



June 2024

MSCI Transition Aware Select Indexes

This product insight gives an overview of the MSCI Transition Aware Select Indexes, which are designed to support investors seeking to drive decarbonization of the economy by financing climate transition.



Contents

Introduction: Financing the climate transition	3
Climate transition has created opportunities	4
MSCI Transition Aware Select Indexes Methodology overview	5
Exclusion criteria	6
Key index metrics	6
Index applications	7
Conclusion	8

Introduction: Financing the climate transition

Investors are increasingly recognizing the impact of climate change on the global economy, an awareness that has begun to influence decision making in their portfolios. Transitioning to a low-carbon global economy is essential if the goals outlined in the 2015 Paris Agreement are to be met. As a result, assessing and managing climate-transition risks has become an increasingly important aspect of the institutional investment process.¹

Financing the climate transition is an alternative investment approach to the well-known portfolio-decarbonization approach. The approaches are compared in Exhibit 1. Both approaches aim to lower a portfolio's carbon footprint in the long run but use different economic strategies to achieve this goal. Whereas the latter focuses on reducing the financed emissions of a portfolio through portfolio reweighting, the former aims to finance companies that are climate-transition leaders in their sectors (i.e., frontrunners in transitioning their business models).

Exhibit 1: Strategic approaches to climate investing

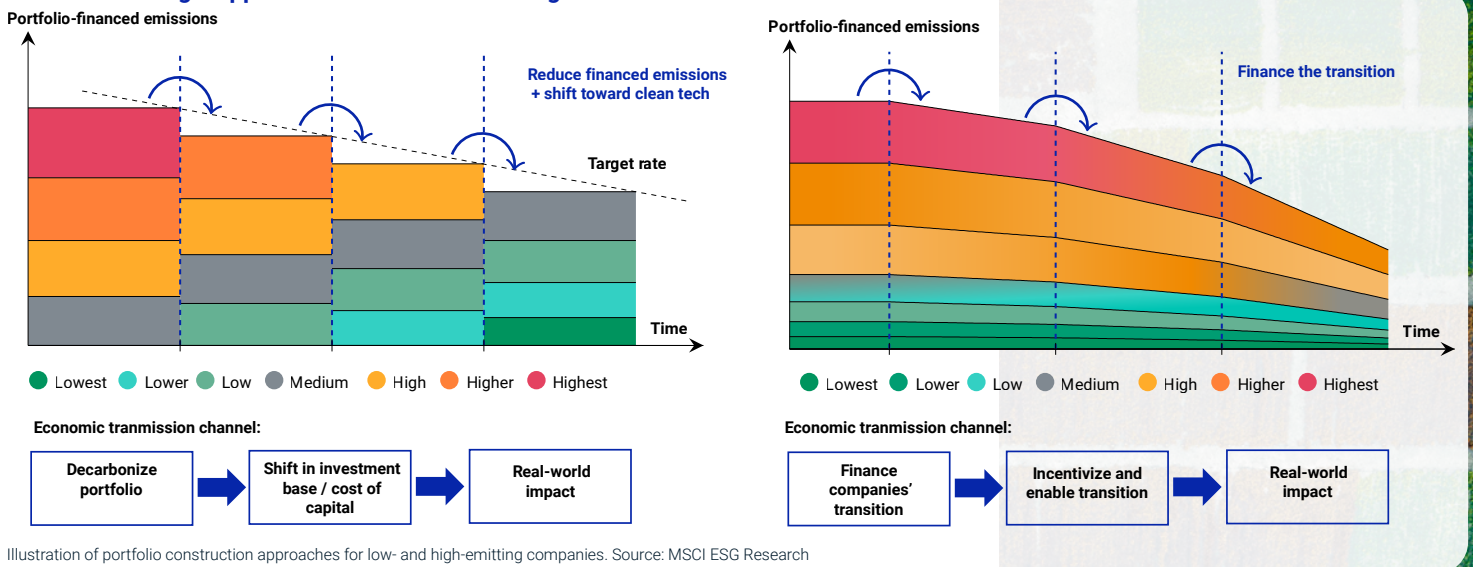
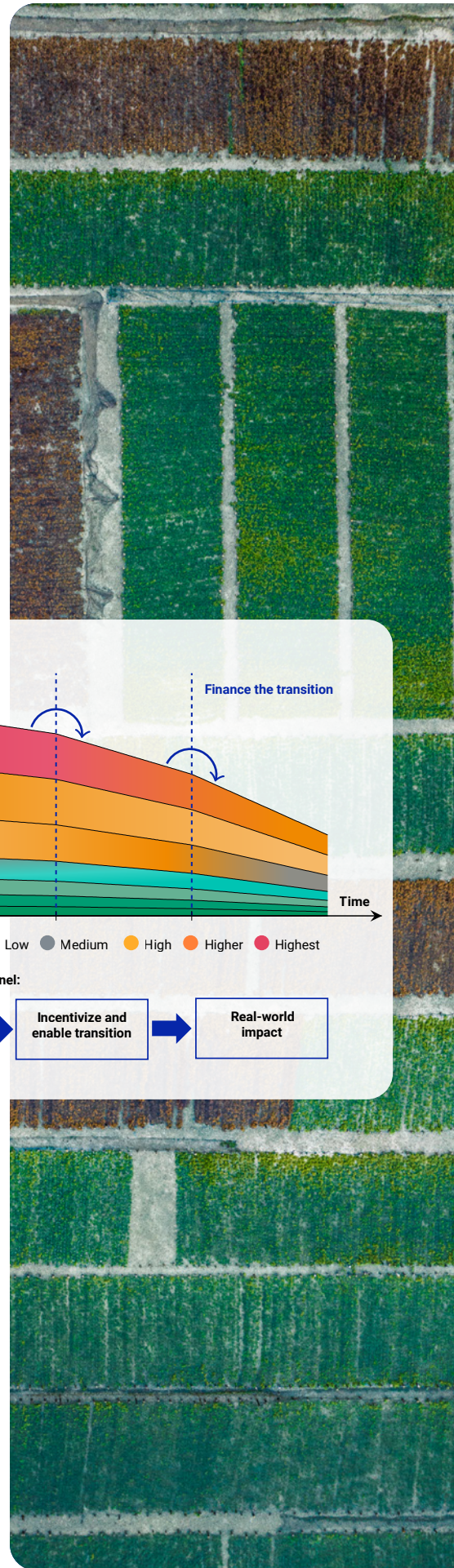


Illustration of portfolio construction approaches for low- and high-emitting companies. Source: MSCI ESG Research

Both approaches have advantages and limitations. The decarbonization approach allows investors to meet pre-defined emissions targets but may lead to lower levels of portfolio diversification and higher tracking error, especially if the decarbonization rate of the broader investment universe is much slower. The financing-the-climate-transition approach allows for diversified market representation and offers the opportunity to invest in companies that are leading their sector counterparts in transition efforts. While this approach would provide higher exposure to companies that have set targets or a track record in emissions reduction, it does not guarantee meeting pre-defined decarbonization targets.

It is important to understand that the approaches have slightly different investment objectives. In practice, investors can choose to allocate capital to both, which may allow for combining their respective advantages.

¹ Climate-transition risk refers to the potential costs faced by businesses due to the global shift toward a more-sustainable, low-carbon economy.





Climate transition has created opportunities

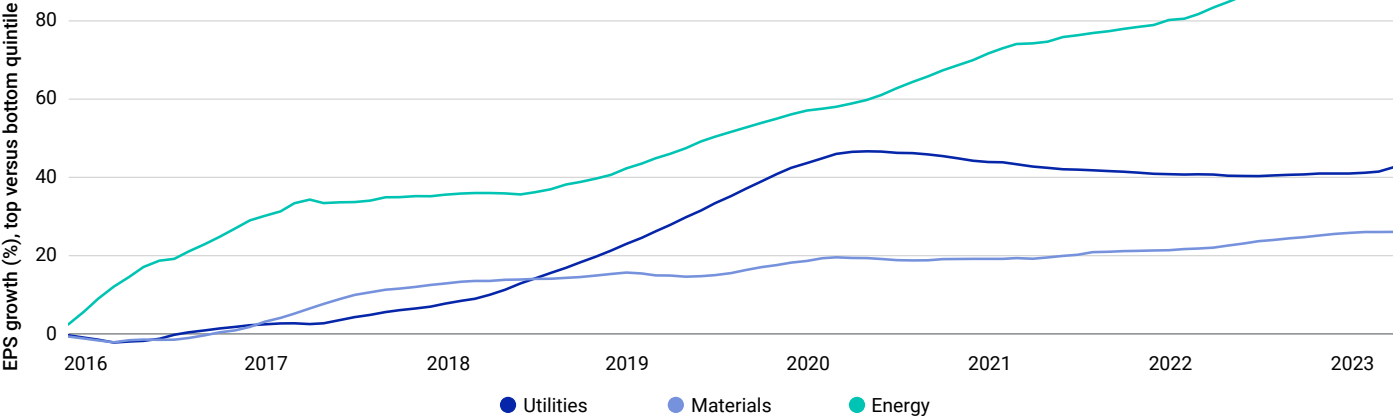
A global economy taking steps to decarbonize is likely to create opportunities for companies that are transitioning their business models in the face of climate change. An increasing number of investors are also looking for ways to seize financial opportunities from the transition.

The transition to low carbon requires significant investments in new technology (e.g., installing new wind- or solar-power capacity, increasing energy efficiency, and adopting carbon-capture and storage solutions) to replace existing fossil-fuel-based technology. This technology transition offers significant opportunities for investing in the companies leading the way. At the same time, some investors may consider that investments in companies lagging in the technology transition pose risks.

The approach of financing the climate transition also has a clear economic rationale: from a company perspective, it addresses the financial need of companies to transition their business models, and from an investor’s perspective, it offers the opportunity to invest in companies that are leading their sector counterparts in rebuilding their business models.

This technology shift has already started to materialize in the form of a shift in corporate earnings in global equity markets, as measured by the MSCI ACWI Investable Market Index (IMI) and shown in Exhibit 2. In the three most-carbon-intensive Global Industry Classification Standard (GICS®)² sectors (i.e., utilities, materials and energy), companies with higher exposure to green revenues showed higher earnings-growth rates than their sector peers with lower green revenues.

Exhibit 2: Faster earnings growth associated with higher green revenues



Green revenues include MSCI ESG Research’s estimates of revenues from energy efficiency, alternative energy and green buildings through the [MSCI ACWI Sustainable Impact Index Methodology](#). The universe is the constituents of the MSCI ACWI IMI as of April 2023. Source: Chris Cote and Guido Giese, “[The Climate Transition Is Increasingly about Opportunity](#).” MSCI ESG Research, May 15, 2023.

² GICS is the global industry classification standard jointly developed by MSCI and S&P Global Market Intelligence.

MSCI Transition Aware Select Indexes Methodology overview

The MSCI Transition Aware Select Indexes (the “Indexes”) are designed to represent the performance of companies that have been assessed as leaders in terms of their positioning and actions relative to a climate transition. The Indexes follow a transparent rules-based methodology framework that offers visibility into security selection and weighting.³ Companies are included based on their sector-relative greenhouse gas (GHG) emissions intensity and measures taken to reduce emissions. The methodology reflects the financing-the-climate-transition approach of climate investing.

The Indexes follow a bottom-up approach in which the constituents of the underlying MSCI Indexes (the “Parent Indexes”) are selected based on an assessment of the following three dimensions:

- 1 One or more GHG-emissions-reduction targets approved by the Science Based Targets initiative (SBTi).
- 2 Revenue above a threshold from greener businesses (i.e., greater than or equal to 20%).
- 3 Relative to sector peers based on GHG emissions (Scope 1 + 2) intensity. The Indexes use this assessment to select the top 50% (by market capitalization) of the securities from each GICS sector in the Parent Indexes. This selection is limited to the companies that disclose emissions-reduction targets.

Exhibit 3: Climate-change metrics used in index construction

Climate metric	Calculation	Rationale
SBTi-approved emissions-reduction targets	A company's emissions-reduction targets are independently approved as science-based targets and are aligned with the goal of keeping global warming at or below 2°C.	Setting comprehensive and credible targets is key to managing and mitigating transition risks.
Green-business revenue	Measures a company's revenue generated from products or services related to various clean-tech themes.	Indicates to what extent companies have already started to transition their business models toward products and services that are aligned with the low-carbon economy.
GHG-emissions intensity	Scope 1 + 2 GHG emissions per USD 1 million of a company's enterprise value including cash (EVIC).	Proxy for a company's transition risks, particularly in the absence of the other two climate metrics.

³ This document provides a high-level overview of the methodology. For full methodology details, please refer to: <https://www.msci.com/documents/10199/6870d8de-59df-ac4a-89a8-5e375afd289e>



Although assessing and managing climate-transition risks is an important investor objective, institutional investors must also consider their fiduciary responsibilities. Generally, investors need to balance the trade-offs between achieving climate objectives and financial objectives, such as tracking error and diversification (e.g., country and sector allocations). The selected stocks are weighted in terms of financial metrics in proportion to their market capitalization in the Parent Index. Additionally, the index methodology incorporates specific rules so that the active weights at the issuer, sector and country levels do not deviate significantly from the Parent Index.

Furthermore, the Indexes exclude companies that do not disclose their emissions or emissions-reduction targets in the more-carbon-intensive sectors, namely, energy, materials, industrials and utilities.

More details on the calculation methodology of climate metrics and the index methodology rules are available in the [MSCI Transition Aware Select Indexes Methodology](#).

Exclusion criteria

Controversial weapons



ESG controversies



Tobacco



Thermal coal mining



Thermal coal power



Unconventional oil and gas



Compliance with the United Nations Global Compact Principles



Key index metrics

We compare the simulated performance and other characteristics for the MSCI World Transition Aware Select and MSCI World Climate Paris Aligned Benchmark Select Indexes from December 2018 through March 2024 in Exhibit 4.⁴ Both indexes had, on average, a similar number of constituents and similar turnover during the period.

The index methodologies contrast the two climate-investing approaches: financing the climate transition (MSCI World Transition Aware Select Index) versus portfolio decarbonization (MSCI World Climate Paris Aligned Benchmark Select Index).

Exhibit 4: Key metrics and backtested performance

	MSCI World Index	MSCI World Transition Aware Select Index	MSCI World Climate Paris Aligned Benchmark Select Index
FINANCIAL METRICS			
Total return* (%)	12.7	13.6	12.5
Total risk (%)	18.2	17.9	18.5
Return/Risk	0.70	0.76	0.68
Active return (%)	0.0	0.9	-0.2
Tracking error (%)	0.0	1.5	1.9
Information ratio		0.60	-0.09
Number of constituents**	1,568	749	762
Turnover*** (%)	2.5	10.4	12.0

Data period for financial metrics is Nov. 30, 2018, to March 31, 2024. * Gross returns are annualized in USD. ** Calculated based on monthly average.

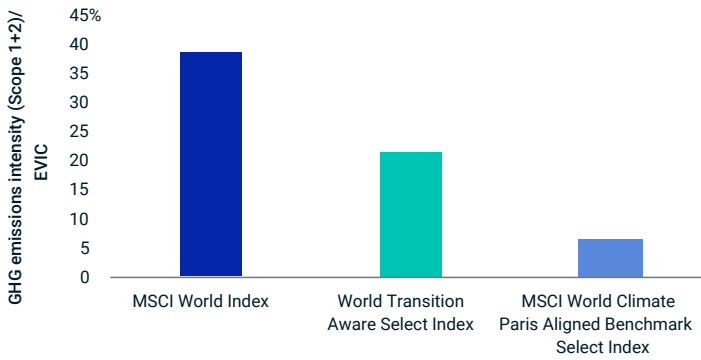
*** Calculated as annualized one-way index turnover divided by index reviews.

⁴ The analysis and observations in this report are limited solely to the period of the relevant historical data, backtest or simulation. There are frequently material differences between backtested or simulated performance results and actual results subsequently achieved by any investment strategy. Past performance – whether actual, backtested or simulated – is no indication or guarantee of future performance. None of the information or analysis herein is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision or asset allocation and should not be relied on as such.

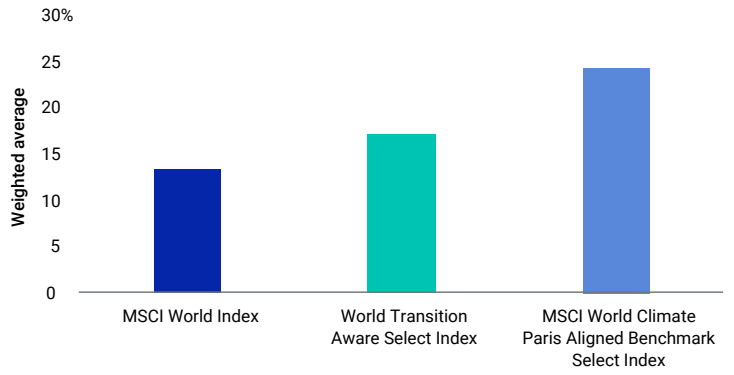
Both climate indexes had a significantly better climate profile compared to their parent MSCI World Index across several key climate metrics.

Exhibit 5: Key climate metrics

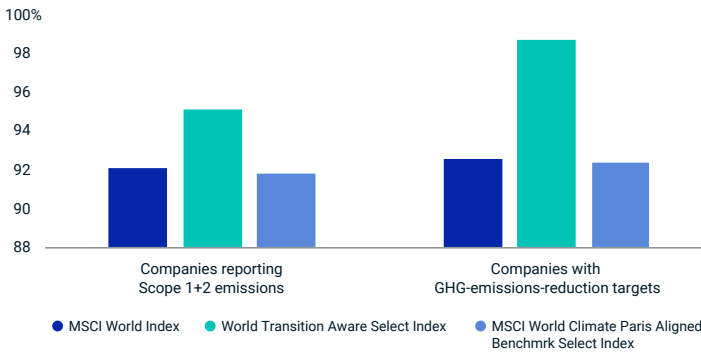
Panel A. GHG-emissions-intensity footprint



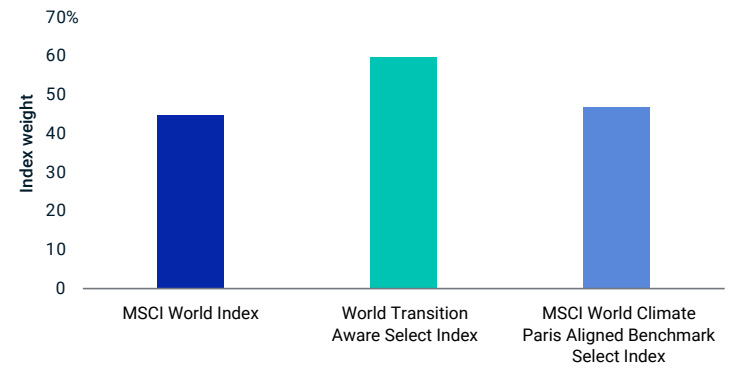
Panel B. Exposure to clean-technologies-solutions companies, ≥ 20% revenue



Panel C. Exposure to companies reporting emissions and targets



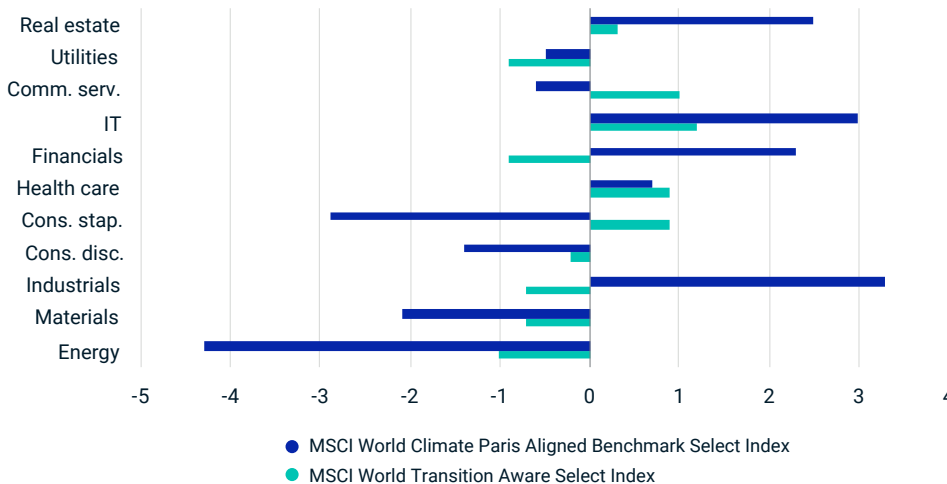
Panel D. Exposure to companies with SBTi-approved targets



Data as of March 29, 2024. GHG emissions intensity to EVIC is defined as the weighted average Scope 1 + 2 GHG emissions intensity normalized by EVIC. Unit is tons of CO2/USD million EVIC.

Sector exposures of the MSCI World Transition Aware Select Index have been in line with the MSCI World Index, not exceeding, on average, the sector weights by more than 1% between Nov. 30, 2018, to March 31, 2024.

Exhibit 6: Average active sector exposures



Data from Nov. 30, 2018, to March 31, 2024.

Index applications

MSCI Transition Aware Select Indexes can be used in the following ways:

- 1 The basis for index-based strategies, such as index-linked funds or ETFs.
- 2 Benchmarks for climate-aware portfolios to assess their financial and climate characteristics compared to active managers' portfolios.
- 3 The underlying index for structured products and derivatives.

An aerial photograph of a vast aquaculture farm. The water is a deep green color, and the farm is composed of numerous rectangular pens separated by dark lines. Each pen is filled with thousands of small, white and yellow floats. A small boat is visible in the lower-left quadrant of the image.

Conclusion

As investors adapt their investment strategies to cope with the challenges and to capture the opportunities associated with the transition to a low-carbon economy, a holistic approach could embed transition-risk measures that reflect companies' carbon footprints, commitments to reduce the carbon footprint through published targets and revenues from green businesses. Combining these datasets could provide an extensive assessment of companies' transition profiles. The MSCI Transition Aware Select Indexes could therefore play a crucial role for institutional investors, as both a benchmark and as the basis of indexed allocations.



Saurabh Katiyar

Executive Director, MSCI Research

Krati Gupta

Executive Director, MSCI Research



About MSCI Inc.

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process.

To learn more, please visit www.msci.com

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI. All rights in the Information are reserved by MSCI and/or its Information Providers.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information may include "Signals," defined as quantitative attributes or the product of methods or formulas that describe or are derived from calculations using historical data. Neither these Signals nor any description of historical data are intended to provide investment advice or a recommendation to make (or refrain from making) any investment decision or asset allocation and should not be relied upon as such. Signals are inherently backward-looking because of their use of historical data, and they are not intended to predict the future. The relevance, correlations and accuracy of Signals frequently will change materially.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked Investments"). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. The calculation of indexes and index returns may deviate from the stated methodology. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on www.msci.com.

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of msci.com.

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such, provided that applicable products or services from MSCI ESG Research may constitute investment advice. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. MSCI ESG and climate ratings, research and data are produced by MSCI ESG Research LLC, a subsidiary of MSCI Inc. MSCI ESG Indexes, Analytics and Real Estate are products of MSCI Inc. that utilize information from MSCI ESG Research LLC. MSCI Indexes are administered by MSCI Limited (UK) and MSCI Deutschland GmbH.

Please note that the issuers mentioned in MSCI ESG Research materials sometimes have commercial relationships with MSCI ESG Research and/or MSCI Inc. (collectively, "MSCI") and that these relationships create potential conflicts of interest. In some cases, the issuers or their affiliates purchase research or other products or services from one or more MSCI affiliates. In other cases, MSCI ESG Research rates financial products such as mutual funds or ETFs that are managed by MSCI's clients or their affiliates, or are based on MSCI Inc. Indexes. In addition, constituents in MSCI Inc. equity indexes include companies that subscribe to MSCI products or services. In some cases, MSCI clients pay fees based in whole or part on the assets they manage. MSCI ESG Research has taken a number of steps to mitigate potential conflicts of interest and safeguard the integrity and independence of its research and ratings. More information about these conflict mitigation measures is available in our Form ADV, available at <https://adviserinfo.sec.gov/firm/summary/169222>.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P Global Market Intelligence. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and S&P Global Market Intelligence.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data.

Privacy notice: For information about how MSCI collects and uses personal data, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.

©2024 MSCI Inc. All rights reserved | CBR0624