Improving the carbon footprint with indices

Climate change presents significant risks to assets that can be faced with sustainable index concepts

Last year's United Nations Climate Change Summit in Paris concluded with the adoption of a momentous agreement between nearly 200 countries to limit global warming below 2°C, clearly signalling that the world is ready to take a step in the right direction to mitigate climate change. Though primarily a political signal, the agreement has increased pressure on companies along with investors. One major message of the climate change conference was that carbon emissions will no longer be economically justifiable in any business model in the future.

In recent years, it has become apparent that fossil energy has no bright investment future. As world leaders attempt to address and stem the effects of global warming, long-term investors in particular are becoming increasingly aware of the risks climate change presents to their assets. Companies are also beginning to act more responsibly; almost 600 companies and investors have already joined We Mean Business, a coalition of organisations working with thousands of the world's most influential businesses and investors.

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One of the organisations is the Montréal Carbon Pledge, which drives investors' commitment to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis. Support for the Montréal Carbon Pledge is coming from investors across the globe: more than 120 investors with over US$10 trillion in assets under management have been participating, since the Paris Climate Change Conference. Several leading institutional investors, like the Norwegian Sovereign Wealth Fund or Allianz Group, have decided not to invest in businesses relying on fossil energy.

This decision is forward-looking: a change towards a more sustainable investment approach is also demanded from the governmental side. In 2015, France has introduced mandatory carbon reporting for portfolios of pension funds, insurance companies and other institutional investors. Other countries want to implement similar obligations as governments are pushing hard. Obviously, institutional investors are expected to reflect the growing concerns about climate change in their portfolios. So far, however, it has not been as easy to implement sustainable investments. Pension funds, for example, are often obligated to follow a pre-defined benchmark. As a result, and in order to avoid undesired tracking errors, they can only rely on indices that embed low carbon filters. Some investors may want to get the most out of the leading sustainable companies only, while others would consider companies and their whole supply chain additionally.

Reliable and independent data as the basis for sustainable indices

Reliable and certified data are the basis for any low carbon strategy. Yet, many investors do not have the time and expertise to analyse the carbon emissions of every company or do not have access to all necessary data. Therefore more than 800 investors, who account for more than one third of assets worldwide, rely on the data of CDP – the former Carbon Disclosure Project – a leading international non-governmental organisation. CDP manages the world's largest database of its kind with information on more than 2,000 listed companies. Its data helps investors to analyse the environmental risks and financial opportunities across their portfolios.

STOXX partnered with CDP to use their dataset of corporate environmental information as a high-quality source to calculate the STOXX Low Carbon index family that was introduced earlier this year. The index family provides a range of innovative solutions for investors with different low-carbon strategies, based on established benchmark and blue-chip indices such as EURO STOXX 50 and STOXX Europe 600. Investors can choose to address climate risks without giving up their benchmark respectively. As an example, the EURO STOXX 50 Low Carbon Index has reduced carbon emissions by half, while retaining similar risk and return figures compared to the EURO STOXX 50 Index over the past three years. The STOXX Low Carbon Indices consist of four sub-families offering varying degrees of carbon exposure. Using the indices, investors can mitigate their carbon risk, without changing their overall risk-return profile, or exclude fossil fuel holdings altogether.

The STOXX Industry Leaders Low Carbon Indices are one of the sub-families and allow investors to gain diverse exposure to industry leading companies, while having reduced the carbon footprint by more than 80 per cent over the past three years. At the beginning of 2015, price hikes supported the performance of most indices. The STOXX Europe Low Carbon 100 Index for instance outperformed its parent index during the sideways and downward trend afterwards, outperforming it by more than 10 per cent

compared to the STOXX Europe 600 since January 2015. Therefore this concept could be attractive to investors not bound to a benchmark.

Climate change risks and opportunities hidden in supply chains

According to CDP, the companies' own emissions often account for just 15 to 25 per cent of the total emissions across their supply chain, a fact not considered in the majority of cases. There is a small group of companies that besides implementing programmes to reduce their own emissions, also employ strategies to reduce emissions of their whole supply chain. These companies are rewarded with a place on CDP's A list, based on their emissions reduction actions and results. This group is recognised as being the most transparent and fact based. The selection criteria are strict: just 113 companies worldwide were included in the 2015 A list.

Investors can invest in this holistic approach with the help of the STOXX Global Climate Change Leaders Index, which is the first index available to market participants that tracks the CDP A list. CDP A list research showed that this small group of Climate Change Leaders accounted for US$23 billion in climate change investments; almost half of the US$50 billion invested altogether. The index has reduced carbon emissions by nearly 80 per cent with annualised returns of more than nine per cent over the past three years. Hence, investors can support the forward-looking, effective strategies and significantly reduce climate risks in their portfolio straight away.

The UN Climate Change Summit has underlined the importance of minimising global carbon emissions in the future. Many governments and companies are aware of their responsibilities and investors can support their efforts. Passive investing is a crucial part of being prepared for future investment requirements. Low-carbon index strategies do not only cater to a socially responsible investment approach, but have shown to perform similarly to, or even better than, their traditional counterparts. ■

ABOUT STOXX

STOXX Ltd. is a global index provider, currently calculating a global, comprehensive index family of over 7,500 strictly rules-based and transparent indices. Best known for the leading European equity indices EURO STOXX 50, STOXX Europe 50 and STOXX Europe 600, STOXX Ltd. maintains and calculates the STOXX Global index family which consists of total market, broad and blue-chip indices for the regions Americas, Europe, Asia/Pacific and sub-regions Latin America and BRIC (Brazil, Russia, India and China) as well as global markets.

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