

# Sustainability Now Podcast

## “Transition Risk vs. Temperature Alignment: What Really Drives Fund Outcomes?”

Transcript, 13 March 2026

**Speaker 1** What's up everyone, and welcome to the weekly edition of Sustainability Now, where we cover how the environment, our society and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato, and this week we are talking about a new method for understanding whether a fund is actually investing in companies that are going to be successful in lowering their emissions and, of course, performing well. Thanks, as always for joining us. Stay tuned. Back in the forever ago of early twenty twenty six, before the sky split open, when we were talking to investors about a fund's climate credentials, we were usually focusing on its carbon footprint, how much CO2 the companies inside it were producing. It's a useful metric for fund because it's standardized and it's decently reported by the companies they hold. But it has a pitfall in that it's backward looking, and it could sometimes be hard to find meaning in it for something collective, like a fund, which is a collection of held companies and on its own, it misses how the world is reacting to those carbon emissions, or more so, the world's effort to transition away from highly polluting processes, which seems more than ever a pretty useful thing for us to do right now. But what if we could score funds on how much transition risk they face, and how prepared they are to deal with any kind of transition that's happening in the global economy? Would that score actually matter for funds performance, or would it maybe be better at predicting the trajectory of the funds holding companies carbon emissions? These were the questions on the mind of my guest and colleague today, Kishan Gangadhar. He had these questions while he and his three coauthors were conducting research on the recently published and of course, publicly available research report titled Positioning Portfolios for the Energy Transition. And so to understand his research and what it meant and why we should care. I called up Keishan and asked him to take me through it, and I first wanted him to set the stage as to what the main question he was trying to answer exactly with this report. To put it to me in concrete details.

**Speaker 2** Yeah. So there was a couple of couple of aspects. One was to understand at the fund or portfolio level, did we see an association between transition risks and financial performance. And the other aspect was also to provide a framework or provide some sort of structured common language to understand their transition positioning, uh, through a sort of two dimensional lens of both transition pressure, which essentially is your risk exposure versus transition readiness, which is strategic preparedness and involvement in sort of technology based solutions. And, and I think a useful way to think of it, actually think of it as a navigation system. So. emissions data tells you where you've been. Climate alignment tells you where you're headed in the in the long term. But understanding your transition positioning, sort of your risk and readiness exposure tells you whether your strategy is built for the road ahead, right?

**Speaker 1** So that's the logic. They looked at two dimensions of the transition question in their research. There's transition pressure. That's how much risk is bearing down on you the company, because of the energy transition in the form of changing regulations, technology shifts and business model exposures. And then there's transition readiness. Whether you're actually doing something about that transition pressure, are you setting credible climate targets? Are you investing in clean tech? Are you putting governance in place that is actually paying attention to this shift in operational and consumer preference? And what the author's ultimate goals were is to see if measuring these two aspects provided some insight into a fund's financial performance and carbon emissions trajectory. And I should say that the answer to this question becomes the more consequential. When you think about the climate commitments massive investors like pension funds have made, which are beginning to falter due to a lack of action in the real world, meaning we're probably past the one point five degree warming limit. And so any one point five

degree alignment target made by an investor is likely not going to happen. So what should they do about that fact? Should they abandon ship? Should they double down? Should they find some middle ground of telling an emissions reduction story in parallel with a risk return story? There's a chance that by adopting a different framework, such as the transition readiness framework, a pension fund could say that, look, we're not one point five degree aligned today, but we're positioning ourselves in companies that are actively building toward a lower carbon economy. And that positioning might be associated with both stronger returns, yes, but also a stronger decarbonisation outcome over the next past several years. But I'm getting ahead of myself with all this. Let's first talk about what they found regarding transition scores and the almighty financial performance.

**Speaker 2** Yeah. So what we did was we applied the MSCI the energy Transition framework to over over thirty seven thousand funds. So these were mutual funds and ETFs globally representing around fifty trillion dollars in assets. And we looked at whether stronger transition positioning. So a higher transition energy transition score, uh, showed up in financial performance. And we found that funds with higher energy transition scores typically delivered stronger historical returns across multiple time horizons. So to give an example, for every one point increase in a fund, energy transition score returns were around one point seven percent per annum, higher on average. For climate and transition named funds. We found this effect was even stronger, so closer to three percent. And importantly, we saw that both sector allocation and security selection contributed to contributed to these higher energy transition scores.

**Speaker 1** Let me put some numbers on that. For every one point increase in funds transition score compared to a peer, its returns were about one point seven percent per year higher on average over the twenty twenty two to twenty twenty five period. That performance bump was even stronger for funds that specifically carried the climate or transition name. Now, a name nods to things aesthetically, sure, but there also is some regulatory and reputational weight that is going to be carried around a fund with a name like climate or transition, and they're going to have to probably be investing in something to do with the climate or with transitioning away from high emitting processes. So take that as you will. Now, if you have a climate fund, you saw a two point nine percent higher average return than your peers, and a transition fund had a two point seven percent higher average return than their peers. Now, it should be said that part of the reason is probably sector composition. Higher scoring funds tended to hold more technology and financial companies less energy and materials companies. And if you haven't been paying attention lately, technology companies have been on quite the bull ride. But it wasn't just that. Even with in the same sector, the higher scoring funds were holding better positioned companies, meaning it's possible the companies in the sector, as well as the overall sector itself, were contributing to the result, not just the market as a whole, not just tech as a whole, but we really have no way of knowing that because the authors did not, admittedly decompose exactly how much of the return difference came from being in the right sector at the right time versus picking the right company within that sector? But the fact that with the scores climbed also performance climbed within every single factor, from energy to tech tells you that it's probably not purely a sector story. And for the transition score, it's an encouraging finding. Still, this is only proven correlation, not causation.

**Speaker 2** On the flip side, we saw that transition readiness, which essentially is a stronger strategic preparedness and involvement in technology based solutions, was more closely associated with stronger decarbonization outcomes. And I think what was really valuable from that, it really sort of showed these two levers available to investors when thinking about both financial and climate objectives within their funds or portfolios, and the way in which investors can lean into both characteristics when pursuing different goals.

**Speaker 1** This is the part that I think matters a lot for understanding this framework. The two pillars of the score pressure and readiness, they don't produce the same outcome. The paper found that the lower exposure to transition pressures was the stronger driver of financial returns. So the funds that avoided the most exposed companies to these transition pressures, I'm talking heavy fossil fuel dependence companies, high policy, vulnerable companies, you know, companies in areas where they're really pushing to lower their emissions. They simply performed better. But transition readiness, which is what Keyshawn mentioned there, and it's companies that were setting credible targets and investing in solutions. This was more closely linked with actual emissions reductions. About three quarters of these high readiness funds, they called them, reduced their carbon intensity over the analysis period compared to a little bit over half of the low readiness funds. So, you know, a less percentage there, you got seventy five percent compared to fifty percent. So investors face a real choice with which factor to look at, should

they lean toward lower pressure trends to help returns, or should they lean toward higher readiness companies to help decarbonization? Really, what you would have to do is you have to look at the framework, you have to look at the levers that are visible, and then you have to decide kind of where you want to go. Uh, but it doesn't mean you can sort of just say, for example, well, my fund is good on the carbon side and you can sit on your hands and ignore any risk from the energy transition that may not fly.

**Speaker 2** A really important aspect to highlight is precisely that difference between transition risk management and climate alignment. So if fund can be well aligned, say, to a specific temperature pathway, but still be heavily exposed to transition related financial risks. And we found in the paper that the correlation between fund energy transition scores and implied temperature rise was around minus zero point four. So relatively modest correlation, telling us that these metrics are far from telling the same story. So if we looked, for example, at funds with one point five degree alignment, transition scores range from around a score of two to a score of actually nearly ten. Um, that's a surprisingly large spread. And it really highlights the material differences in how funds are actually exposed to broader transition risks and opportunities. When we look beyond temperature alignment or emissions, and that's a critical difference here. Um, and a really useful sort of, and a reason for sort of pursuing this research was to understand, um, how portfolios might be positioned for the financial impacts of the energy transition in the next few years. Um, looking beyond perhaps say, their emissions or climate alignment, uh, metrics.

**Speaker 1** This all means that you could have two funds that are both quote unquote on track for their temperature goals, but one is full of low emitting software companies with no transition exposure, while the other holds utilities and industrials that might emit heavily right now but are hopefully aggressively building renewable capacity. They have verified climate targets. They are investing in scalable clean technology, the same temperature alignment between the two funds, but a completely different financial positioning for what the transition might do to their funds holdings over the next five to seven to ten years. And right now, investors are trying to understand, for example, with tech companies, how power demand from huge data center growth will be met and what role clean energy will play. Companies with more clean energy in the mix will have higher readiness and lower pressure, as they've already begun transitioning away from high emitting sources of energy. While those more focused on coal power may and probably would face higher pressure and have lower transition readiness, all things equal. And we found that many, not all, but many US utilities are actually anticipating this change and the huge influx of load growth from data centers. And they are trying to position themselves as best they can toward low emitting sources of energy. NextEra, Edison. Xcel they have some of the highest clean energy rates in our coverage, while AEP and FirstEnergy do not. So understanding the relationship between these utilities and the tech companies that they're going to serve. As it pertains to data centers will be an important one for our future. Or rather, in the framework of this paper and the research that we're talking to, looking at the transition scores of the funds that hold these companies may give us a good idea of its overall carbon trajectory and financial stability. And know this, that there's a lot more in this paper that Keyshawn and his co-authors discussed. There's a lot more interesting topics, a lot more things to dive deep into. They have bucketed the funds that they looked at into quadrants with transition pressure on one axis and transition readiness on the other. So if this is something that you found interesting, you should go and explore these topics in the paper in more detail. Go give it a read and reach out to us with your thoughts. I always like getting random emails. And that's it for the week. I want to thank Keishan for talking to me about the news with a sustainability twist. I want to thank you so much for listening. If you like what you heard, don't forget to rate and review us and subscribe! If you'd like to hear myself or any of the other sustainability now hosts each week. Thanks again and talk to you soon.

**Speaker 3** The MSCI ESG Research Podcast is provided by MSCI Inc. subsidiary MSCI ESG research LLC, a registered investment advisor and the Investment Advisers Act of nineteen forty. And this recording and data mentioned herein has not been submitted to, nor received approval from the United States Securities and Exchange Commission or any other regulatory body. The analysis discussed should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The information contained in this recording is not for reproduction in whole or in part, without prior written permission from MSCI ESG research. None of the discussion or analysis put forth in this recording constitutes an offer to buy or sell or promotional recommendation of any security, financial instrument or product or trading strategy. Further, none of the information is intended to constitute investment advice or recommendation to make or refrain from making any kind of investment decision and may not be relied on as such. The information provided here is as is, and the use of the information assumes the entire risk of any use it may make or permit to be made of the information. Thank you.

## About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit [www.msci.com](http://www.msci.com).

---

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI. All rights in the Information are reserved by MSCI and/or its Information Providers.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. The calculation of indexes and index returns may deviate from the stated methodology. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on [www.msci.com](http://www.msci.com).

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of [msci.com](http://msci.com).

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such, provided that applicable products or services from MSCI ESG Research may constitute investment advice. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been

submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. MSCI ESG and climate ratings, research and data are produced by MSCI ESG Research LLC, a subsidiary of MSCI Inc. MSCI ESG Indexes, Analytics and Real Estate are products of MSCI Inc. that utilize information from MSCI ESG Research LLC. MSCI Indexes are administered by MSCI Limited (UK).

Please note that the issuers mentioned in MSCI ESG Research materials sometimes have commercial relationships with MSCI ESG Research and/or MSCI Inc. (collectively, "MSCI") and that these relationships create potential conflicts of interest. In some cases, the issuers or their affiliates purchase research or other products or services from one or more MSCI affiliates. In other cases, MSCI ESG Research rates financial products such as mutual funds or ETFs that are managed by MSCI's clients or their affiliates, or are based on MSCI Inc. Indexes. In addition, constituents in MSCI Inc. equity indexes include companies that subscribe to MSCI products or services. In some cases, MSCI clients pay fees based in whole or part on the assets they manage. MSCI ESG Research has taken a number of steps to mitigate potential conflicts of interest and safeguard the integrity and independence of its research and ratings. More information about these conflict mitigation measures is available in our Form ADV, available at <https://adviserinfo.sec.gov/firm/summary/169222>.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P Global Market Intelligence. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and S&P Global Market Intelligence.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data.

Privacy notice: For information about how MSCI collects and uses personal data, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.