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Climate Change and Fixed Income Returns:

A Conversation with Kedge

Spoiler Alert: Professor Revelli, what did you discover?

Pr. Christophe Revelli: In the study developed by Ricardo Henriquez, research assistant in **our chair**[1], we determined that fixed income returns *do* react to climate news such as conferences – and they react negatively, and proportionately to the level of news in the media. Our conclusion is that when the regulatory or transition risks rise, bonds reflect a portion of the risk in their prices. Interestingly, bonds seem more sensitive to these risks than to news of individual weather disasters such as hurricane damage. As a complementary measure to environmental risks, the analysis of bonds should take into account these risks as well as weather disasters such as hurricane damage.

Can you give us a few more of your conclusions?

Looking at the data in a different direction, we isolated which factors were associated with the greatest change in returns – that is, which bonds did the market consider to have the most climate risk.

1 Ricardo Henriquez was recently awarded as the best young researcher by the Association Française des Investisseurs Institutionnels (Af2i).

Pr. Christophe Revelli,

Professor of Sustainable Finance and Impact Investing, Kedge Business School, and Kedge/Candriam "Finance Reconsidered: Addressing Sustainable Economic Development" research chairholder.

By *industry*, the sectors with the greatest greenhouse gas emissions are construction materials, oil & gas, and electric utilities. The three sectors which have been most negatively affected by increased climate news including climate conferences and climate regulation proposals, were real estate, industrials, and consumer discretionary – followed next by the obvious energy, materials, and utilities. We attribute this to perception of climate regulatory risk. The obvious suspects are already viewed by the market as 'at risk' of increased climate regulation, while these three industries could be subject to a greater proportionate increase in regulation.

"There is not a fixed ESG definition for a 'sustainable' company. Not only not fixed, but often two systems will offer contradictory sustainability ratings."

By *rating*, we found the obvious conclusion that lower-rated bonds had the most negative response to climate news or climate risk. The sharp degree to which the lower-rated bonds are negatively affected suggests that public credit ratings already incorporate non-financial data related to climate risks – which of course the case.

Studies of ESG factors on security returns vary widely. What makes yours more likely to be accurate?

There is not a fixed ESG definition for a 'sustainable' company. Not only not fixed, but often two systems will offer contradictory sustainability ratings. It should be no surprise, therefore, that academic studies of whether ESG analysis or sustainability ratings affect risks or enhance returns are contradictory and that the body of work is inconclusive.

By changing the question to how to securities prices, in this case bonds, react to a specific and measurable signal – in this case, climate news – we are able to analyse returns against an objective definition.

What can fixed income investors take away?

We would conclude that ESG integration in fixed income portfolio strategy requires investment signals, or information inputs, which are specific to the fixed income asset class.

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