KEYSTONE

The uncomfortable truth about climate change and investment returns

CLIMATE CHANGE WILL HAVE A PROFOUND IMPACT ON INVESTMENT RETURNS OVER THE NEXT 30 YEARS, THOUGH NOT ALL MARKETS WILL BE AFFECTED EQUALLY...

Investors can no longer ignore climate change. Long gone are the days of debating whether it even exists; climate change is here, and it is going to have a major impact on the way we live.

It is already having a major impact on how we invest, but until now we have never really been able to quantify the impact a warming planet may have on investment performance.

That is why the results of the latest analysis from Schroders is so striking. The analysis needs to serve as a wake-up call for the potential impact climate change is likely to have on our investment future.

Each year the Schroders Economics team join forces with the Multi-Asset Investment team to produce 30-year forecasts for investment returns from stock and bond markets around the world. And this year the impact of climate change has been incorporated for the first time.

Their analysis takes account of the physical costs, carbon taxes and losses incurred as some oil and coal reserves have to stay in the ground. The results show that climate change may favour an increased investor emphasis on developed markets, while emerging market returns are negatively impacted, despite remaining potentially attractive.

For investors in Switzerland, Canada and the UK, the rather uncomfortable findings are that over the next 30 years climate change will actually boost returns from their domestic stock markets. In short, this is because a warmer climate should improve productivity in these relatively cold, but developed, markets.

However, it is also due to various other factors such as the potential costs of mitigating the impact of rising temperatures, which in the case of a relatively low-carbon economy such as the UK has less impact than some other nations.

According to their analysis, annualised inflation-adjusted returns from the Swiss

stock market over the next 30 years would be 4.1% without any climate change, but 5.4% with climate change. In Canada, the respective numbers are 4.4% and 5.4%, while in the UK they are 5.7% and 6.0%. The forecast for the MSCI World index goes up slightly with the impact of climate change, from 3.7% per annum to 3.8%.

To put this in context, over 30 years the compounding effect of this is extremely significant: £10,000 invested in the Swiss stock market today at 4.1% would be worth around £33,000 in the year 2050. Taking into account climate change, it would be worth around £48,000.

Although this paints a positive picture in these countries, this is in no way an endorsement of standing still on climate change. The consequences of not taking action on rising temperatures could be devastating across all countries this century. We assume countries will introduce a carbon tax. However, it will probably come too late and be too small to hit the Paris Agreement goal of limiting temperatures to 1.5 degrees warming by the end of the century.

The markets that will suffer most from climate change over the next 30 years are those in the warmest countries, mainly in emerging markets. India is the worst affected, feeling both the productivity hit of rising temperatures and the large potential cost of carbon pricing. Over the next 30 years, inflation-adjusted returns from India's stock market are forecast to be 6.2% per annum without climate change. With climate change, returns are forecast to be 2.3% per annum. To put these in perspective, £10,000 invested today would be worth either approximately £60,000 in 30 years with no climate change, or around £20,000 with. So, the impact of climate change reduces forecasted returns by two-thirds in cash terms.

Among the other worst hit markets are Singapore and Australia, while emerging markets as a whole also take a significant blow to forecast returns. The 30-year forecast for emerging markets equities falls from 6.3% per annum to 4.4% per annum when factoring in climate change.

Of course, all these findings rely on a large number of assumptions and there are significant ranges around the return numbers. Nonetheless, they illustrate where the winners and losers from climate change are likely to be found. The message is clear: the likely long-term divergence in regional performance means that an active approach to managing the risks of climate change is no longer optional, it is essential.

52 Brook Street, Mayfair, London W1K 5DS T. +44(0)20 7078 4855 E. help@keystone-capital.co.uk

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