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A Tectonic Shift Accelerates

In January of last year, I wrote that climate risk is investment risk. I said then that as markets started to price climate risk into the value of securities, it would spark a fundamental reallocation of capital. Then the pandemic took hold – and in March, the conventional wisdom was the crisis would divert attention from climate. But just the opposite took place, and the reallocation of capital accelerated even faster than I anticipated.

From January through November 2020, investors in mutual funds and ETFs invested $288 billion globally in sustainable assets, a 96% increase over the whole of 2019. I believe that this is the beginning of a long but rapidly accelerating transition – one that will unfold over many years and reshape asset prices of every type. We know that climate risk is investment risk. But we also believe the climate transition presents a historic investment opportunity. Essential to this transition has been the growing availability and affordability of sustainable investment options. Not long ago, building a climate-aware portfolio was a painstaking process, available only to the largest investors. But the creation of sustainable index investments has enabled a massive acceleration of capital towards companies better prepared to address climate risk.

Today we are on the cusp of another transformation. Better technology and data are enabling asset managers to offer customized index portfolios to a much broader group of people – another capability once reserved for the largest investors. As more and more investors choose to tilt their investments towards sustainability-focused companies, the tectonic shift we are seeing will accelerate further. And because this will have such a dramatic impact on how capital is allocated, every management team and board will need to consider how this will impact their company's stock.

Alongside the shift in investor behavior, we have seen a landmark year in the policy response to climate change. In 2020, the EU, China, Japan, and South Korea all made historic commitments to achieve net zero emissions. With the U.S. commitment last week to rejoin the Paris Agreement, 127 governments – responsible for more than 60% of global emissions – are considering or already implementing commitments to net zero. Momentum continues to build, and in 2021 it will accelerate – with dramatic implications for the global economy.

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Sustainability and DeeperConnections to Stakeholders Drives Better Returns

In 2018, I wrote urging every company to articulate its purpose and how it benefits all stakeholders, including shareholders, employees, customers, and the communities in which they operate. Over the course of 2020, we have seen how purposeful companies, with better environmental, social, and governance (ESG) profiles, have outperformed their peers. During2020, 81% of a globally-representative selection of sustainable indexes outperformed their parent benchmarks. This outperformance was even more pronounced during the first quarter downturn, another instance of sustainable funds' resilience that we have seen in prior downturns. And the broader array of sustainable investment options will continue to drive investor interest in these funds, as we have seen in 2020.

But the story goes deeper. It's not just that broad-market ESG indexes are outperforming counterparts. It's that within industries – from automobiles to banks to oil and gas companies – we are seeing another divergence: companies with better ESG profiles are performing better than their peers, enjoyinga "sustainability premium."

It is clear that being connected to stakeholders – establishing trust with them and acting with purpose – enables a company to understand and respond to the changes happening in the world. Companies ignore stakeholders at their peril – companies that do not earn this trust will find it harder and harder to attract customers and talent, especially as young people increasingly expect companies to reflect their values. The more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term, durable profits for shareholders.

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