Natural capital and the search for independent return drivers

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Institutional investors have become increasingly sophisticated in their approach to diversification, allocating capital across private markets, real assets and alternative strategies alongside traditional equities and bonds. Yet many portfolios remain concentrated in a relatively narrow set of economic exposures. Different asset classes are often driven by the same forces: interest rates, liquidity, leverage and the pricing of financial assets. During periods of market stress, assets that appear diversified can prove highly correlated. The inflation shock of 2022 highlighted how quickly traditional diversification assumptions can break down when inflation and interest rates reprice simultaneously.

For investors seeking true resilience, the key question is not how many asset classes a portfolio contains, but how many genuinely independent return drivers it can access. Natural capital addresses this challenge by providing exposure to sources of return that differ fundamentally from those embedded in traditional financial assets.

Why Natural Capital?

For Gresham House, natural capital investment includes sustainable forestry, agriculture and nature-based solutions - assets deriving value from biological growth, land productivity and the provision of essential resources. Forests grow regardless of market sentiment, while farmland generates income from food production. Increasingly, these assets access revenues linked to carbon sequestration, biodiversity enhancement and other ecosystem services. These return drivers are materially different from traditional financial assets and underpin the fundamental case for inclusion within a diversified institutional portfolio.

Despite this, natural capital remains underrepresented in many institutional portfolios. As an independent source of return, it can improve portfolio resilience while providing exposure to essential real assets whose supply cannot be expanded through capital alone.

These characteristics reflect the asset class's underlying economics. Sustainable forestry returns are generated from biological growth, timber sales, land appreciation and ecosystem services. Value preservation is supported by timing optionality: harvesting can be accelerated when timber prices are attractive or deferred when markets are weak, while the underlying biological asset continues to grow.

In sustainable agriculture, the investment case rests on productive farmland delivering crop or lease income and long-term land appreciation. The demand driver is straightforward: food is essential. At the same time, the global stock of high-quality, water-secure productive land is finite and under pressure from degradation, urbanisation and climate change. As water scarcity and temperature volatility increase, well-located farmland in resilient regions is likely to become more strategically valuable.

Nature-based solutions add a third dimension. These are investments in conservation, restoration and biodiversity enhancement that can generate revenue through emerging environmental credit markets. In the UK, Biodiversity Net Gain requires developers to deliver measurable biodiversity uplift, while global carbon and ecosystem service markets are creating additional revenue streams for landowners able to deliver verified environmental outcomes.

Structural tailwinds supporting the asset class

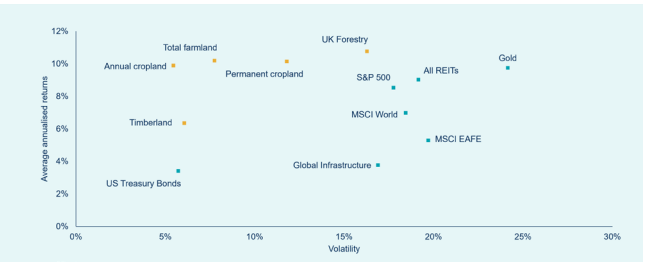
The distinguishing feature of natural capital is that its return profile is rooted in tangible economic activity. Environmental markets strengthen this foundation. Carbon, biodiversity and other ecosystem-service revenues can be accessed directly or layered onto productive forestry and agricultural assets, creating additional return streams alongside the core drivers of timber and food production and land productivity. The result is a return profile that combines tangible real-asset cashflows with exposure to emerging environmental markets, rather than relying on either in isolation.

The long-term investment case is reinforced by several structural trends. Demand for food, fibre and natural resources remains resilient, while the supply of productive land and mature forestry assets is inherently constrained. At the same time, biodiversity, carbon and restoration frameworks are increasingly moving from voluntary ambition towards regulated demand, creating the potential for more durable revenue streams. Growing concerns around resource security, supply-chain resilience and climate adaptation provide further support. Importantly, sustainable land management practices can improve both environmental outcomes and long-term asset productivity, creating opportunities to align financial and ecological value creation.

Empirical evidence reflects these underlying characteristics. Across long-run data, natural capital verticals such as forestry and farmland have demonstrated low correlation to listed equities, competitive absolute returns and strong risk-adjusted performance.

Correlations: Traditional asset classes with agriculture and forestry

Risk and return: Traditional asset classes with agriculture and forestry



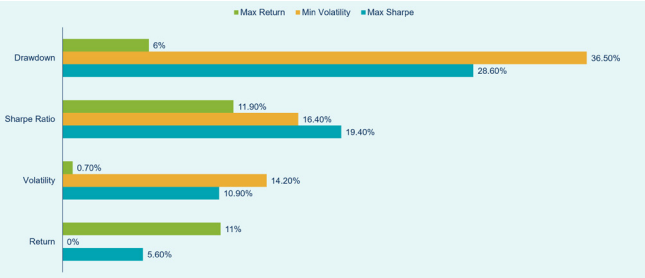
Source: NCREIF Total Farmland Index, NCREIF Annual Cropland Index, NCREIF Permanent Cropland Index, MSCI World Infrastructure, Gold Prices, FTSE NAREIT All Equity REITs, MSCI EAFE, US Treasury bonds, S&P 500 index; Gresham House analysis, April 2026. USD Returns (1999–2025). Past performance is not a reliable indicator of performance. Capital at Risk

Portfolio benefits

For asset owners, the relevance of natural capital is best assessed at portfolio level. Modelling suggests natural capital can improve both portfolio efficiency and resilience. In an illustrative portfolio of equities, bonds, private equity and infrastructure, optimisation work consistently allocates to natural capital across maximum Sharpe ratio, minimum volatility and maximum return objectives, with optimal allocations of 15%, 19% and 10% respectively. This reflects the combination of low correlation, attractive risk-adjusted returns and exposure to return drivers that differ from traditional financial assets.

The portfolio impact is meaningful. Relative to a benchmark portfolio (55% equities, 30% bonds, 7.5% private equity and 7.5% infrastructure), annual returns improve by up to 11%, volatility declines by as much as 14%, and Sharpe ratios increase by approximately 12–19%. Maximum drawdowns are reduced by up to 35%, highlighting the contribution of natural capital to both portfolio efficiency and downside protection.

Relative Improvement: Optimal natural capital allocations vs benchmark



Source: NCREIF; FTSE Nareit; LBMA; S&P Dow Jones Indices; Bloomberg; Bank of England; Office for National Statistics; Gresham House research (1995-2025). Past performance is not a reliable indicator of performance. Capital at Risk.

The majority of these benefits appear to be captured within a 5–10% allocation range: large enough to influence portfolio outcomes without illiquidity becoming a dominant consideration. For many pension funds and insurers, this range may represent a practical starting point for a strategic allocation funded from real assets, real estate, inflation-sensitive or broader alternatives portfolios.

How should investors approach natural capital?

While the portfolio benefits of an allocation to natural capital are clear, allocations across individual natural capital strategies should reflect investors' return objectives. Income-oriented investors are likely to emphasise agriculture or contracted nature-based cash flows. Liability-aware investors often favour forestry and agriculture for their inflation linkage and long-duration characteristics. Total return investors can blend exposure across the three pillars to capture complementary return drivers. Investors with explicit environmental objectives can tilt towards restoration, carbon, or biodiversity strategies, provided underwriting remains financially disciplined.

Beyond asset allocation, manager selection is a key determinant of outcomes. As an operationally intensive asset class, returns are influenced by factors including acquisition discipline, soil and water quality, species and crop selection, harvest timing, regulatory expertise, and the ability to originate and manage environmental revenue streams. Performance can therefore vary significantly across managers, placing a premium on specialist expertise.

Gresham House is one of the leading specialist natural capital managers globally, with capabilities spanning acquisition, biological asset management, environmental markets, and long-term stewardship. Its natural capital platform spans sustainable forestry, sustainable agriculture, and nature-based solutions across five countries, managing €7.2bn[1] of natural capital assets and drawing on more than three decades of specialist experience.

Why now?

The opportunity is timely because the asset class is becoming more accessible to institutions while the underlying asset base remains finite. Historically, natural capital was difficult to access: local, operationally intensive, illiquid, and highly specialist. Today, better data, longer institutional track records, more sophisticated investment vehicles, enhanced sustainability reporting, and clearer policy frameworks are making the asset class easier for mainstream investors to evaluate and access.

Greater accessibility will attract additional capital. Yet the supply of high-quality natural capital assets remains constrained. Productive farmland, commercial forestry assets, and many environmental markets cannot be expanded quickly or at scale. As institutional participation increases, competition for these scarce assets is likely to intensify, providing long-term support for valuations.

For investors, this creates a favourable combination of improving accessibility and constrained supply. Those that establish allocations early may therefore be better positioned to access the highest-quality opportunities before broader demand becomes fully reflected in pricing.

Risks and portfolio implications

None of this removes the need for risk discipline. Natural capital investors face illiquidity, weather events, pests, disease, wildfire, commodity price movements, currency exposure and policy change. These risks must be underwritten and mitigated through diversification, conservative assumptions, insurance, active management and robust governance. Importantly, many risks differ from the equity, duration, leverage and liquidity risks already embedded within most institutional portfolios.

For diversified investors, that distinction may be as important as the return profile itself as it can strengthen diversification at the total portfolio level.

Conclusion

Modern portfolios do not need more asset categories; they need independent return drivers. Natural capital offers exposure to biological growth, productive land, essential demand, and emerging environmental markets through a unique combination of return drivers that is difficult to replicate elsewhere.

As institutional capital increasingly recognises these characteristics, access to the highest-quality assets is unlikely to become easier. The structural case is likely to endure. The entry conditions may not.

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[1]Gresham House, fee-earning AUM and committed capital as at 31 December 2025. Includes Molpus Woodlands Group whose acquisition was announced on 31 March 2026 and is still pending regulatory approvals. The transaction remains subject to customary closing conditions including regulatory approvals.

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