

THE GREEN CHIP REVIEW

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Carbon Trading: The World's Next Biggest Market

Special Report

If you haven't been following the debate surrounding capping and trading emissions, you're missing out. Not only does it have implications for how our nation — and the world — produces energy; it has the potential to offer a myriad of opportunities for well-informed investors.

You see, California has been asking for permission to regulate greenhouse gas emissions since 2004, but the philistines at the Environmental Protection Agency (EPA) have yet to grant it permission to do so.

For quite some time the EPA's excuse was that they didn't have the power to regulate emissions. That's funny. . . greenhouse gases harm the environment and the EPA is supposed to protect the environment. Maybe their organization should consider a name change. . .

Back in April, the Supreme Court ruled that the EPA did in fact have the authority to regulate greenhouse gas emissions. Like we didn't see that one coming.

After that decision, you'd expect everything to come up roses. But this administration doesn't make anything easy, even obeying Supreme Court decisions. So here we are, a substantial time since that decision, and the EPA still hasn't given California (or the eleven other states that would do so), permission to regulate emissions.

And while it would be nice to have the federal government's support, it looks like the rest of America is ready to move on without it.

Already, corporate behemoths like General Electric, DuPont, Johnson & Johnson, and others have come together to form the United States Climate Action Partnership.

Even oil juggernauts like Shell, BP, and ConocoPhillips have joined this coalition, which calls itself "an expanding alliance of major businesses and leading climate and environmental groups that have come together to call on the federal government to enact legislation requiring significant reductions of greenhouse gas emissions."

Now you can be certain the environmental groups that are a part of this alliance are there with pure intentions, but I'm willing to bet some of those companies are looking for a way to make a buck from the capping of emissions.

Carbon Market Potential

According to a recent *New York Times* article, carbon trading is one of the "fastest-growing specialties in financial services." And companies are scrambling to get a slice of a market now worth well over 100 billion and that could grow to \$1 trillion within a decade.

The article, "In London's Financial World, Carbon Trading Is the New Big Thing," goes on: "Carbon will be the world's biggest commodity market, and it could become the world's biggest market over all."

If you doubt that assertion, consider this: Every year, humans generate about 38 billion tons of carbon dioxide.

And that number will continue to grow, as developing nations demand more energy that will likely be produced by coal and other carbon heavy sources of fuel.

As more international governments start to regulate their country's emissions, and as more companies start to voluntarily limit their emissions (as we're seeing in the U.S.), the demand for available carbon credits will skyrocket. And so will their price!

One need only revert to the simple law of supply and demand to see that this industry is going to be huge. If increased demand dictates an increase in price, getting in now could be one of the wisest investment moves you make in the first half of this century.

Carbon Trading: an Introduction

Europe has had a carbon market (surprise, surprise), for quite some time now. Each member state of the EU gets an annual emission allocation, which is then divvied up among its worst emissions-producing companies.

The companies are then legally obliged to produce no more emissions than they are allowed. If a company comes in under target, it can sell its excess allowance as "carbon credits" to other firms that have overshot their targets. But if it exceeds its target, it has to pay a penalty and then go to the market to buy credits to make up the difference.

Right now, with an abundance of carbon credits available, their price is relatively low. But with the second phase of the program (2008-2012), starting to rev up—bringing with it a reduced amount of credits and more stringent targets — the price of carbon credits is set to explode.

The United States has a version of a carbon market as well. . .

Established in 2003, the Chicago Climate Exchange (CCX) is one of North America's only voluntary and legally binding greenhouse gas (GHG) reduction and trading systems.

The companies that join the exchange commit to reducing their aggregate emissions from the same baseline used by the EU: 6% by 2010. Currently, the exchange has more than 200 members, ranging from corporations like Ford and Motorola; to municipalities such as Oakland and Chicago; to

educational institutions such as Tufts University and the University of Minnesota; to farmers and their organizations such as the National Farmers Union and the Iowa Farm Bureau.

Emissions reductions are independently verified and count for about 4% of total U.S. GHG emissions — leaving plenty of room for growth.

Investing in Carbon

The only pure play is to buy Certificates in Emission Reductions (CERs). However, the sole way to currently do so is through an established carbon fund set up by huge capital firms. The most well-known firm that does this, Climate Change Capital, requires a minimum investment of \$33.3 million — leaving little opportunity for small investors.

Or, you could invest directly in the company that owns the carbon exchange Climate Exchange Plc. (LSE: CLE).

These guys cornered the market early. They even own the Chicago Climate Exchange (CCX).

But if those shares are too pricey, there's still hope for getting into the carbon market.

More than One Way to Profit

Carbon isn't just a one trick pony. There are a few ways to make sure you get your share of this opportunity. . .

You see, as this industry grows and matures, companies are going to be looking to make money from it in any way possible.

So if you don't have the \$33 million and change needed to break into trading CERs, there's still hope.

For starters, you could invest in companies that reduce emissions simply by the nature of their business. Companies that produce clean energy will soon be profiting on two fronts; they'll be selling their power and the carbon credits they acquired while making it.

For example, a company that produces electricity via a clean renewable resource may not only sell the electricity, but also the carbon credits earned from not burning fossil fuels. . . so long as the emission reductions are certified by an independent third party.

Of course, this arrangement would be much easier to understand and keep track of if a cap and trade system were implemented by the federal government. In fact, just capping the amount of emissions would do wonders.

Today, only 3% of our electricity is renewably produced. A 12% increase in the next twelve years would not only send renewables through the roof, but would create a pretty sweet carbon market as well.

Recent Carbon Headlines

Senate Committee Passes Bill to Force EPA Action on CA Waiver

GE, AES Ramp Up Venture Behind Green Credit Card

Global Voluntary Carbon Market Grows by 200 Percent in 2006

XShares to Develop Carbon Emission Credits ETFs

Blue Source Moving into Carbon Trade Standards Lawmakers Unveil Industry-Backed Climate Bill

As the demand increases for carbon credits, many companies are coming on the scene that specialize in reducing emissions. These are companies that help reduce the overall emissions of a variety of businesses, like farms, factories, and utilities.

These companies are not only getting premium consulting fees, but a portion of the carbon credit proceeds, as well.

You should take a look at Ecology & Environment Inc. (AMEX: EEI), which offers a range of environmental consulting services, including environmental planning, management, and regulatory compliance.

This is just one example of such a company, and there's yet another way to tap into this industry.

As more governments begin to cap carbon emissions and initiate trading schemes, there will need to be regulatory bodies that measure and confirm reduced emissions. And those agencies will need new instruments and technologies to measure and record.

The bottom line is, the savvy investors that stay on top of this nascent industry will witness the birth of an entire new generation of dominant companies - and the making of legendary profits.

For more on opportunities in carbon markets, as well as the booming alternative energy market (our current portfolio is up 66%), join [Green Chip Stocks now](#).

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