

2 Integrating ESG and Climate into Portfolios



ESG Factors Have Improved Equity Returns...

While the perception that ESG principles hinder equity performance may linger in places, considerable data shows the opposite.

For example, ESG leaders showed resilience before and during the global pandemic. Worldwide, ESG-focused companies have not only seen higher returns, but stronger earnings growth and dividends.

Tools and Resources

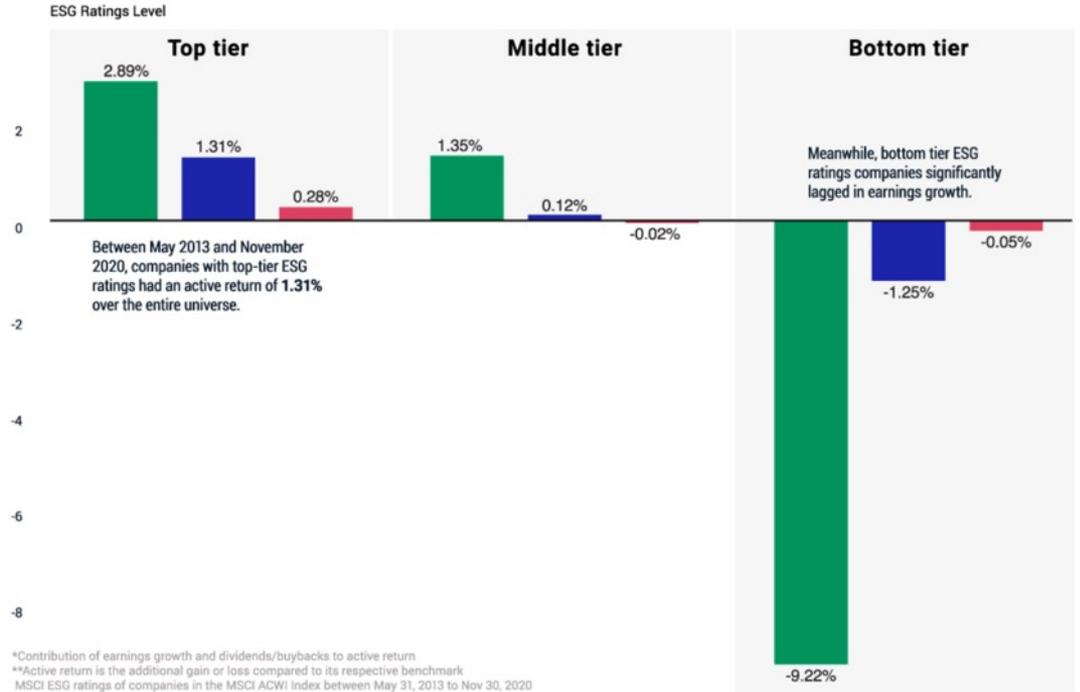
[How Have Stocks Responded to Changes in Climate Policy?](#)

[The Truth Behind 5 ESG Myths](#)

[Foundations of climate Investing](#)

Dispelling the myth that ESG comes at the expense of performance

Decomposition of Returns by ESG Ratings ● Earnings growth* ● Active return** ● Dividends & buyback*



... and Improved The Risk Return Profile of Bond Portfolios

Institutional investors made significant progress in incorporating ESG factors into their bond portfolios. Similar dynamics are now impacting retail portfolios and funds. ESG ratings had characteristics distinct from credit ratings and delivered financial value after accounting for credit ratings. The two types of rating systems complemented each other.

MSCI's analysis found that higher-ESG-rated bond portfolios realized higher risk-adjusted returns. They also exhibited significantly lower drawdowns, reflecting the defensive characteristics of an ESG bond strategy.

Tools and Resources

[Can Green Spreads Uncover ESG's Influence on Bond Prices?](#)

[What ESG Ratings Tell Us About Corporate Bonds](#)

Issuers from High-ESG-Score Tercile Had More Resilient Excess Returns

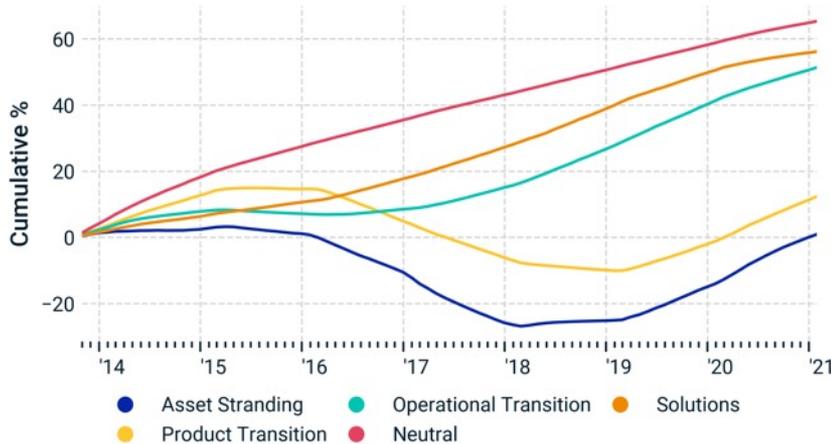


Financial Differences Between Greenhouse Gas Leaders and Laggards Can Be Significant

MSCI research has shown that higher carbon intensity leads to lower valuations, higher capital costs and a negative impact on stock price.

This impact is concentrated in the most carbon-intensive companies.

Earnings Growth



Stock Performance

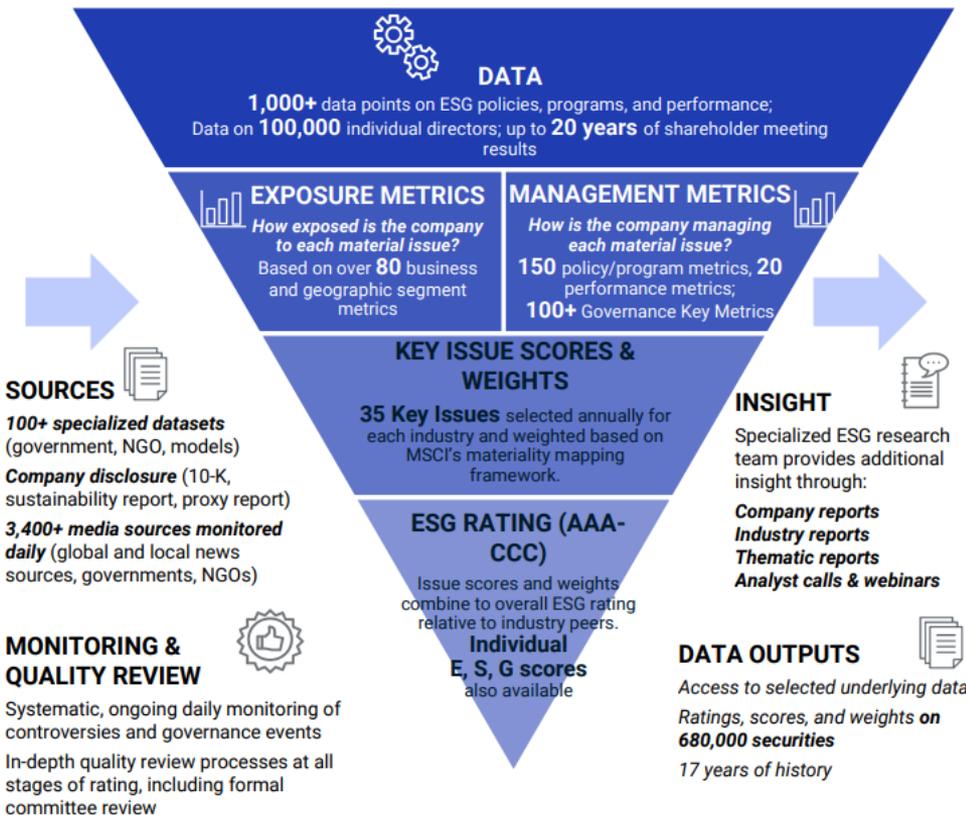


Equal-weighted low carbon transition categories within MSCI ACWI IMI

Building an ESG Framework

ESG ratings provide a consistent framework to facilitate comparative decisions. This consistency is the foundation of security analysis and subsequent ESG-driven portfolio construction.

It enables decisions based on factors that go deeper than corporate statements on ESG intent. Experience has shown that these statements have, on occasion, been misaligned from ESG reality (often referred to as “greenwashing.”) Advanced technology, including artificial intelligence, will further reduce reliance on voluntary disclosures from companies.



Tools and Resources

[ESG Fund Ratings Search Tool for 8500+ companies](#)

[ESG and Climate Funds in Focus](#)

[ESG Indexes](#)

[Understanding MSCI Climate Indexes](#)

MSCI's Ratings Methodology



ESG risks and opportunities can vary by industry and company. Our MSCI ESG Ratings model identifies the ESG risks, (what we call Key Issues), that are most material to a GICS® sub-industry or sector.

MSCI's ESG ratings measure a company's resilience to financially material environmental, societal and governance risks. While not a general measure of corporate "goodness" or a barometer on any single issue they provide a window into a critical facet of risk to financial performance.

With over 13 years of live track history we have been able to examine and refine our model to identify the E, S, and G Key Issues which are most material to an industry.

Tools and Resources



[Inside ESG Ratings](#): How Companies Are Scored



[What are ESG Fund Ratings?](#)



[Climate Matters: What's in an ESG Rating. And What's Not.](#)

CCC	B	BB	BBB	A	AA	AAA
<p style="text-align: center; color: #e91e63;">LAGGARD</p> <p>A company lagging its industry based on its high exposure and failure to manage significant ESG risks</p>		<p style="text-align: center; color: #ff9800;">AVERAGE</p> <p>A company with a mixed or unexceptional track record of managing the most significant ESG risks and opportunities relative to industry peers</p>			<p style="text-align: center; color: #008000;">LEADER</p> <p>A company leading its industry in managing the most significant ESG risks and opportunities</p>	

MSCI's Ratings Methodology



We assess thousands of data points across 35 ESG Key Issues for more than 8,500¹ companies globally. MSCI focuses on the intersection between a company's core business and the industry-specific issues that may create significant risks and opportunities.

The Key Issues are weighted according to impact and time horizon of the risk or opportunity. Corporate Governance and Corporate Behavior are typically broadly applied while environmental and social factors can vary significantly by industry.

MSCI ESG Score									
Environment Pillar				Social Pillar				Governance Pillar	
Climate Change	Natural Capital	Pollution & Waste	Env. Opportunities	Human Capital	Product Liability	Stakeholder Opposition	Social Opportunities	Corporate Governance	Corporate Behavior
Carbon Emissions	Water Stress	Toxic Emissions & Waste	Clean Tech	Labor Management	Product Safety & Quality	Controversial Sourcing	Access to Communication	Board	Business Ethics
Product Carbon Footprint	Biodiversity & Land Use	Packaging Material & Waste	Green Building	Health & Safety	Chemical Safety	Community Relations	Access to Finance	Pay	Tax Transparency
Financing Environmental Impact	Raw Material Sourcing	Electronic Waste	Renewable Energy	Human Capital Development	Consumer Financial Protection		Access to Health Care	Ownership	
Climate Change Vulnerability				Supply Chain Labor Standards	Privacy & Data Security		Opportunities in Nutrition & Health	Accounting	
					Responsible Investment				
					Insuring Health & Demographic Risk				

● Key Issues selected for the Soft Drinks Sub Industry (e.g. Coca Cola)
● Universal Key Issues applicable to all industries

Tools and Resources

[www.MSCI's ESG Ratings](https://www.msci.com/esg-ratings)

Ratings in Practice: ESG and Working Conditions

Safety protocols are a key sustainability issue for the industrial sector. Here's how two companies compare. Investors can choose to support companies that take greater lengths to protect their workers.

Tools and Resources
[The Power of a Sustainable Dollar](#)

Red flag
South African mining company

-  **11 fatalities in 2019**
-  Faced lawsuits from miners surrounding lung diseases contracted from dust exposure in gold mines
Settlement cost: **\$350M**
-  Lags peers in high incident rates
-  Lags peers in setting incident reduction targets

CCC	B	BB	BBB	A	AA	AAA
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Industry leader
U.S. mining company

-  **Zero fatalities in 2019**
-  Board-level oversight monitors health and safety performance
-  Leads peers in low incident rates

Leads industry in

-  Lost time incident rate
-  Total recordable injury rate

CCC	B	BB	BBB	A	AA	AAA
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Source: MSCI ESG Research (Dec, 2020)

In Practice: Implied Temperature Rise (ITR)

What does it measure?

The Implied Temperature Rise (ITR) metric provides an indication of how well public companies align with global temperature goals

Expressed in degrees Celsius, it is an intuitive, forward-looking metric that shows how a company aligns with the ambitions of the Paris Agreement

It covers companies' Scope 1, 2 and 3 carbon emissions (may include estimates)

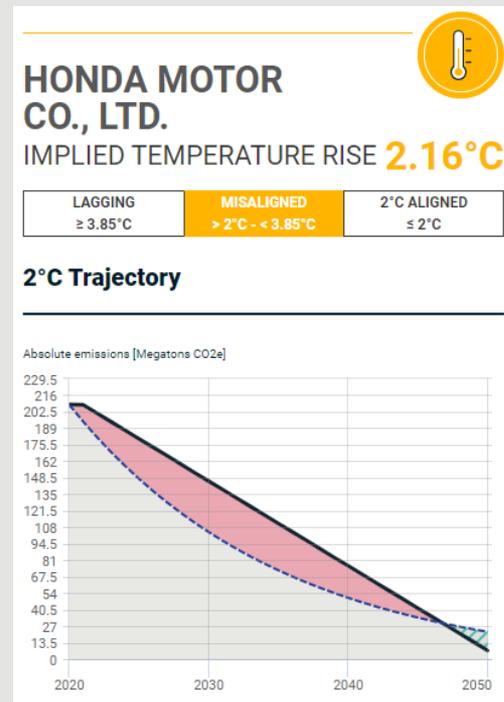
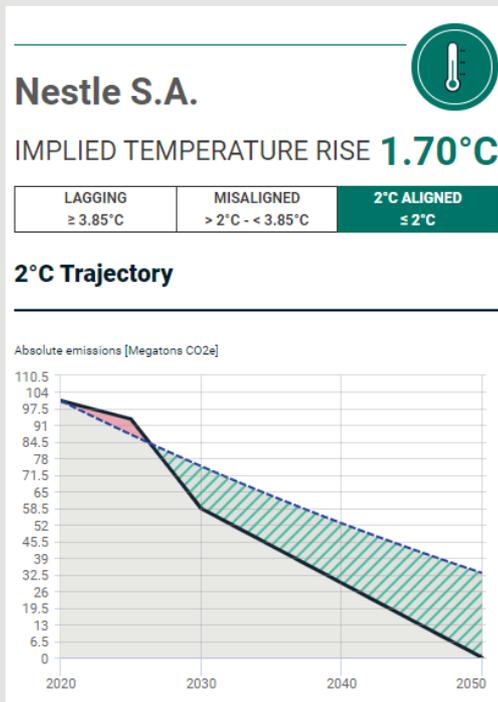
Based on data that can be easily examined and traced, together with analysis of companies' decarbonization targets

Tools and Resources

[What Implied Temperature Rise Means for Funds](#)

[The Implied Temperature Rise of 'Paris-Aligned' Indexes](#)

[ESG Ratings and ITR Search Tool](#)



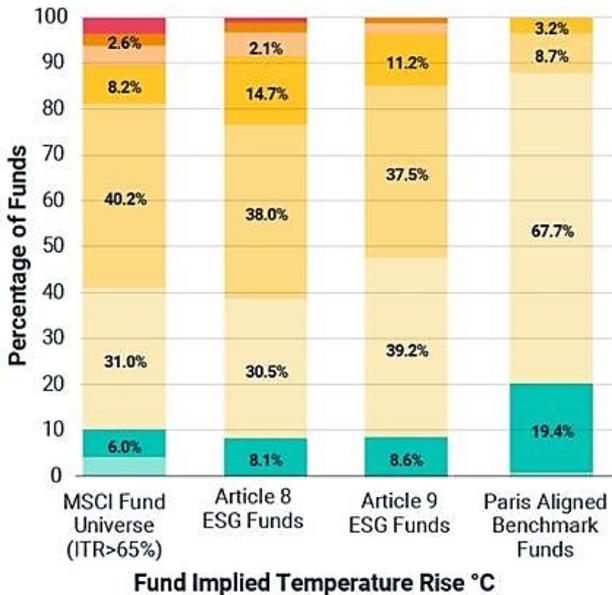
In Practice: Sustainable Fund Selection

Wealth managers are increasingly integrating climate considerations into fund selection and portfolio construction. Data points such as Fund Implied temperature rise can be used to filter the universe in this regard.

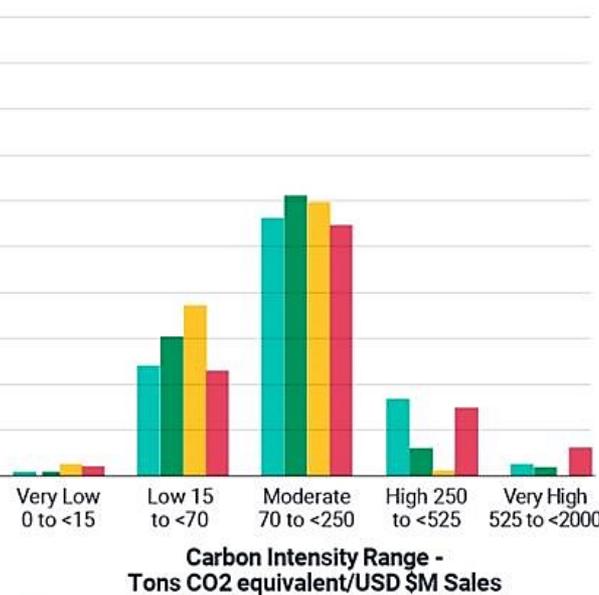
Tools and Resources

- [ESG and Climate Funds in Focus](#)
- [ESG Funds – A Global shift in investments](#)

Implied Temperature Rise of Labelled Equity ESG Funds



Carbon Intensity of Labelled Equity ESG Funds



Fund Implied Temperature Rise °C

- 1-1.5°C
- 1.5-2°C
- 2-2.5°C
- 2.5-3°C
- 3-3.5°C
- 3.5-4°C
- 4-4.5°C
- 4-4.5°C
- 5+°C

Carbon Intensity Range - Tons CO2 equivalent/USD \$M Sales

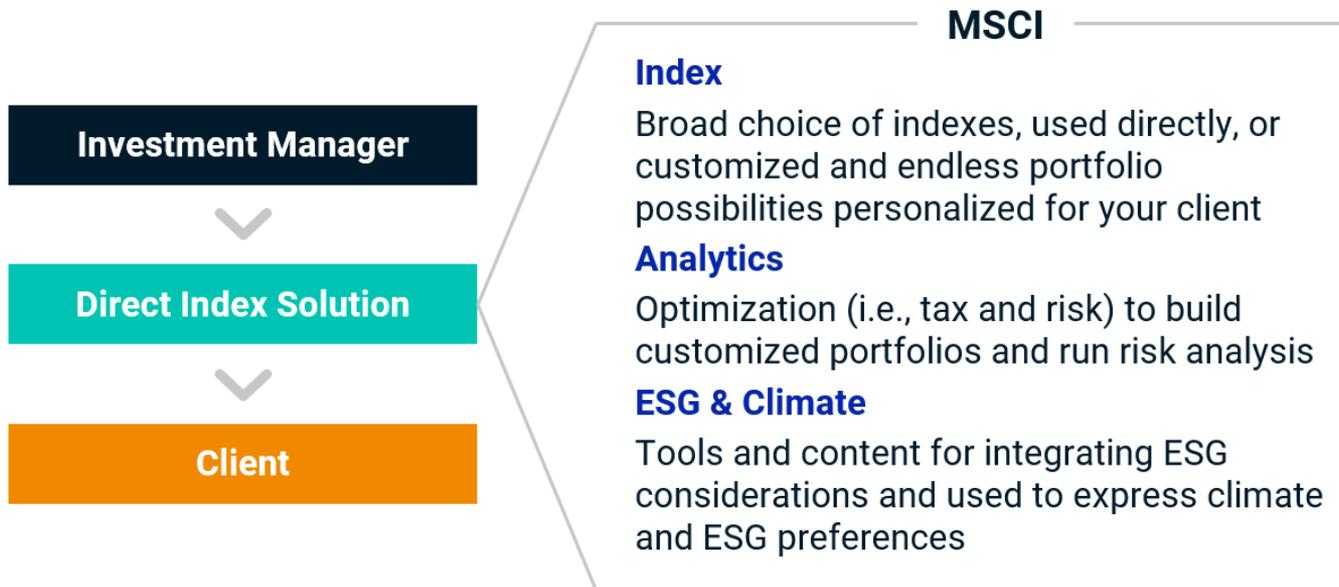
- Article 8 ESG Funds
- Article 9 ESG Funds
- Paris Aligned Benchmark Funds
- MSCI Fund Universe



Climate funds defined as mutual funds and ETFs that have "climate" in the product name and include climate specific considerations in the investment strategy. Uncategorized Climate Funds = 106, Article 8 Climate Funds = 45, Article 9 Climate Funds = 72. Data as of Nov. 11, 2021. MSCI ESG Research LLC. Information Classification: GENERAL

In Practice: Direct Indexing

Investors can customize any one of the MSCI Indexes suite to better align a client's portfolio with their climate preferences, lower risk and reduced tax burden.



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