

## Taking a Thematic Indexing Approach to Sustainability: Examining the Case for Clean Energy

### Introduction

*As debates continue over how much is enough to green the world's energy supply, transparent, diversified and liquid strategies may help investors play their part while also pursuing sustainable outcomes, says Jason Ye, Head of Strategy Indices in APAC at S&P Dow Jones Indices (S&P DJI).*

Fresh from the discussions at COP27 in November, clean energy is top of mind on the global agenda. For many investors, the financial incentives to move as quickly as possible from fossil fuels to renewables such as solar, wind and hydroelectric power are greater than ever.

In short, the cost of climate change is at a tipping point. The economic impact of the increasing frequency and severity of disruptive natural disasters hit USD 343 billion last year—over 95% of which was due to weather and climate-related events—making 2021 the third-costliest year on record, according to Aon's annual report.<sup>1</sup>

The numbers appear to get even more striking as time goes on. Deloitte, for example, estimates that climate change could cost the global economy USD 178 trillion over the next 50 years.<sup>2</sup>

It is no surprise to see extreme heatwaves, drought and flooding become more common. The World Meteorological Organization's latest findings show the past eight years on track to be the eight warmest on record.<sup>3</sup>

Yet in the face of the mounting evidence, the journey toward a renewables-led future is proving to be relatively slow and long. Perhaps most revealing is the UN's own 2022

<sup>1</sup> <https://www.aon.com/weather-climate-catastrophe/index.aspx>

<sup>2</sup> <https://www2.deloitte.com/global/en/pages/about-deloitte/articles/global-turning-point.html>

<sup>3</sup> <https://public.wmo.int/en/media/press-release/eight-warmest-years-record-witness-upsurge-climate-change-impacts>

progress report on its 17 Sustainable Development Goals (SDGs); it concludes that, when it comes to affordable and clean energy, the current progress is insufficient.<sup>4</sup>

For example, the pace of electrification has slowed amid the growing challenge of getting to those hardest to reach. Intensified efforts are needed in the least developed countries to jump-start access to clean cooking fuels and technologies. Without these, the health of 2.4 billion people is at risk. Further, rising commodity, energy and shipping prices have increased the cost of producing and transporting solar photovoltaic modules, wind turbines and biofuels worldwide.

Despite these trends, investors may offer optimism for greening the world's energy, based on how they allocate capital. The motivation should be strong; achieving the desired goal can potentially boost the size of the global economy by USD 43 trillion in net present value terms from 2021 to 2070, according to Deloitte.

## Cleaning Up with More Capital

There are many reasons why investors may be encouraged by the combination of public and private sector support for renewables.

Among various recent initiatives, the U.S. and the United Arab Emirates agreed to invest USD 100 billion in clean energy projects, with the aim to produce 100 GW of clean energy worldwide by 2035.<sup>5</sup> Meanwhile, the European Investment Fund (EIF), the region's largest venture capital and private equity financier, made a clear statement at COP27 by signing investments totaling EUR 247 million (USD 247 million) to enable five equity funds to back EUR 2.5 billion of climate action investment that helps deliver the EU's climate and energy targets.<sup>6</sup>

On a grander scale, governments representing over half of global GDP agreed at COP27 to the "Breakthrough Agenda," a 12-month action plan to help make clean technologies cheaper and more accessible everywhere.<sup>7</sup>

Interest in renewable energy and clean tech across developed and emerging markets has been accelerating. In the first 10 months of 2022, for example, the UNFCCC (UN Climate Change) said USD 94 billion had been committed by governments to

<sup>4</sup> <https://unstats.un.org/sdgs/report/2022/Goal-07/>

<sup>5</sup> <https://www.power-technology.com/news/us-uae-clean-energy/>

<sup>6</sup> [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_22\\_6802](https://ec.europa.eu/commission/presscorner/detail/en/IP_22_6802)

<sup>7</sup> <https://climatechampions.unfccc.int/breakthrough-agenda/>

demonstrating clean energy technologies by 2026 in response to U.S. president Joe Biden's USD 90 billion challenge.<sup>8</sup>

Further, a report by the International Energy Agency (IEA) showed that global energy investment is set to increase by 8% in 2022 to reach USD 2.4 trillion, much of which is focused on clean energy.<sup>9</sup>

At the same time, however, the IEA believes today's levels of capital spending are still far from sufficient to tackle the energy and climate crises, plus it is mostly taking place in advanced economies and China.

The World Economic Forum (WEF) agrees. It says that for clean energy transitions to be successful, institutional investors, corporates and governments must increase funding for renewable infrastructure, particularly in emerging and developing economies. Private funding is an essential component, too, with the WEF estimating that India's net-zero emissions target alone needs a USD 10 trillion investment.<sup>10</sup>

## Closing the Sustainability Gap

Beyond funding, information gaps and short-termism may also present challenges for investors when originating and investing in clean energy assets. The limited availability of transparent and reliable data on unlisted asset returns, as well as asset-specific and macro-financial risks, restrain investor participation, says the WEF.

In line with such investment shortfalls and the desire for more visibility, portfolio managers and asset allocators may want to consider the scale of this potentially lucrative opportunity.

"Many investors are increasingly looking at a wider array of instruments to make their mark via exposure to a cleaner and more sustainable energy future," says S&P DJI's Jason Ye.

In particular, to capitalize the ever-sharper focus on sustainable investing, an index-based thematic approach provides the typical benefits of indexing—such as lower costs, diversification, liquidity and product transparency—while also targeting a specific SDG, he explains.

The visibility associated with these solutions has attracted increasing flows into the funds that are tracking the [S&P Global Clean Energy Index](#). Although launched well

<sup>8</sup> <https://climatechampions.unfccc.int/breakthrough-agenda/>

<sup>9</sup> <https://www.iea.org/reports/world-energy-investment-2022>

<sup>10</sup> <https://www.weforum.org/agenda/2022/09/energy-crisis-investment-renewable-energy-developing-economies/>

over a decade ago, the methodology and index construction have evolved in conjunction with changes in market expectation and the availability of more granular data.

“We get a lot of questions from investors about why certain companies are included or excluded, especially when we rebalance the index,” says Ye. “We respond to the feedback by making the methodology transparent, which enables those funds that use the index to express specific views to end clients.”

Ultimately, by keeping up with market practices as well as preferences for clean energy, index-based solutions are helping investors achieve sustainability objectives and meet any specific exposure targets in order to adhere to guidelines.

[Click here](#) to learn more about sustainable investing through index-based thematic strategies.

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