as an investment) how would you recommend they choose their collection?

First and foremost, buy what you like. Do your research - buy the work of photographers who have been around for a while. Speculate on some emerging photographers whose work will cost less - but entails higher risk. Spread the risk by purchasing a variety. Always make sure the printing is of top quality and store it correctly. Fanatics store visual art in stringent climate controlled conditions - in the dark, out of public view; but this denies a daily enjoyment of the work.

How important is provenance in the context of photography?

When it comes to selling photographs, provenance is probably even more important than for other visual art forms such as painting, because of the extra need to inspire buyer's confidence in the originality and authenticity of the photographic print. Signed certificates of authenticity are valuable - when buying, ask if the photographer provides them.

"Australian photographs are a good buy"... please elaborate.

There are around 20 million people living in Australia and as there has only been 220 years of European settlement - the conventional art market is relatively young. There are a lot of very creative, original artists who are slightly removed from the mainstream. But since it is a small market that is isolated from other outlets - it has been a buyer's market.

How do you identify "top quality selling at below comparable prices"?

Art quality has two aspects. Technical quality can be measured fairly easily using objective means. With regard to photography the obvious questions are - is the photographer producing images that have the appropriate lighting, grain, sharpness, composition etc. The second aspect is creativity - how original, how interesting is the image? Does it affect you? This is largely subjective, but overall most art can be classified as being very good or ordinary.

What differs most, when it comes to opinions, is what people like and what they don't. Someone used to assessing art can decide an image is technically good and very creative - but they might not personally like it. If they were purchasing it purely as an investment, they may want to buy it anyway.

INVESTING IN PHOTOGRAPHY II

It is fairly easy to compare images worldwide by applying the same basic criteria. It is then obvious if prices in one region are below the average in another.

What sort of photography is currently fetching a fortune ... will it continue to do so in the near future? Why? Why not?

I suspect the highest prices would be fetched by historical photographs, particularly of celebrities. I would expect that prices would endure for those up the top of the tree, but for 'stars' that may fade in people's memories, the price of photographs is likely to slip.

In Australia there are many landscape photographers and for personal reasons it's a field I have avoided. To me it's far more interesting to photograph a combination of a cultural aspect (rural work) and the landscape, so that the images have historical significance and are impossible to replicate in years to come. Many landscapes will remain the same for decades if not hundreds of years, so the probability of obtaining similar photographs exists. Images that are just pretty pictures without any layers of deeper significance or meaning, are less likely to gain in value. I believe truly successful images are timeless - they don't lose their power as they age.

Comments, remarks...

Framed paintings have been around for hundreds of years. There is a well established industry built around paintings that inspires confidence among investors. In contrast, photography is a relatively new medium and hence people have tended to be reluctant to voice their opinion on what most appeals to them, what they think is 'good' and how they should assess its value. This has been encouraged by those in the art world who perceive a visual art pecking-order, with oil painting at the pinnacle. This "pecking-order view" is denying the attribute that non-digitally manipulated photography has – "believability", which a painting does not.

Photography is still emerging as an investment area. Investors who buy early are better poised to make the highest profits in the long term. It is certain that photographs produced before the era of digital manipulation and/or produced by photographers who do not digitally manipulate their images, will rise more rapidly in value. The only unknowns are by how much prices will rise, and how rapidly.

LITIGATION INVESTING - PALM BEACH CAPITAL ADVISORS, LLC

Sovereign Litigation Investment Trust (SLIT) III

Focus: factored government attorney fees

Strength: government agency liability; offers uncorrelated returns

Weakness: demand for investible capital is inconsistent and sometimes the states are late in paying

Opportunities: niche market, growth

Threat: cheaper sources of funds

Risk: low - government receivables, never a non-collection in 8 years

Sourcing: the attorneys come to the trust's manager for the service and often factor all their government cases to smooth out their cash flow

Ability to efficiently allocate capital: in theory this could pose a problem - if a trust targets returns of 12% pa - they would have to place "capital" to work regularly. They would be challenged by "quiet times" in demand. This is where management skills and having a well oiled network are crucial - as cases need to be found. The trusts is usually set up to pay the investors a priority return before management gets any incentive. So the 12% is not guaranteed if the capital can't be placed - but, then the trust receives no incentive fees until investors receive their return first.

No. of litigation cases held in trust - many, as the trust would factor as little as USD500
Avg. duration litigation case lasts, until claims are paid out: 60-140 days.

Reward: irrespective of whether the attorney wins or loses the case - debt is due from the state as the state hired the attorney

Sovereign Litigation Investment Trust (SLIT) V

Focus: factored government fees

Strength: government agency liability; offers uncorrelated returns

Weakness: demand for investible capital is inconsistent and sometimes the states are late in paying

Opportunities: niche market, growth

Threat: cheaper sources of funds

Risk: low - factored receivables

Sourcing: the attorneys come to the trust's manager for the service and often factor all their government cases to smooth out their cash flow

Ability to efficiently allocate capital: it is harder to earn enough to offer a 12% yield - 9-10% is more realistic (most people assume the risk is too high at 12%, and may do so at even at 10%, although both programs are nearly identical)

No. of litigation cases held in trust - many, as the trust would factor as little as USD500
Avg. duration litigation case lasts, until claims are paid out: 60-140 days.

Reward: irrespective of whether the attorney wins or loses the case - debt is due from the state as the state hired the attorney

Scope for litigation trusts: this is slated to develop into a growing industry due to relatively high yields offered

Barriers to entry: expertise; ability to raise capital; most investors have never heard of litigation investment - educational process involved.

Competition: limited thus far, but growing

Investment Criteria: Target audience - accredited investors under US Reg D requirements for US citizens and residents.
 access to investors: globally

Trust size: USD1 - 4mn

Liquidity provided: Need to be invested for the life of the trust - normally three years.
Transparency provided: Quarterly distributions when available

Authorities trust is regulated by: Formed as a Delaware Statutory Trust (ie a Business Trust) and Regulation D 506 offering documents under SEC private placement rules.

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**© Opalesque Ltd.
8 Samou Street
St. Omologites
Nicosia 1640
Cyprus**

**+49-89-2351 3055
info@opalesque.com**

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