Low carbon credit performance in a 400% oil rally

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Oil prices have quintupled since the lows in 2020 which, if used as a proxy for general carbon exposures, should have driven a substantial outperformance in carbon intensive credits. Low carbon credits have indeed underperformed, but to a very marginal extent: the current drawdown in the carbon relative index based on ECOBAR[1] is a mere 25 basis points (0.25% of return). The relative return of the low carbon strategy was -15bp in 2021.

As illustrated in Figure 1, this should be taken in context that over the six years for which there is data, the low carbon index has outperformed by 1.83% in return terms or 28 basis points of returns per year with 2021 as the first down year. This may seem small in the context of other investment return prospects, but for a benchmarked real money manager, this would be considered sizable. The annualized Sharpe ratio is 1.27.

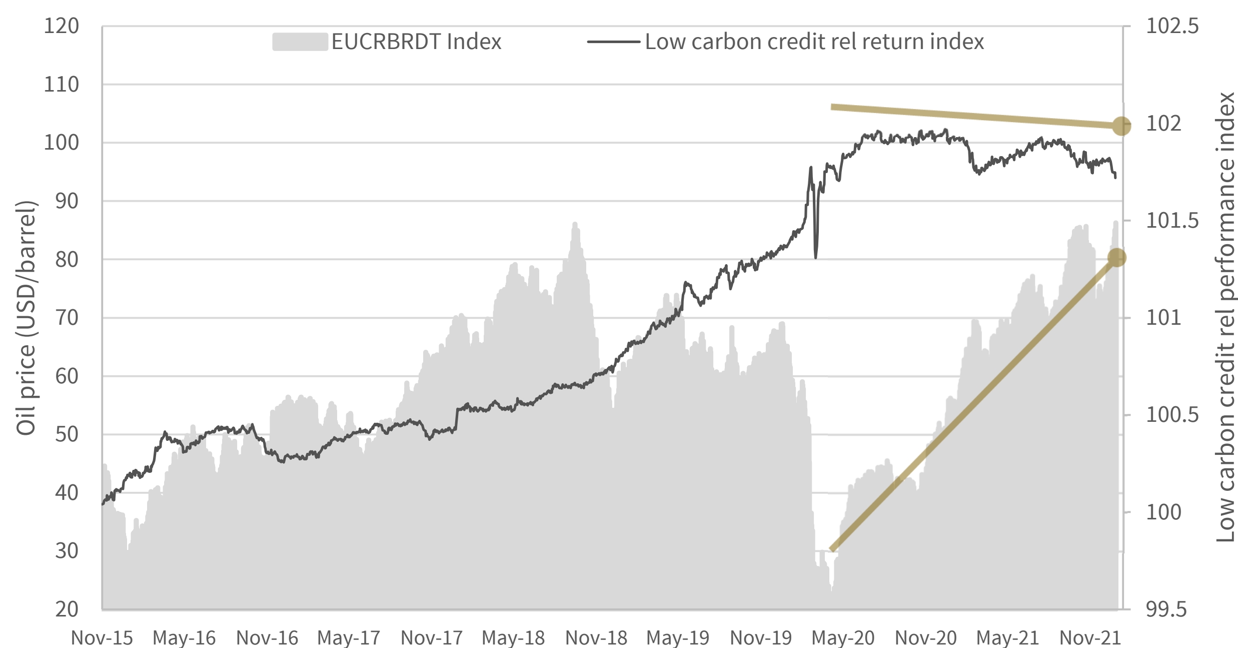

Figure 1. Relative return of the S&P500 IG carbon efficient re-weighted bond index versus its standard equivalent, duration and spread beta neutral and oil prices (measured here as the EUCRBRDT index). Source: S&P, AFII calculations, Bloomberg.

[1] The low carbon relative performance index is constructed by using an identical set of issuers (based on the S&P IG corporate bond index) but reweighting portfolio weights using the ECOBAR methodology and a duration and spread beta neutral weighting scheme. The S&P bond indices are available: carbon-efficient and traditional index. Refer to "Low carbon credit performance: 2015-2020", AFII, 27 Jan 2021, for a methodology overview. The indexes have been running live since 2018. The key technical document is "Credit alpha and CO2 redution: A portfolio manager approach", SSRN, Apr 2017.

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