A multi-asset approach to navigating net zero

Highlights from BlackRock's latest research paper on the practical implications of moving from climate pledges to practice for multi-asset investors

What net zero means for investors: The Paris Agreement seeks to limit temperature increases to 1.5-2°C above pre-industrial levels, which is often equated to transitioning to a "net zero" global economy by 2050. Aligning a portfolio to this objective doesn't mean building a portfolio with zero emissions today. The spirit behind the Paris Agreement lies in transitioning the most impactful sectors (such as energy) to lower carbon intensity. From a portfolio perspective, this requires a multi -year pathway.

Carbon metrics across asset classes: Different carbon metrics have different utility for investors. We evaluate various approaches to forward-looking metrics and identify an approximate "decarbonisation rate" at the asset class level for multi-asset portfolio constructors.

Monitoring portfolios and milestones: The portfolio pathway to 2050 is long. We explore incorporating interim milestones and conducting annual reviews to ensure the portfolio is evolving consistent with its chosen pathway or adapt as needed.

Building an implementation plan: Strategies that align with the Paris Agreement can include building blocks across index, factor and alpha-seeking strategies. We explore re-allocating to certain asset classes with more explicit climate goals.

Upcoming research: We advocate a flexible framework for portfolios, recognising this is an evolving space. Topics for future exploration include climate goals for government bond allocations or measuring portfolios against temperature alignment metrics. Investors globally are focusing on decarbonisation. In March 2021, 22 asset owners with $1.2 trillion in assets committed to cutting their portfolios' carbon emissions to net zero by 2050.[1] There is also a tidal wave of pending regulation that will require asset owners to report on climate risk. For example, UK regulations requiring trustees to disclose climate-related risks will start to become a standard. Beyond the UK, the G7 summit held in London in June led to an agreement that G7 nations will mandate climate reporting in line with the recommendations of the global Taskforce on Climate-related Financial Disclosures.

Conclusion

Aligning a portfolio to net zero by 2050 is not like flicking a light switch: it's a journey. Throughout the paper, we advocated the need for a clear framework to design multi-asset investment strategies that align with the Paris Agreement. We need to understand what data is available, as well as recognising some of its limitations. We have explored selecting portfolio level goals, introducing interim milestones and annual reviews and considering an array of building blocks. The benefit of such a framework is also to be flexible. We recognise this is an evolving space and we need to be able to adapt as more insights become available. For example, we are undertaking extensive research on how best to incorporate government bonds in multi-asset portfolios from a climate perspective and other lenses for constructing portfolios including temperature alignment approaches and scenario analysis to stress-test portfolio pathways.

If you would like to find out more, read the full report on our insights page.

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In association with BlackRock®

[1] Institutional Investors Group on Climate Change, March 2021.