

Insight

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Climate credit as a source of alpha

**How a core investment-grade allocation
can help meet net-zero targets**



How can investors in Asia-Pacific align their credit allocations to net-zero commitments, meet increasing regulatory obligations and maintain returns?

Introduction

Most institutional investors have significant allocations to corporate credit within their portfolios, tied to financial objectives. And as climate-related disclosure regulation develops across Asia-Pacific (APAC), there will be increasing demand on asset owners to deliver those returns while evidencing credible alignment to decarbonisation. This creates two potential challenges.

The first is that climate-related regulatory frameworks in APAC vary widely. Compared with the UK and EU, sustainable investing frameworks in APAC have developed later and less uniformly, making them potentially more complicated to navigate. The good news is that policies are increasingly converging.

The second challenge is to deliver net-zero commitments without sacrificing returns.

In the years immediately following the COVID pandemic, low-carbon investments were performing well. There was no visible trade-off between sustainability and solid returns. However, from 2022 onwards, with the onset of inflation and an energy crisis, low-carbon asset returns began to deviate significantly from the broad market indices.

In a market environment where high-emitting sectors like energy and industrials strongly outperformed the rest, many low-carbon portfolios missed out on large returns - while being overexposed to sectors like renewable energy that were underperforming.

The trade-off between low-carbon investments and returns became stark. Disillusionment among some investors, coupled with the politicisation of ESG, led to a general decline in new commitments to low-carbon investments and, in some instances, a turn away from existing commitments.

However, the introduction of climate and sustainability disclosure requirements is prompting asset owners in APAC to engage more intensively with the climate profile of their portfolios. Disclosures are increasing in transparency in certain areas, while new regulations and frameworks are requiring investors to align their portfolios with sustainability and climate objectives - and to demonstrate credible progress over time. This is sharpening investors' focus on how to balance regulatory expectations, net zero ambitions and long-term return goals.

In this article, we explore how asset owners can achieve this by incorporating a climate approach in their core fixed-income allocations. Maintaining a broad investment universe and, within it, aligning allocations to climate goals can support long-term returns and net-zero alignment alike, by helping avoid the structural biases that come from more simplistic approaches.

1 Key sustainable investing regulation in APAC

Although the region's transition pathways will be gradual and uneven, the trend in regulation means it is essential for firms – and their investors – to demonstrate accountability and forward momentum.

Across APAC, regulatory emphasis varies by jurisdiction. In some markets, the primary focus remains on strengthening climate and sustainability disclosures (for example, in Japan). In others, regulation is increasingly centred on transition-focused expectations (as in Singapore).

For asset owners, this means navigating a varied regulatory landscape, strengthening disclosures where required, and demonstrating credible transition plans and measurable progress where regulatory expectations are more forward looking.

Singapore

The UK and Singapore have a history of collaborating on sustainable finance, such as through the UK-Singapore Financial Dialogue.¹ In recent regulation, they have both prioritised credible, decision-useful transition plans as the backbone of sustainable finance. Both also referenced the need for globally comparable transition plans rather than prescriptive green taxonomies.

In October 2023, the Monetary Authority of Singapore (MAS) opened a set of Transition Planning Guidelines for consultation, confirmed in March 2026.^{2,3}

Also in 2023, Singapore moved from concept to practice through the Singapore Asia Taxonomy (SAT), providing practical guidance on how banks, investors and borrowers can label and finance green and transition activities.⁴

The taxonomy places a strong emphasis on entity-level transition plans, and not just asset-level metrics.

For asset owners, this means assessing the credibility of companies' transition pathways, not just their end targets. Investors will also have to demonstrate how their capital allocations support measurable improvement over time.

Japan

In March 2023, Japan's Financial Services Agency (FSA) published the first stage of mandatory sustainability disclosure rules. These require all listed companies in Japan to disclose sustainability-related information using the TCFD pillars of strategy, metrics and targets, governance and risk management.^{5,6}

Then, in March 2025, the Sustainability Standards Board of Japan issued national sustainability disclosure standards aligned with ISSB S1 (general requirements for disclosure of sustainability-related financial information) and S2 (climate-related disclosures).⁷

This regulatory clarity supports a broader shift among large Japanese asset owners, who are moving away from passive ESG index exposure, and towards active strategies, including in private markets, that can evidence real-world transition outcomes.

Hong Kong

In December 2024, the Hong Kong Institute of Chartered Public Accountants (HKICPA), the sustainability reporting standard setter in Hong Kong, issued sustainability and climate-related disclosure standards on a full alignment basis with IFRS S1 and S2.^{8,9}

All main issuers have been required to disclose against the new climate requirements on a “comply or explain” basis since January 1, 2025, with staggered adoption for other organisations.¹⁰

The IFRS S2 aligned climate disclosures include the mandatory disclosure of transition plans, and the use of scenario analysis.

For asset owners, this enhances the ability to assess the credibility of issuers’ transition strategies and supports more active stewardship and capital reallocation decisions. It also reduces investors’ reliance on proxy indicators or backward-looking ESG scores.

Australia

In September 2024, the Australian Accounting Standards Board (AASB) issued its two inaugural sustainability reporting standards, the voluntary AASB S1 (for sustainability-related financial information) and the mandatory AASB S2 (for climate-related disclosures). Both are aligned to ISSB standards.¹¹ The latter will be implemented in phases and has been mandatory for the largest listed entities since January 1, 2025.¹²

Asset owners and superannuation (“super”) funds must now provide clearer evidence on their climate risk exposure, transition planning, governance and strategy.

A challenge for super funds is that the Your Future, Your Super (YFYS) performance test introduced in 2001 has impacted funds’ investment decisions, in some cases making it harder for the funds to take large active bets.¹³ This can create tension between regulatory expectations on sustainability and performance.

What this means for APAC asset owners

Climate-related regulation across APAC is advancing quickly, but not uniformly. Yet the direction of travel is increasingly consistent, moving towards credible transition plans, better disclosure, and alignment with global standards.

In this context, investors need practical tools to assess the credibility of transition plans. They also need investment strategies that balance benchmark sensitivity, liquidity needs, and long-term transition and customer outcomes.

The good news is that this is possible.

2 Taking the leap: incorporating climate in core allocations

The key step to balance returns and climate objectives is for investors to apply a climate lens to their whole core investment-grade portfolio. They can then take a sophisticated approach to maintain diversification and avoid structural sector biases.

This involves recognising that, in every sector of the economy, some companies are better equipped for the net-zero transition and more resilient to the effects of climate change than others. By applying this “readiness” filter across sectors, investors can access opportunities across the full fixed-income universe.

Within this pool, strong fundamental credit research will help find companies that can also deliver strong returns. Adding active management and a robust portfolio construction approach can then help a portfolio to compete on returns, even compared to a non-screened index.

Maintaining a broad opportunity set

Establishing a broad and diversified investment universe is key to creating a robust allocation.

First, to maintain the integrity of the allocation from a climate perspective, investors should design a transition roadmap for their portfolio, with set targets and deadlines within a clearly defined investment framework. This can also help them decide which companies to engage with, and how to support them in their net-zero transition.

Then, focusing on companies’ business models, identifying those that are decarbonising their whole operations means investment doesn’t have to be limited to labelled bonds (like green, sustainable, and sustainability-linked bonds). This allows asset owners to choose from a much broader opportunity set.

For example, in our proprietary climate-risk model, we assess top-down physical and transition risks across 159 industry sectors. Within each sector, we then assess individual issuers on their emission disclosures and carbon reduction targets; their climate strategy and governance; their climate risk measurement and scenario analysis; and their capital expenditures. This enables alignment with ISSB and similar standards and provides a broad, diversified investment universe.

Rather than tilting a portfolio toward issuers with high ESG scores given by a rating agency, this approach builds the investment universe from the bottom up based on companies’ credibility on climate resilience. Not only can this support a portfolio’s long-term risk and return profile, it is also a more robust way to meet regulatory climate requirements.

Identifying key sources of investment performance

The next step is to strengthen the portfolio's long-term risk and return profile and capture sources of return, for which investors have several tools at their disposal.

One is to take a top-down approach to optimise the portfolio's active duration and credit beta (i.e. capturing market returns). But to avoid over-reliance on the direction of credit spreads, we believe a robust portfolio construction process – particularly around sectors and curves – can enhance not only efficiency but also resilience.¹⁴

While efficiency seeks to maximise returns through an optimal risk allocation across the credit universe, it typically assumes normal market conditions and can leave portfolios exposed in risk-off environments.

Resilience, by contrast, looks beyond historical volatility, to consider factors such as mean-reversion potential (i.e. the potential of an asset's price to move back to its long-term average after a sharp rise or drop) and the likelihood of capital gains or losses under stress scenarios. This provides deeper insight and supports the construction of portfolios that can better withstand shocks and recover more effectively.

It is also important to offset some of the natural sector underweights (like energy) created by taking a climate lens, for example by using correlation and optimisation to reduce the risk of underperforming in an energy rally.

The second tool is bottom-up issuer selection, to capture alpha (i.e. returns above those of the benchmark). In today's environment of compressed spreads and increasingly asymmetric risk profiles, investors need a disciplined, high-conviction approach to issuer and security selection, underpinned by robust, value-driven and forward-looking fundamental research.

It can be tempting to add significant amounts of high-yield bonds to achieve alpha, but as these also carry higher risk, investors should set a reasonable limit, and focus on carefully selected rising stars and catalyst-driven issuers (i.e. issuers whose bond price is expected to be significantly changed by a specific event or announcement). More broadly, investors can improve outcomes by switching their allocations between opportunities with comparable efficiency and resilience profiles, rather than continuously increasing overall risk.

Beyond that, allocations with a climate filter can be positioned to exploit market inefficiencies created by the net-zero transition.

Markets often struggle to price long-term, non-linear risks like climate change. By identifying transition leaders early across economic sectors, asset owners can allocate to bonds that look undervalued and issuers that are better positioned in the net-zero context. These can outperform over the long term, once markets become better able to price the transition.

Thorough fundamental research among the green issuers that provide mitigation and adaptation solutions to climate change can similarly identify bonds that offer a complexity premium, and names that are more insulated from cyclical trends.

Embedding downside protection

Downside protection is a critical element of thoughtful portfolio construction. This can include the way investors spread their risk exposure between bonds with shorter and longer maturities, and the deployment of selective hedges to shield a portfolio against adverse market conditions.

But being aware of specific risks and deciding what bonds to avoid can also boost outperformance. For instance, companies that ignore the low-carbon transition may face sudden regulatory fines, carbon taxes, or obsolescence. That will also increase the risk they become “fallen angels” (dropping from investment grade to high yield). Avoiding them can mitigate the risk of capital losses.

Taking a tactical approach to labelled bonds can also protect returns. Some labelled bonds include a “greenium” – a premium that investors pay for the label. By focusing on issuers’ whole business model, investors can choose to buy either standard or labelled bonds of those companies that align with their climate ambition, depending on how expensive the greenium is. This ensures they don’t sacrifice yield for the sake of a label.

Supplemented by engagement

As well as deliberate investment practices, active engagement can help a portfolio shift to net zero by influencing issuers’ transition plans, capital allocation and emissions trajectories, improving real world outcomes.

For example, credit investors can ask issuers to set near-term and net-zero science-based targets, and to use industry ratings such as CDP (formerly the Carbon Disclosure Project). Where barriers exist, investors can explore credible alternatives to drive companies’ net-zero progress. That can in turn improve the risk-return profile of their portfolio.

It is worth noting that bondholders can express their views at each bond issuance – often multiple times a year. They also have a unique opportunity to engage with issuers where the influence of equity investors is limited, including private companies and state-owned or state-controlled utilities. Many of those are among the largest global carbon emitters and rely heavily on debt to fund their capital expenditures. By engaging with them, investors have a chance to drive significant real-world change.

3 Conclusion

As climate regulation evolves across APAC and globally, companies and investors must increasingly demonstrate that they are aligned to net-zero pathways. Jurisdictions, firms and asset owners alike are starting from different points, which can create challenges. It is important to carefully assess investment strategies, to build portfolios that can deliver returns, resilience and climate alignment over the long term.

As more regulators adopt international standards – albeit with local adaptations – and firms increasingly comply with transition requirements, we believe it’s time for core fixed-income allocations to incorporate a climate approach. In this way, investors can continue supporting the transition and reflecting the reality of the economies they work in. This is the best mitigation against sectoral biases and underperformance, supporting good long-term outcomes.

- 1 [HM Treasury, “UK and Singapore strengthen collaboration in sustainable finance and FinTech”, GOV.UK, May 8, 2024.](#)
- 2 [“MAS guidelines for financial institutions on transition planning for a net zero economy”, Monetary Authority of Singapore, October 18, 2023.](#)
- 3 [“MAS sets supervisory expectations on financial institutions for transition planning practices in addressing environmental risk”, Monetary Authority of Singapore, March 5, 2026.](#)
- 4 [“Singapore-Asia taxonomy for sustainable finance, 2023 edition”, Monetary Authority of Singapore, December 2023.](#)
- 5 [Keiichi Ushijima et al., “What’s next for Japanese sustainability disclosure standards”, EY, October 13, 2023.](#)
- 6 [Task Force on Climate-related Financial Disclosures, accessed March 16, 2026.](#)
- 7 [“IFRS Sustainability Standards Navigator”, IFRS, 2026.](#)
- 8 [“Hong Kong Financial Reporting Standard S1: General Requirements for Disclosure of Sustainability-related Financial Information”, Hong Kong Institute of Certified Public Accountants, December 12, 2024.](#)
- 9 [“Hong Kong Financial Reporting Standard S2: Climate-related Disclosures”, Hong Kong Institute of Certified Public Accountants, December 12, 2024.](#)
- 10 [“Roadmap on sustainability disclosure in Hong Kong: Ambition, assurance, enablement”, Hong Kong Special Administrative Region of the People’s Republic of China, December 2024.](#)
- 11 [Australian Accounting Standards Board, “Climate-related financial disclosure”, Australian government, May 16, 2025.](#)
- 12 [Department of Finance, “Commonwealth climate disclosure requirements”, Australian government, December 19, 2025.](#)
- 13 [The Treasury, “Your Future, Your Super review”, Australian government, April 2023.](#)
- 14 [“Beyond efficiency: Building resilient investment portfolios”, Aviva Investors, December 8, 2025.](#)

Key risks



Investment risk

The value of an investment and any income from it can go down as well as up. Investors may not get back the original amount invested.



Credit and interest rate risk

Bond values are affected by changes in interest rates and the bond issuer's creditworthiness. Bonds that offer the potential for a higher income typically have a greater risk of default.

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