The idea that climate risk represents investment risk has moved from a novelty in the investment world to something approaching mainstream thinking in just a few years.

This shift has recently accelerated as a result of four powerful reinforcing moves: first, record damages from extreme weather events in 2020 have underscored the importance of pricing in physical risk; second, regulation globally has shifted decisively toward a net zero economy; third, clean energy innovations are reducing the cost and carbon intensity of energy production; and finally, investor sentiment appears to be turning in favor of sustainable strategies.

While the momentum behind sustainability is commendable, it is still the beginning of a long journey. An estimated USD50 to USD100 trillion in capital investment is required to rebuild a “net zero” global economy — one that emits no more greenhouse gas than it removes from the atmosphere by 2050. To put this in perspective, achieving such an objective will take the equivalent of at least 10 Marshall Plans per year for three decades.

The time frame, scale, and complexity of this challenge can seem daunting even to experienced professional investors. Many investors have an intuitive sense that climate risks are investment risks — and our clients say they expect to double their allocations to sustainable investments over the next five years. Today, the questions we get most often are around how to navigate the low-carbon transition and incorporate climate risks into portfolios.

New climate-oriented tools are helping investors with the economic transition, and one widely available means for clients to effect change right now is through exchange-traded funds (ETFs). Today, there are nearly 600 sustainable ETFs available globally (up from 30 a decade ago), a growing number of which enable investors to customize portfolios around climate needs — from reducing carbon exposure, to prioritizing a low-carbon transition, to targeting themes such as clean energy. Many of these ETFs can serve as foundational building blocks for people seeking out affordability, transparency, and convenience when investing for the low-carbon transition.

We believe that financial markets are only beginning to appreciate the potential impact of the shift toward sustainability on asset prices. The convenience that ETFs provide can further catalyze a synchronized move toward sustainability that we believe over time will help make the most sustainable assets more valuable and the least sustainable assets less valuable. BlackRock thinks such a tectonic shift will reward first mover investors and give companies meaningful incentives to accelerate their transition to a low-carbon economy.
Introduction

We believe that investors who don’t consider the effects of climate change on the global economy and asset prices aren’t seeing the whole picture. Emerging research suggests that companies that are well adapted to a low-carbon economy are better positioned than peers to grow earnings, and that greenhouse gas efficiency has links to financial performance. 7

BlackRock believes climate risk is investment risk, and market participants increasingly share this view. References to sustainability, including climate, on the quarterly earnings calls of the largest U.S. companies have tripled over the past decade, and investors plan to double their sustainable assets under management, from 18% to 37%, within the next five years. 8

We believe that the biggest potential benefits will accrue to the global investors who are quickest to ready their portfolios for the new era of climate investing.

Financial performance differences between the most and least low-carbon-ready companies (%)

Cumulative %

-20 0 20 40 60 80

Utilities

Materials

Energy

EPS growth difference Return difference

In 2020 alone, natural disasters led to an estimated USD 210B in damages, the highest ever recorded and up from the inflation-adjusted average of the last ten years of approximately USD 185B.

Source: Munich Re NatCatService database (as of March 30, 2021).

What percentage of your assets are invested sustainably in 2020? And what is your estimate for the percentage of assets under management that will be invested sustainably by 2025?

Global

18% 37%

EMEA

21% 47%

APAC

12% 22%

AMRS

13% 20%

2020

2025

Data providers and index firms are increasingly using climate information to search for linkages between low-carbon economy readiness and financial performance metrics such as earnings per share (EPS). This chart depicts the difference in EPS and equity performance between MSCI ACWI IMI companies with the highest (top quintile) Low Carbon Transition Scores and the lowest (bottom quintile) Low Carbon Transition Scores in sectors that are most exposed in terms of higher-risk LCT categories (utilities, materials, energy), according to MSCI.

MSCI (data relates to the MSCI ACWI IMI from Oct. 31, 2013, to June 30, 2020). MSCI Low Carbon Transition (LCT) Scores are a comprehensive measure for transition risk (start date for LCT data collection was October 2013). The score aggregates companies’ risks due to direct emissions (Scope 1, Scope 2), risks due to their upstream supply chain (Scope 3 upstream emissions), and risks inherent in their products and services (Scope 3 downstream emissions). The LCT Score take into account companies’ green opportunity exposure by measuring avoided emissions from green technology in Scope 3 emissions and companies’ climate transition risk management. Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.

Climate risk includes:

- Physical risk: Increased risk to companies’ assets and activities caused by the direct impact of changing weather patterns and natural catastrophes.

- Transition risk: Impact of the transition to a low-carbon economy on a company’s long-term profitability.

Source (data chart): BlackRock Global Client Sustainable Investing Survey. July – September 2020. Respondents included 425 investors in 27 countries representing an estimated USD25 trillion in assets under management. Sustainable investments are defined as portfolios which have a distinct ESG objective such as thematic or impact, apply exclusionary screens, or optimize towards ESG. It does not include ESG-integrated portfolios, company engagement or proxy voting. There is no guarantee that any forecasts made will come to pass; https://www.blackrock.com/corporate/literature/publication/blackrock-sustainability-survey.pdf

Climate risk includes:

- Increased risk to companies’ assets and activities caused by the direct impact of changing weather patterns and natural catastrophes.

- Impact of the transition to a low-carbon economy on a company’s long-term profitability.

Source: Munich Re NatCatService database (as of March 30, 2021).

Transition risk

Climate risk includes:

- Increased risk to companies’ assets and activities caused by the direct impact of changing weather patterns and natural catastrophes.

- Impact of the transition to a low-carbon economy on a company’s long-term profitability.

Source: Munich Re NatCatService database (as of March 30, 2021).
Investors over the coming decades will experience the impact of climate on asset prices in four ways:

1. **Physical risk**
   - Through increased frequency and intensity of weather events.

2. **Regulation**
   - Stricter climate policies and growing consumer preferences will affect how companies account for, and make decisions about, their carbon footprints.

3. **Innovation**
   - The increasing number of sustainable ETFs, mutual funds, and individual securities targets companies with the highest earnings growth.

4. **Preferences**
   - Investors over the coming decades will experience the impact of climate on asset prices in four ways:

The transition to a low-carbon economy will bring investment opportunities to the fore, while risks threaten economies of U.S. state and local debt issuers, commercial real estate, and the equities of U.S. electrical utilities. The first-ever climate-related regulation will increasingly affect how companies account for, and make decisions about, their carbon footprints.

Innovation is also helping investors discern where there is potential for strong investment performance and where there are risks. The U.S. has a long history of leading the world in innovation, and BlackRock believes that this trend will continue.

The increasing number of sustainable ETFs, mutual funds, and individual securities targets companies with the highest earnings growth. Over the past five years, companies with the most patents around green energy also have tended to have the highest earnings growth. MSCI, for example, uses clean energy patents as a proxy for potential future emissions.

The price of electricity from new power plants has been falling at a steady rate since 2010. The cost of electricity from gas and coal-fired plants has fallen by more than 60% over the past decade.

Sustainable ETFs with climate considerations tend to be more affordable than comparable mutual funds in the U.S.
Incorporating climate risks and opportunities into every portfolio

BlackRock sees three approaches to climate investing:

1. **Reduce**
   - Exposure to carbon emissions and fossil fuels
   - Prioritize companies based on their climate footprint

2. **Prioritize**
   - Companies that are better positioned for the transition to a low-carbon economy
   - Target climate themes

3. **Target**
   - Thematic and impact investments
   - Reduce exposure to carbon-intensive sectors

Call for action: Recognize that the ongoing transition toward a low-carbon economy will transform financial markets and industry with the investment landscape. For successful investors, this transition must be understood and recognized in the same way that the shift away from leveraged capital markets was captured by the financial crisis and its aftermath.
and helping to catalyze increasingly robust and standardized climate data and metrics to better serve the industry.

Sufficiently reliable data. Additionally, we’re helping more investors manage and meet their climate objectives by tracking investment portfolios’ trajectories toward net zero, which can be representative of other investors in the Funds or investment strategy and is not a guarantee of the future performance or success of the Funds or the investment strategy. There can be no assurance that an active trading market for shares of an ETF will develop or be maintained.

Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the issuer of the bond will not be able to repay its obligations to investors.”

Climate-oriented investing used to be difficult to access except for the handful of large institutions that had the resources to hire in-house climate specialists or the means to commission climate analyses. A broad spectrum of investors, from asset owners to wealth managers, are increasingly calling for a proactive approach to climate change and natural catastrophe risks. We are also committed to reducing the carbon footprint, dedicating capital and talent towards climate change and natural catastrophe risks. We are also committed to reducing the carbon footprint, dedicating capital and talent towards climate change and natural catastrophe risks.


Financial Times, “Volvo Cars to go all electric by 2030 as it shifts sales online, March 2, 2021;” Reuters, “Nippon Steel to boost R&D spending to hasten decarbonization,” March 1, 2021.


Ibid.


CDP Worldwide (November 2020).