

PRESS RELEASE

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Carbon Shock Analysis: a \$100 increase in carbon prices potentially causes a 30% fall in global equity prices

Van Lanschot Kempenn seeks out opportunities to reduce carbon risk in clients' portfolios and to invest in the transition to a sustainable economy

- The sensitivity of equity markets to carbon pricing risk has increased over the past 12 months due to rising energy prices and geopolitical tensions, according to Van Lanschot Kempenn's annual Carbon Shock Analysis.
- Van Lanschot Kempenn's base case scenario of a \$100 global carbon price increase on polluting companies shows a potential 6%-30% fall in global equity valuations - ranging from 6% in the case of Scope 1 and 2 emissions and up to 30% for Scope 1, 2 and 3 emissions¹.
- A \$150 global carbon price increase on polluting companies could cause an even greater fall in global equity valuations - ranging from 9% in the case of Scope 1 and 2 emissions and up to 43% for Scope 1, 2 and 3 emissions. Van Lanschot Kempenn believes this increase is necessary in developed countries to achieve the Paris climate goals.
- The analysis shows that the impact of higher carbon prices and the scope of emissions coverage is not fully priced into markets – creating opportunities for investors who are allocating to the transition economy.
- Applying an appropriate sustainable benchmark for a global equity portfolio could lower the carbon-transition price risk by 70-80% for global equities and by 90% for European equities.

The sensitivity of equity markets to carbon pricing risk has increased over the past 12 months due to rising energy prices and geopolitical tensions. Van Lanschot Kempenn has updated its model on the impact of a shock increase in carbon prices globally - implemented through a carbon tax or through emissions trading scheme (ETS). The analysis focuses on how responses to climate change can be integrated into investment analysis in order to protect and enhance the portfolios of long-term investors.

Van Lanschot Kempenn's analysis models a worst-case scenario but expects the impact to be spread over a number of years.

Maarten Edixhoven, Chair of the Management Board of Van Lanschot Kempfen, said. *“The current energy crisis has raised concerns that meeting global climate goals has become less urgent. However, nature is telling us that it is still a high priority by the number of huge environmental impacts we are seeing. We think the focus on reducing carbon emissions will – and should – only get stronger in the medium term.*

“As an entrepreneurial wealth manager with a strong focus on sustainability we aim to act as a guide to our clients in the current climate and energy transition. Reducing the carbon-transition risk in clients’ portfolios is essential in this respect. Also, we are seeking out opportunities to invest in the transition to a sustainable economy, in both investment and non-investment related services to our clients. We’ve reallocated to lower carbon or climate transition tilted assets and we’re investing in green technologies in both private and public markets.”

Current carbon price must rise to meet Paris objectives and geopolitical energy security risks

The war in Ukraine and Europe’s urgent need to reduce reliance on Russian gas imports have accelerated the need to provide affordable financing for green energy solutions. At COP27, the IMF called for a \$75/ton carbon price², but several institutions, such as the Intergovernmental Panel on Climate Change (IPCC) and the Network for Greening the Financial System (NGFS), now estimate that a carbon price of more than \$100 would be required to achieve the Paris Climate Agreement³. According to the World Bank, just 23% of global greenhouse gas emissions are covered by a carbon pricing mechanism⁴. The IMF estimates that the global average carbon emission price is currently no more than \$5 (per tCO₂e)⁵.

Also, the need for energy independence - which mirrors the broader trend of deglobalisation - increases the likelihood of carbon emission prices increasing rapidly in the coming years and being applied to a greater number of high emitting companies.

Impact of base case \$100 increase in global carbon pricing

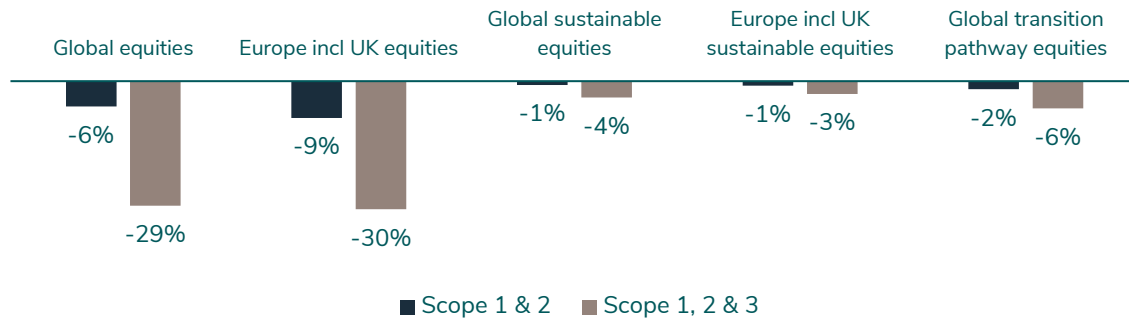
Given the accelerating pace of global warming, Van Lanschot Kempfen has upgraded its base case scenario to \$100, up from the \$75 carbon price rise 12 months ago, when the model indicated a \$75 rise could cause a 4-20% fall in global equity valuations.

In its updated Carbon Shock Analysis, Van Lanschot Kempfen’s base case suggests a price rise of \$100 per tCO₂e on polluting companies’ Scope 1 and 2 emissions. This could knock an average of around 6% off the value of global equities and 9% from European (including UK) equities. If the tax were applied to polluters’ scope 1, 2 and 3 emissions, the average hit to equities would be -30%⁶.

The impact of higher carbon pricing varies significantly across markets, however. Sustainable indices are far less impacted by from the negative impact than the traditional alternatives. For example, European (including UK) equities would be worst affected by a Scope 1-3 tax (30%)

compared to a sustainable counterpart such as an index of ESG-screened European equities (3%). This disparity is illustrated below.

Impact on equity markets of \$100 increase in carbon price

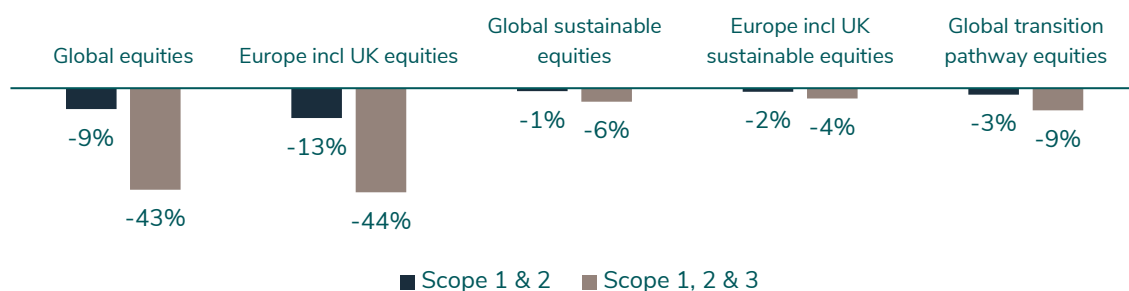


Impact of \$150 increase in global carbon pricing

It is likely that even a \$100 rise in the global average carbon price will not be sufficient to meet the Paris targets. Van Lanschot Kempfen's secondary shock analysis of an increase of \$150 per tCO₂e highlights that with a higher carbon price level - which accelerates beyond the Paris goals - equity prices could fall more significantly over time. Van Lanschot Kempfen believes a rise of \$150 is necessary in developed countries to achieve the Paris climate goals. Current pledges by governments appear to be insufficient to reach targets.

A price rise of \$150 per tCO₂e on polluting companies' Scope 1 and 2 emissions could knock an average of 9% off global equities and 13% off European equities. If the tax were applied to company's Scope 1, 2 and 3 emissions, the hit could average -43% for global equities and -44% for European equities. Again, the impact varies by market, but sustainable indices remain considerably better protected against climate transition shocks; falling 6 to 9% for sustainable global equity indices and 4% for European sustainable equivalents, as illustrated below.

Impact on equity markets of \$150 increase in carbon price



Michel Iglesias del Sol, Chief Investment Strategist, and Arif Saad, Co-Head Investment Strategy UK added: *“Our analysis shows that the sensitivity of equity markets for higher carbon prices has increased over the past year, despite Covid-19 putting a pause on international travel and more companies announcing climate commitments. We need higher carbon prices to have a chance at significantly reducing emissions. However, the greater the increase, the greater the impact on equity valuations.*

“Our research suggests that the costs and benefits of decarbonisation are still not yet fully priced into equity markets. Long term asset owners - such as pension schemes - should reposition equity portfolios to make them more robust to deal with changes in carbon pricing and regulation. This could mean reallocating away from standard indices or tracking alternative sustainable benchmarks. As the analysis suggests, an ESG leader or transition pathway index will be better protected against the risks of higher carbon tax.”

Careful construction of investment portfolios can substantially limit climate risks

The analysis shows that selection of an appropriate sustainable benchmark for a global equity portfolio can lower the carbon price risk by 70-80%. For a European equity portfolio, this risk could be reduced by 90%.

The Van Lanschot Kempfen analysis demonstrates how responses to climate change can be integrated into investment analysis to protect and enhance the portfolios of long-term investors. This could be achieved by a combination of reducing the climate-transition risk from existing equity holdings and – for example - reallocating existing equities to lower carbon or climate transition tilted equities. Another example of an opportunity to benefit directly from the transition economy is investing in green technologies, through new focused allocations across both public and private markets.

Thematic strategies - focusing on clean energy, clean water, food supply and sustainable farmland - are key long-term allocations that should benefit from the climate transition and mitigate physical climate risks, alongside satellite opportunities within infrastructure (listed and unlisted) and impact-focused private equity strategies focusing on disruptive technologies.

ENDS

Notes to editors

¹The research analyses both the impact of different carbon prices on equity markets, implemented through either a carbon tax or emissions trading scheme (ETS), and also the effect of higher prices across emissions Scopes 1 to 3 on different parts of company value chains.

The GHG Protocol Corporate Standard classifies a company's greenhouse gas emissions into three 'scopes'. Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased

energy. Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

² [EXCLUSIVE COP27: IMF chief says \\$75/ton carbon price needed by 2030 | Reuters](#)

³ [Global Warming of 1.5 °C — \(ipcc.ch\)](#) and [NGFS Climate Scenarios for central banks and supervisors](#)

⁴ [Carbon Pricing Dashboard | Up-to-date overview of carbon pricing initiatives \(worldbank.org\)](#)

⁵ [Remarks by the Managing Director at COP27's Finance Day Opening Ceremony \(imf.org\)](#)

⁶ Van Lanschot Kempen has modeled this analysis as a change in carbon pricing, not an absolute level; i.e. the \$75 analysis concerns a \$75 increase rather than an absolute price of a \$75. There are globally 68 different pricing mechanisms already in force as at July 2022, so the starting point is different depending on the region. For context, the majority of global economies are currently less than \$30 / t CO₂e. The Nordics & Switzerland are outliers, with a range from \$80 / t CO₂e to \$130 / t CO₂e.

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About Van Lanschot Kempen

Van Lanschot Kempen, a wealth manager active in Private Banking, Professional Solutions, Investment Management and Investment Banking, with the aim of preserving and creating wealth, in a sustainable way, for both its clients and the society of which it is part. As a sustainable wealth manager with a long-term focus, Van Lanschot Kempen proactively seeks to prevent negative impact for all stakeholders and to create positive long-term financial and non-financial value. Listed at Euronext Amsterdam, Van Lanschot Kempen is the Netherlands' oldest independent financial services company, with a history dating back to 1737. To fully leverage the potential of the Van Lanschot Kempen organisation for its clients, it provides solutions that build on the knowledge and expertise across its entire group and on its open architecture platform. Van Lanschot Kempen is convinced that it is able to meet the needs of its clients in a sustainable way by offering them access to the full range of its products and services across all its businesses.

For more information, please visit vanlanschotkempen.com

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