

News Release

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Climate change and artificial intelligence seen as risks to investment asset allocation, finds new report by BNY Mellon Investment Management and CREATE-Research

Research outlines impact on asset allocation as a result of these ‘supertanker’ trends.

Amsterdam, 16 September 2019 – Two secular forces or ‘supertanker’ trends, climate change and artificial intelligence (AI), are reshaping the future of investing, finds new research study launched today by BNY Mellon Investment Management and CREATE-Research.

89% of the institutional investors (“investors” or “respondents”), with combined assets under management of approximately \$12.75 trillion, that took part in extensive and structured interviews as part of the study regard the two supertanker trends as investment risks. Almost all (93%) view climate change as an investment risk that has yet to be priced in by all the key financial markets globally, while over 85% view AI as an investment risk that could potentially provoke societal backlash as well as geopolitical tension.

The report, [*Future 2024: Future proofing your asset allocation in the age of mega trends*](#), examines how climate change and AI are perceived by investors globally, the investment issues and solutions they are giving rise to and the potential impact of these supertanker’ trends on asset allocation approaches and the asset management industry.

AI and climate change: risk or opportunity?

Both AI and climate change are viewed as materially important factors by investors.

Over half (57%) of the respondents view climate change as a risk and an opportunity; 36% view it as a risk only and 7% view climate change as an opportunity only. Investment specific challenges related to climate change centre on areas that are unknowable, requiring judgemental calls about the future. These include:

- Slow progress on carbon pricing – envisaged under the Paris Agreement – is leaving investors guessing at what point draconian governmental action will become inevitable;
- Dilemma on the future of stranded assets, with investors weighing up whether to mitigate investment risks now or later at potentially higher costs;
- Engagement with carbon emitters is more difficult for investors in fixed income than equities, with fewer opportunities to engage with companies via voting rights or annual general meeting (AGM) attendance;
- Question marks on whether environmental, social, and governance (ESG) investing is a risk factor now or will be in the future, as benefits are already captured with other factors such as quality and low variance.

In response to the challenges arising from climate change, investors are factoring in the potential for draconian measures, ensuring they have intensive engagement with companies, increasing investment in green bonds and accepting ESG as a risk minimising tool.

Half (52%) of the investors surveyed, who stated AI was a risk, also regarded it an opportunity, whereas 33% saw it as only a risk and 7% regard it as an opportunity only¹. The rise of AI is seen to create four investment specific challenges:

- Corporate lifecycles will get shorter as AI creates winners and losers, as shown by the impact of the earliest versions of the iPhone on Nokia in 2007;
- Sectoral boundaries will blur, as AI reconfigures entire products, as seen with Tesla, which straddles multiple sectors, causing valuation issues;
- Onshoring of manufacturing activities will diminish the prospects of emerging economies, with 3D printing shifting the geographical centers in global supply chains;
- Intangible values of companies will be enhanced in ways that are hard to measure for asset valuation purposes.

In response to these challenges, investors are increasingly mixing active and passive investment strategies, focusing on idiosyncratic risk in portfolios, targeting emerging innovation leaders and blending hard and soft metrics in their analysis.

Michael Jasper, Country Head NL Business Development at BNY Mellon Investment Management, commented:

“The best opportunity is rarely the most obvious one. For investors caught up in the day-to-day maelstrom of constant change, choosing the right path can be difficult. Compounding these challenges are large secular trends, such as artificial intelligence and climate change. Already we are witnessing a change in the way markets operate in response to these two supertanker trends. These will be the defining challenge not just for the current generation of asset managers and investors, but for generations to come.”

Changes afoot for asset allocations and the investment industry

Secular themes such as AI and climate change are also key factors driving changes in asset allocation. Overall, the study indicated that new future allocations will favour private markets more than public ones, as the search for uncorrelated absolute returns intensifies. Private debt will be used to support young start-ups, while private equity will be relied upon to capitalise on corporate restructuring driven by AI. The report found that investor allocations to private markets are currently between 19 - 31% but are expected to rise.

Headlong growth in passive funds has been observed in the past decade, with ETFs and smart beta accounting for 20 - 40% of investors' portfolios who were interviewed for the study and is also an area expected to rise in the next decade.

Mitchell Harris, chief executive officer of BNY Mellon Investment Management, said: “The study highlights two shifts that stand out within asset allocation – the move from active to passive and from public to private markets. Both are indicative of the reincarnation of the old core-satellite model. We believe passive will be raising their share of core assets, while active will be focusing on satellites that dominate either inefficient or illiquid markets. The separation of alpha and beta is structural but the two styles of active and passive investing will remain interdependent.”

The research also explored several foundational trends that are reshaping the global asset management industry, such as the increased personalisation of retirement planning, and the emergence of millennials and women as growing client segments. In addition, flows into retail and wealth channels are increasing as defined benefit plans advance into run-off phase, and one-stop-shop financial planning is set for take-off with the proliferation of smart phones and 5G networks.

Amin Rajan, Project Leader at CREATE-Research, commented: “Newly emerging investor segments see a clear distinction between product alpha and solution alpha – beating the markets via stock picking versus meeting investors' predefined financial goals and personal values. Today's asset management industry may well be unrecognisable by the end of the next decade in the face of mega trends. Success is about navigating through the fog to create a new future, far removed from old connections and causality.”

Ends

Notes to editors:

¹ 8% viewed it as neither a risk nor opportunity

About the research

The report asks:

- How are artificial intelligence and climate change currently perceived in terms of their future opportunities and risks?
- What specific investment issues do they give rise to and what solutions are being or will be adopted?
- In the process, how are the asset allocation approaches changing and what have the outcomes been so far?
- How will the asset management industry be reshaped, as it advances into the age of mega trends?

The method used to answer the questions relied on two strands: a literature survey of about 400 widely respected research studies; bolstered by in-depth, structured interviews with 45 CIOs, investment strategists and portfolio managers among pension plans, asset managers and pension consultants in 16 countries. They are Australia, Canada, China, Denmark, Finland, France, Germany, India, Japan, Singapore, South Korea, Sweden, Switzerland, the Netherlands, the UK and the US.

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CREATE-Research is an independent research boutique specialising in strategic change and the newly emerging asset allocation models in global asset management. It undertakes major research assignments from prominent financial institutions and global companies. It works closely with senior decision makers in reputable organisations across Europe and the U.S. Its work is disseminated through high profile reports and events that attract wide attention in the media. Further information can be found at www.create-research.co.uk.

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