Quick Take: Must Decarbonization Bite When Emitters Outperform?

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The 2022 investing environment: Motivation to overweight emitters

- As commodity prices soared in 2022, there was natural motivation for active strategies that didn't include explicit carbon constraints or tilts to increase exposure to high-emitting sectors, owing to industry and stock-selection opportunities associated with the changing market environment.
- To illustrate, the top chart shows a dramatic increase in the Weighted Average Carbon Intensity (WACI) of a hypothetical baseline systematic global strategy that incorporates bottom-up and top-down return forecasts and sophisticated portfolio construction. For most of the year, its WACI is more than twice that of the benchmark and Net Zero-compliant levels.

Can low-carbon clients maintain alpha when conditions favor emitters?

- Yet even in conditions that favor emitters, sophisticated systematic carbon-constrained strategies can still retain substantial alpha exposure. As the bottom chart illustrates, adding a carbon exposure constraint to the simulated baseline global portfolio reduces *ex-ante* alpha exposure by less than 10% during 2022, and we see the same for regional variants of the hypothetical strategy. Moreover, in less extreme market environments, like in 2021, the drop-off in alpha exposure is negligible.
- This success in maintaining alpha exposure derives from a broad investment universe and sophisticated portfolio construction. That combination provides flexibility to overweight high-alpha, carbon-efficient stocks in high-emitting sectors. As evidence, after adding the carbon constraint to the hypothetical global strategy, the portfolio is still able to take a 4% overweight to energy during 2022.
- The results offer evidence that when the investing climate benefits emitters, sophisticated approaches to decarbonization can help investors better maintain key financial characteristics of their investments.

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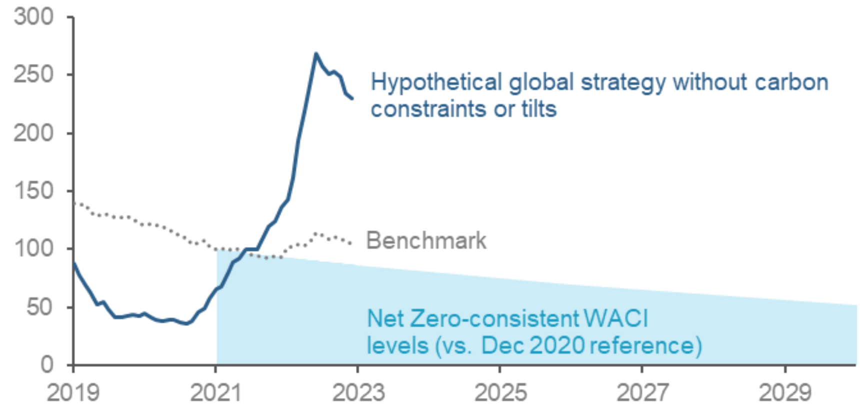
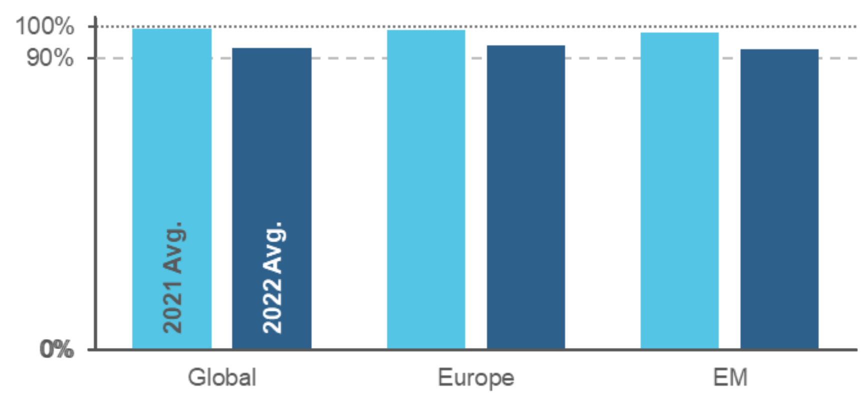
Weighted Average Carbon Intensity (WACI)

Based on scope 1+2 emissions



Impact of Carbon Constraints on *Ex-ante* Alpha Exposure

Hypothetical carbon-constrained strategies as percent of unconstrained



Source: Acadian. Hypothetical long-only portfolios with the indicated universes and benchmarked to associated MSCI Indexes. Exercises run from 2019 to 2022 with initial AUM of USD2bn and minimum USD100mn market cap. Carbon constrained strategies employ a net-zero glide path and fossil fuel restrictions. Charts are meant to be educational illustrative examples and do not reflect performance of actual portfolios. Hypothetical results are not indicative of actual future results. Every investment program has the opportunity for loss as well as profit. Index and Carbon Data source: MSCI Copyright MSCI 2023. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI. Carbon emissions are estimated by Acadian where coverage from MSCI is missing.

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