Quick Take: Decarbonizing Portfolios is Easier with Utilities out of Favor

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Presently, utilities disproportionately drive the carbon intensity of global benchmarks.

- Utilities comprise less than 3% of MSCI World's weight but account for nearly 40% of its carbon intensity. (Scope 1+2 Emissions / Revenue; Figure 1)

Recently, low volatility managers have leaned away from utilities with little performance cost.

- While low volatility equity managers traditionally have overweighted utilities to reduce portfolio risk, staples and less conventional allocations, such as pharma, have been more effective diversifiers since the market selloff in Q1 2020. (Figure 2)
- Over the same period, utilities have also lost appeal to many bottom-up stock pickers. Many investors shunned utilities as they underperformed both in the 2020 sell-off and the long speculative rally that followed. The MSCI World Diversified Multiple-Factor Index, for example, reduced its active exposure to utilities over three rebalances, starting with 2020 H2. (Figure 3)

Decarbonization will require greater deliberation as the utilities outlook improves.

- Attenuation of utilities' expected betas, more attractive valuations, or strong performance during episodes of risk aversion will likely stimulate investor demand. When this happens, low volatility managers will need to apply more sophisticated methods to balance decarbonization and risk-reward objectives.

Figure 1: Contributions to MSCI World Carbon Intensity

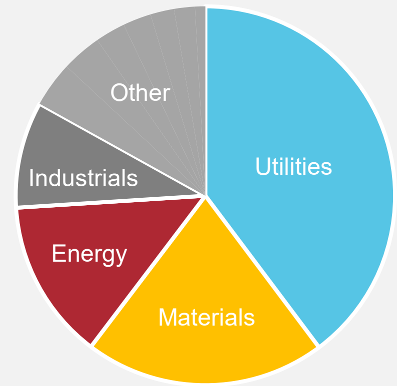

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Figure 3: Utilities' Active Weight in MSCI's Diversified Multi-Factor Index

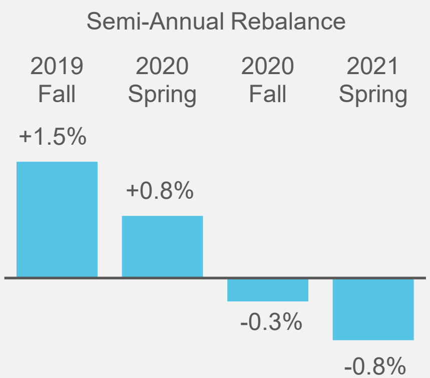
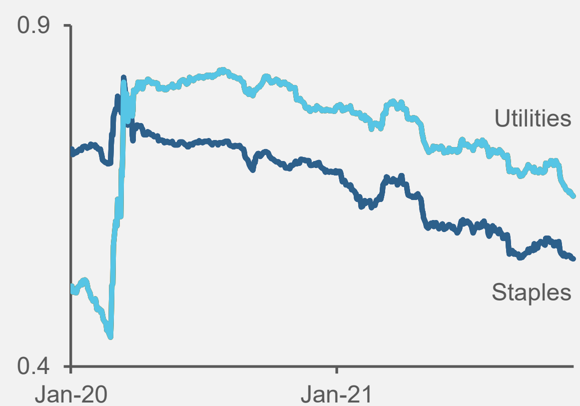


Figure 2: Expected Betas vs. MSCI World



Sources for all charts: Acadian based on data from MSCI. For illustrative purposes only.

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