# Understanding the Pricing of Carbon Emissions: New Evidence from the Stock Market*

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**Abstract**

Are carbon emissions priced in equity markets? The literature is split with different approaches yielding conflicting results. We develop a stylized model showing that, if emissions are priced in equity markets, stock returns depend on expected emissions and the product of the innovation in emissions and the price-dividend ratio. Building on this insight, we derive and test new predictions. We find that emissions are priced in equity markets, but the magnitude of such pricing depends on how "super emitters" (mostly firms operating in electric power generation) are modeled. Our theoretical insight also helps reconcile seemingly divergent results in the literature.

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# 1 Introduction

Whether carbon emissions are priced in asset markets is crucial for understanding if, and how, financial markets incentivize the transition to a less carbonized economy. Carbon-emitting firms may face a higher cost of capital if carbon transition risks are priced into asset markets, or if investors who oppose emissions reduce their investment in polluting firms. Surprisingly, in the context of equity markets, there is still no consensus on whether polluting firms are forced to pay a premium to raise capital—with different empirical approaches yielding divergent results (e.g., Gormsen et al., 2024; Bolton and Kacperczyk, 2021; Zhang, 2025; Bolton and Kacperczyk, 2023; Aswani et al., 2024; Pastor et al., 2021; Pedersen et al., 2021).

In this paper, we develop a stylized model and derive new predictions that we then test using data from the U.S. stock market. We document that firms' emissions intensity, defined as $CO_2$ emissions divided by revenues, is a positively priced characteristic, but the magnitude of such pricing depends on the econometric specification used to model a few "super emitters"—mostly firms in electric power generation. Our analysis also shows that several regressions in the literature are mis-specified in a way that hinders the ability to find evidence of pricing for emissions intensity—thus reconciling divergent existing results.

Our empirical analysis is based on an intuitive theoretical insight that we illustrate in a stylized model. Specifically, we posit that firms' emissions intensity is well approximated as a random walk and is a priced characteristic. We then use the log linear return decomposition in Campbell and Shiller (1988) and Campbell (1991) to derive an equation relating firms' annual returns to their emissions intensity. This equation shows (i) how emissions intensity affects firms' expected returns and (ii) that the return residual is driven by the product of the firms' emissions intensity surprises with their price-dividend ratios:

$$\underbrace{r_{i,t} - r_{f,t}}_{\text{Excess return}} = \gamma e_{i,t-1} \overbrace{- \gamma \underbrace{\left(\frac{P_{i,t-1}}{D_{i,t-1}}\right)}_{\text{Price-dividend ratio}} \underbrace{\left(e_{i,t} - e_{i,t-1}\right)}_{\substack{\text{Emissions intensity} \\ \text{surprises}}}}^{\text{Residual}},$$

where $e_{i,t-1}$ is emissions intensity of firm $i$ at time $t-1$.

We use this pricing equation to derive five new testable predictions. First, a simple

regression of excess returns on *lagged* emissions intensity yields unbiased and consistent estimates. Second, a similar regression of excess returns on *contemporaneous* emissions intensity suffers from measurement error (the regressor should be *expected* emissions intensity) and omitted variables bias (the regressor is correlated with the emissions intensity surprise in the regression residual). Third, the omitted variable bias in the "contemporaneous" regression is more pronounced in the subsample of firms with high price-dividend ratios, as their stock prices and returns are more sensitive to changes in future required returns. Fourth, the omitted variable bias in the "contemporaneous" regression vanishes if the residual driven by the emissions intensity surprise is included in the regression. Fifth, there are specific sign restrictions associated with the estimation of our theoretically derived equation above.

Our theoretical framework also helps trace conflicting results in the literature back to specific modeling choices. First, several studies regress excess returns on *contemporaneous* emissions intensity finding small, insignificant (Bolton and Kacperczyk, 2021), and even negative (Aswani et al., 2024) estimated coefficients. We show that this regression suffers from measurement error and omitted variable bias that jointly shrink the estimated coefficients on emissions toward zero, and potentially to negative values. Second, several studies (e.g., Bolton and Kacperczyk, 2021; Aswani et al., 2024) analyze whether emissions intensity is priced by regressing *monthly* excess returns on *annual* emissions intensity. We show that this regression suffers from both an omitted variable bias (emissions are not known to investors during year $t$ but are correlated with what investors likely learn about emissions during the year) and measurement error (investors might receive other information about emissions at a higher frequency than annual)—again shrinking the estimated coefficient.

We test these five predictions by combining data on emissions from S&P Trucost with stock and firm information from CRSP and Compustat. Our final data set is an unbalanced sample covering 3,125 firms across 22 industries with annual frequency from 2002 to 2023. We begin by documenting that the distribution of emissions intensity is extremely skewed with a small subset of firms reporting very large emissions intensity. These extreme values are overwhelmingly concentrated in "Electric Power Generation, Transmission and Distribution" (NAICS code 2211), a sub-sector of "Utilities" (NAICS code 22).

Our empirical results are structured in four parts. First, we show that emissions intensity

is priced in equity markets by estimating our preferred "lagged" specification. Specifically, we regress, at an annual frequency, returns on lagged emissions intensity (scope-1 and scope-1+scope-2, separately), together with a set of lagged firm-level controls. Our sample excludes firms operating in "Electric Power Generation, Transmission and Distribution" to avoid fitting these few "super emitters" with all other firms in the same regression model. The evidence in support of emissions intensity being priced survives within industry (i.e., using industry fixed effects) and is remarkably stable to the choice of control variables. This regression is highly sensitive to the inclusion of "super emitters." Specifically, we show that the magnitude and significance of the estimated coefficients on emissions intensity increase as we winsorize emissions intensity more aggressively (effectively progressively dropping "super emitters" from the sample).

Second, our data supports the second model prediction by showing that the estimation of a specification of returns on *contemporaneous* emissions intensity yields small and statistically insignificant coefficients. According to our model, this attenuation is driven by omitted variable bias and measurement error. Note that this estimation is consistent with the small and statistically insignificant estimates in Bolton and Kacperczyk (2021) and the often negative estimates in Aswani et al. (2024). We then show that our third prediction is also verified in the data. Specifically, the attenuation of the emissions intensity coefficient is particularly severe in the subsample of firms with large price-dividend ratios as these stocks are particularly sensitive to a permanent change in the required rate of return.

Third, we show evidence in support of the last two predictions. Specifically, we include the theoretically-derived omitted variables in the "contemporaneous" and "lagged" regressions, thus fixing the omitted variable bias in the former and both the omitted variable bias and measurement error in the latter. Our estimates support the theoretical prediction as the estimated coefficient on emissions intensity increases as we progressively fix the biases. The data also confirm the sign restrictions predicted by our model.

Fourth, we show that our results are driven by the post-Climate Accord period and are more pronounced for small firms. The first result supports the interpretation that our estimates are driven by a pricing factor related to $CO_2$, rather than some other non-$CO_2$ related priced factor omitted from our regressions. The second result helps us reconcile our

findings with those in Zhang (2025) that, by weighing regressions by firm size, gives less importance to observations where pricing is the strongest.

Note that our finding that emissions intensity is priced may stem from the portfolio choice of investors who oppose investing in polluting firms or from a required compensation for transition risk. There is, of course, the third possibility that emissions intensity is correlated with firms' cash flows, which might, in turn, be associated with a cash flow risk premium. This possibility is unlikely to be a concern in our setting since the literature has shown that emissions intensity is uncorrelated with firms' cash flows (Aswani et al., 2024) and earnings surprises (Atilgan et al., 2023).

**Contribution to the literature.** Our paper makes two contributions to the literature. First, we develop a new approach to test whether a characteristic is priced in asset markets. By simply relying on assumed stochastic properties of the characteristic and the log-linear return decomposition of Campbell and Shiller (1988) and Campbell (1991), our tests can be applied to other settings. In the context of carbon emissions, our analysis disentangles required returns from realized returns, thus implicitly building on the theoretical literature illustrating how hedging motives (Baker et al., 2022), nonpecuniary disutility (Pastor et al., 2021), and investors' preferences (Oehmke and Opp, 2023; Pedersen et al., 2021; Zerbib, 2022) might shape the relation between emissions and equity returns.[1]

Second, our results contribute to the empirical literature on the pricing of carbon emissions showing that emissions are priced after all. In our novel empirical approach, unlike almost all existing empirical studies, we (i) build on a theoretically derived relation between expected and unexpected returns, (ii) derive five new predictions and test them in the data, and (iii) highlight how several existing empirical approaches are likely mis-specified, hindering

[1]Specifically, Baker et al. (2022) points out that brown firms may command a premium as they tend to pay off in states in which pollution is high, Pastor et al. (2021) shows how nonpecuniary disutility from holding brown stocks can reconcile the existing empirical evidence, and Pedersen et al. (2021), Zerbib (2022), and Oehmke and Opp (2023) show that investors' opposition to polluting firms helps explain the relationship between emissions and stock returns.

the ability to find evidence of pricing.[2] Notably, our results help reconcile the finding that emissions intensity affects institutional investors' demand (Pedersen et al., 2021) by amounts that are large enough to be priced (Bolton and Kacperczyk, 2021), but appear to not be priced (Bolton and Kacperczyk, 2021, 2023; Aswani et al., 2024). In line with our results, Gormsen et al. (2024) finds that green firms *perceive* their cost of capital to be lower since 2016, Hsu et al. (2023) finds a strong emissions intensity-return relation (interpreted as evidence of a new systematic risk related to environmental policy uncertainty), and Eskildsen et al. (2024) finds a modest emissions-return relation using forward-looking returns.

**Outline.** The remainder of the paper is organized as follows. Section 2 presents the theoretical framework relating carbon emissions intensity to required returns, derives five new predictions, and discusses how to reconcile the divergent results in the literature. Section 3 introduces our data and discusses a few facts about emissions intensity. Section 4 tests our predictions in the context of the U.S. stock market. Section 5 concludes.

# 2 Theoretical framework

Our theoretical framework is structured in three parts. First, Section 2.1 presents a stylized model showing how investors' preferences (i) about the mean and variance of their wealth and (ii) about investing in stocks issued by $CO_2$ emitters affect firms' required and realized returns. Building on these results, Section 2.2 derives a new equation relating emissions to firm returns in the case emissions are priced in the stock market. Third, Section 2.3 uses this derived relationship to propose new empirical predictions, which we then test in Section 4.

[2] Our approach can be interpreted as a new way to improve the signal-to-noise ratio in determining whether emissions intensity is priced. For other attempts, see Berg et al. (2022), Eskildsen et al. (2024), and Pástor et al. (2022)).

## 2.1 Stylized model

Our setting focuses on investors' preferences and the timing of information on emissions.[3]

**Timeline.** We consider a stylized asset pricing model that has four dates: $0, t, 1, 2$. At date 0, investors trade assets and form portfolios of risky assets (stocks) and one-period risk-free assets. At date $t < 1$, investors receive information on the emissions of the firms that issued the risky assets. At date 1, investors re-optimize their portfolios by trading risky and risk-free assets. At date 2, the assets are liquidated and investors consume.

**Assets.** The economy has an infinitely elastic supply of risk-free assets with gross return $r_f$ between $t = 1$ and $t = 2$. In addition, there are $N$ risky assets. Their supply is denoted by the $N \times 1$ vector $\bar{X}$, where the units of $\bar{X}$ are shares of stock. The risky assets can only be liquidated at date 2. At that time, their value is given by the $N \times 1$ vector $v$, which has a distribution $v \sim \mathcal{N}(\bar{v}, \Omega)$.

**Investors.** There are $M$ investors indexed $m = 1, \dots M$. Investors choose their portfolios to maximize their utility over date-2 consumption and date-2 emissions. Investor $m$'s vector of risky asset holdings is denoted by $X_m$. Investors have mean-variance preferences over their date-2 consumption and have a non-pecuniary dislike for holding shares of firms with high emissions.[4] Specifically, the utility of investor $m$ is:

$$U_m[W_{m,2}, \mathbb{E}(e_{m,t})] = \mathbb{E}(W_{m,2}) - \frac{1}{2} A_m Var(W_{m,2}) - \nu_m \mathbb{E}(e_{m,t}) \tag{1}$$

where $W_{m,2}$ is the wealth of investor $m$ at $t = 2$, $A_m$ is investor $m$'s risk aversion, $\mathbb{E}(e_{m,t})$ is the expected emissions of investor $m$'s investments, and $\nu_m$ is investor $m$'s dislike for emissions. We assume that positive values of $e_{m,t}$ are associated with more pollution. Hence,

[3] For fuller asset pricing models, see Pastor et al. (2021), Pedersen et al. (2021), and Baker et al. (2022).

[4] In our reduced form framework, we assume that investors dislike holding shares of polluting stocks. Baker et al. (2022) shows how hedging needs and additional motives may lead to such preferences.

negative values of $e_{m,t}$ (e.g., from shorting polluting firms) are desirable.

While our discussion often refers to $e_{m,t}$ as the "emissions" of investor $m$'s portfolio, our entire analysis is based on firm-level emissions normalized by firm revenues—a measure often referred to as "emissions *intensity*" in the literature. Similarly, our empirical analysis in Sections 3 and 4 is entirely based on emissions intensities. For a discussion of how institutional investors use emissions intensities to build ESG portfolios, see Bolton and Kacperczyk (2021).

We assume the expected emissions from an investor's holdings of asset $i$ are equal to the number of shares the investor holds times firms' expected emissions per share ($e_i$). Aggregating across firms, the expected emissions of investor $m$'s holdings are:

$$\mathbb{E}(e_{m,t}) = X'_m e$$

where $e$ is the $N \times 1$ vector of firms' emissions per share.

**Solving the model.** The model is solved by backwards induction from the portfolio choice problem at $t = 1$. At $t = 1$, investors solve:

$$\max_{X_{m,1}, B_{m,1}} U_m[W_{m,2}, \mathbb{E}(e_m, t)]$$

subject to the identity

$$W_{m,2} = X'_{m,1} v + B_{1,m} r_f, \tag{2}$$

and subject to the budget constraint

$$X'_{m,1} P_1 + B_{1,m} = W_{1,m}, \tag{3}$$

where $B_{1,m}$ is investor $m$'s allocation in the risk-free asset at $t = 1$, $r_f$ is the risk-free asset gross return, $P_1$ is the vector of prices of the risky assets at $t = 1$, and $W_{1,m}$ is the investor $m$'s wealth at $t = 1$. First, we solve for $B_{1,m}$ in (3) and plug it into (2). Second, we plug this expression into (1) and further simplify, thus rewriting the optimization problem for investor

$m$ as:

$$\max_{X_{m,1}} r_f W_{1,m} + X'_{m,1}(\bar{v} - r_f P_1) - \frac{1}{2} A_m X'_{m,1} \Omega X_{m,1} - \nu_m X'_{m,1} e$$

The first order condition for investor $m$ is:

$$X_{m,1} = \frac{1}{A_m} \Omega^{-1}(\bar{v} - \nu_m e - r_f P_1)$$

Note that, relative to a standard mean-variance problem, expected emissions alters $\bar{v}$ to $\bar{v} - \nu_m e$.

The market clearing condition requires the sum of investors' asset demands to equal the outstanding supply. Imposing market clearing yields:

$$\sum_{m=1}^{M} \frac{1}{A_m} \Omega^{-1}(\bar{v} - \nu_m e - r_f P_1) = \bar{X}$$

where $\bar{X}$ is the vector of aggregate supply for each stock. Solving for the vector of prices of risky assets ($P_1$) yields:

$$P_1 = \frac{1}{r_f} \left( \bar{v} - \frac{\Omega \bar{X} + e \sum_{m=1}^{M} \frac{\nu_m}{A_m}}{\sum_{m=1}^{M} \frac{1}{A_m}} \right) \tag{4}$$

We assume all elements of $P_1$ are positive. Under this assumption, the vector of gross expected returns on risky assets from $t = 1$ to $t = 2$, $r_i$, is:

$$r_i = \bar{v}./P_1 = r_f \bar{v}./ \left( \bar{v} - \frac{\Omega \bar{X} + e \sum_{m=1}^{M} \frac{\nu_m}{A_m}}{\sum_{m=1}^{M} \frac{1}{A_m}} \right), \tag{5}$$

where the expression "./" represents the element-by-element division of the two vectors. Furthermore, the assets' risk premium from $t = 1$ to $t = 2$, $r_i - r_f$, is given by:

$$r_i - r_f = \bar{v}./P_1 - r_f = r_f \left[ \bar{v}./ \left( \bar{v} - \frac{\Omega \bar{X} + e \sum_{m=1}^{M} \frac{\nu_m}{A_m}}{\sum_{m=1}^{M} \frac{1}{A_m}} \right) - 1 \right]. \tag{6}$$

**Effect of news about emissions on equity prices and required returns.** Our model generates two main insights. Suppose that, between $t = 0$ and $t = 1$, there is new information about higher emissions for asset $i$ between $t = 1$ and $t = 2$. First, this news reduces the price

of the asset at $t = 1$ ($P_1$) as shown in (4)—equivalently, this news lowers the *realized* return between $t = 0$ and $t = 1$ below what was expected at $t = 0$. Second, this news increases the asset's *required* return ($r_i$) and risk premium ($r_i - r_f$) between $t = 1$ and $t = 2$, as shown in (5) and (6), respectively. More generally, our model shows that news about an increase in expected emissions (i) reduces contemporaneous *realized* returns and increases *required* returns in future periods. The next section develops a few tests based on this intuition.[5]

## 2.2 Relating emissions and returns

We now derive how emissions are related to firm returns in the case emissions are priced in the stock market. Our analysis begins with the decomposition of excess returns for risky asset $i$ at time $t$ into two components: (i) expected excess returns (i.e., required excess returns) conditional on time $t-1$ information and (ii) an innovation in excess returns based on information that arrives between $t-1$ and $t$:

$$r_{i,t} - r_{f,t} = \mathbb{E}_{t-1}(r_{i,t} - r_{f,t}) + [\mathbb{E}_t - \mathbb{E}_{t-1}](r_{i,t} - r_{f,t}) \tag{7}$$

The first term on the right shows that required returns between $t-1$ and $t$ are based on time $t-1$ information. The second term is the innovation in returns. The Campbell (1991)'s log-linearization of the present value relationship shows that this second term is due to innovations in expected future required returns, expected future risk-free rates, and

[5]Imposing market clearing and simplifying, we find that the change in investors' risky asset holdings at $t = 1$ due to a change in expected emissions is given by:

$$dX_m = \frac{1}{A_m}\left(\frac{\sum_{s=1}^{M}\frac{\nu_s}{A_s}}{\sum_{s=1}^{M}\frac{1}{A_s}} - \nu_m\right)\Omega^{-1}de,$$

so that, given positive (negative) news about expected emissions, an investor increases (decrease) her allocation if her dislike for emissions ($\nu_m$) is lower (higher) than a risk tolerance-weighted average of the dislike for emissions of all other investors in the economy.

expected future dividend growth:

$$[\mathbb{E}_t - \mathbb{E}_{t-1}](r_{i,t} - r_{f,t}) \approx [\mathbb{E}_t - \mathbb{E}_{t-1}] \left[ -\sum_{s=1}^{\infty} \rho_i^s (r_{i,t+s} - r_{f,t+s}) - \sum_{s=1}^{\infty} \rho_i^s r_{f,t+s} + \sum_{s=0}^{\infty} \rho_i^s g_{i,t+s} \right] \quad (8)$$

where $\rho_i$ is a parameter of linearization (smaller than one) given by $e^{\bar{g}_i - \bar{r}_i}$ (where $\bar{g}_i$ is the average growth rate of firm $i's$ dividends), and $\bar{r}_i$ is the average expected future required return for firm $i$. The decomposition is broken into three terms. The first term shows that positive innovations in future risk premia negatively affect returns at time $t$. The second term shows that positive innovations in future 1-year risk-free rates negatively affect contemporaneous returns. The last term shows that positive innovations in future dividend growth positively affect returns.

Our goal is to apply the insights in (7) and (8) in a simple setting where emissions are priced. To this end, we make a few assumptions.

**Assumption 1.**

$$\mathbb{E}_{t-1}(r_{i,t} - r_{f,t}) = \gamma \mathbb{E}_{t-1}[e_{i,t}] \quad \textit{with} \quad \gamma > 0.$$

This assumption states that firm $i$'s required excess returns at time $t$ depend on time $t-1$ beliefs about firm $i$'s emissions at time $t$ ($e_{i,t}$). This assumption also implies (i) that expected emissions are a positively priced characteristic ($\gamma > 0$) and (ii) that emissions is the only variable determining required returns—this strong part of the assumption is only for expositional purposes and we relax it in our empirical work (and could relax it in our theoretical work without altering the intuition).

**Assumption 2.**

$$e_{i,t} | I_{t-1} \sim N(e_{i,t-1}, \sigma_u^2) \qquad \forall t$$

This assumption implies that emissions for each firm $i$ follow the equation:

$$e_{i,t} = e_{i,t-1} + u_{i,t},$$

further implying that each firm's emissions follow a random walk with the innovation $u_{i,t}$ distributed i.i.d. across firms, i.e., $u_{i,t} \sim N(0, \sigma_u^2)$

This assumption is a reasonable approximation of the data as the first order autocorrelation of emissions intensity (our measure of emissions in the data) is nearly 1.[6] Using annual data, Zhang (2025) documents annual autocorrelation coefficients for emissions intensities of 0.99 for scope-1 emissions and 0.94 for scope-2 emissions. In addition, Bolton and Kacperczyk (2021) shows, using autoregressions, that emissions and emissions intensity are highly persistent.

As a final note, these two assumptions can be generalized to allow (i) for expected technical progress, which would correspond to a random walk with downward drift, and (ii) for innovations in emissions ($u_{i,t}$) to be heteroskedastic across firms or industries. Since these refinements do not qualitatively alter the derivations below, we do not explore them further.

**Assumption 3.** *$r_f$ and and $g_i$ are constant.*

This assumption is for simplicity in order to focus on emissions in our theoretical analysis. The last assumption and the law of iterated expectations imply:

$$(\mathbb{E}_t - \mathbb{E}_{t-1})e_{i,t+s} = e_{i,t} - e_{i,t-1},$$

for all $s \geq 0$. Applying this assumption together with Assumption 1, and using (8), yields:

$$r_{i,t} - r_f = \gamma e_{i,t-1} - \gamma \left[\sum_{s=1}^{\infty} \rho_i^s\right](e_{i,t} - e_{i,t-1})$$

Using the Gordon Growth model, the term $\sum_{s=1}^{\infty} \rho_i^s = \frac{\rho_i}{1-\rho_i}$ is approximately equal to $\frac{\bar{P}_i}{D_i}$, which is the long-run average price-dividend ratio for firm $i$.[7]

[6] Appendix A shows an alternative derivation in the case emissions intensity follows a AR(1) process.

[7] More specifically:

$$\frac{\rho_i}{1-\rho_i} = \frac{e^{\bar{g}_i - \bar{r}_i}}{1 - e^{\bar{g}_i - \bar{r}_i}} = \frac{e^{\bar{g}_i}}{e^{\bar{r}_i} - e^{\bar{g}_i}} \approx \frac{1 + \bar{g}_i}{\bar{r}_i - \bar{g}_i} = \left(\frac{\bar{P}_i}{D_i}\right),$$

where $\left(\frac{\bar{P}_i}{D_i}\right)$ is the price-dividend ratio in the Gordon Growth model for a firm with constant dividend growth rate $\bar{g}_i$ and constant required return $\bar{r}_i$.

**Theoretically-derived equation.** An alternative, but less general, derivation of this equation (see Appendix B) replaces $\frac{\bar{P}_i}{D_i}$ with $\frac{P_{i,t-1}}{D_{i,t-1}}$. We use this simplified expression in our analysis below, namely:

$$r_{i,t} - r_{f,t} = \gamma e_{i,t-1} - \gamma \left( \frac{P_{i,t-1}}{D_{i,t-1}} \right) (e_{i,t} - e_{i,t-1}) \tag{9}$$

This equation, a key part of our empirical analysis, shows how emissions approximately affect returns in the case (i) required returns are priced linearly, (ii) emissions follow a random walk (a reasonable approximation as previously discussed), and (iii) required returns during period $t$ are only a function of variables known before period $t$.

The first term on the right hand side is the required return conditional on time $t-1$ information. The second term captures how the innovation in emissions during time $t$ $(e_{i,t} - e_{i,t-1})$ affects contemporaneous returns—a positive innovation lowers contemporaneous returns. This insight is consistent with the Campbell (1991) equation and the second implication of our theoretical model illustrated at the end of Section 2.1. This equation also shows that the response to the innovation in emissions is proportional to firms' price-dividend ratios. This intuitive relationships originates from the sensitivity of asset returns to permanent changes in required returns being proportional to the price-dividend ratio in the Gordon Growth model. Note that firms with high price-dividend ratios have high dividend growth rates and/or low required returns—characteristics that make their asset prices and returns more sensitive to changes in future required returns.

Equation (9) crucially relies on the assumption that the contemporaneous negative correlation between innovations in emissions and returns is driven only by news about discount rates. This assumption is consistent with the empirical evidence in Ardia et al. (2023) that documents the prediction that green firms outperform brown firms when climate change concerns increase unexpectedly (Pastor et al., 2021). More importantly, Ardia et al. (2023) finds that high unexpected changes in climate change concerns increase (decrease) the discount factor of brown (green) firms with no noticeable effect on cash flows. Also supporting this assumption, Atilgan et al. (2023) shows that emissions intensity is not a significant explanatory variable for earning surprises (a cash flow measure) but finds that emissions (not

normalized by firm revenues), and changes in emissions, explain earning surprises.

## 2.3 Five testable predictions

We now use the derived relationship between emissions intensity and excess returns to propose new ways to test whether emissions intensity is priced in equity markets and to reconcile seemingly divergent results in the literature.

**Deriving new predictions.** Recall that our theoretically derived equation (9) decomposes returns into an expected return component ($\gamma e_{i,t-1}$) and a residual component ($-\gamma(P_{i,t-1}/D_{i,t-1})(e_{i,t}-e_{i,t-1})$). Given that this residual component is uncorrelated with $e_{i,t-1}$ and has zero mean, an OLS regression of $r_{i,t} - r_{f,t}$ on $e_{i,t-1}$ yields unbiased and consistent estimates for $\gamma$. We refer to this specification as the "lagged" specification:

$$r_{i,t} - r_{f,t} = \alpha + \gamma e_{i,t-1} + \epsilon_{i,t} \tag{10}$$

where the only regressor is emissions intensity in year $t-1$ (we will shortly motivate the choice of an *annual* frequency).

To derive additional predictions, we build on the following "contemporaneous" specification that is sometimes used in the literature:

$$r_{i,t} - r_{f,t} = \alpha + \gamma e_{i,t} + \epsilon_{i,t}, \tag{11}$$

where the only regressor is emissions intensity in year $t$. For simplicity, we derive predictions when the regression is estimated by OLS in cross-section. Assuming that the theoretically derived equation (9) is the true process through which returns are generated, the "contemporaneous" equation (11) is affected by both measurement error and omitted variable bias—the first shrinking the estimated coefficient $\gamma$ towards 0, the second shrinking it downward potentially pushing it to negative values. We now provide the intuition behind the measurement error and the omitted variable biases (see Appendix D for a more formal discussion).

The measurement error is classical. This is because the correct variable to use in equation

(11) is $e_{i,t-1}$ instead of $e_{i,t}$, which is equal to the correct regressor plus noise

$$e_{i,t} = e_{i,t-1} + u_{i,t} \tag{12}$$

since emissions intensity is a random walk (Assumption 2). This classical measurement error shrinks the estimate of $\gamma$ towards 0.

To provide intuition for the omitted variable bias, recall that the residual component in our theoretically derived equation (9) can be written as:

$$\underbrace{\left[-\gamma \frac{P_{i,t-1}}{D_{i,t-1}}(e_{i,t} - e_{i,t-1})\right]}_{\text{Residual component in (9)}} = -\gamma \frac{P_{i,t-1}}{D_{i,t-1}} \times u_{i,t} \tag{13}$$

Focusing only on a single firm $i$, the comparison of equations (12) and (13) shows that, conditional on time $t-1$ information, the regressor $e_{i,t}$ used in equation (11) covaries negatively with the residual in the correct theoretical equation:

$$\text{Cov}_{t-1}\left(e_{i,t}, -\gamma \frac{P_{i,t-1}}{D_{i,t-1}} \times u_{i,t}\right) = -\gamma \frac{P_{i,t-1}}{D_{i,t-1}} \times \sigma_u^2 \tag{14}$$

The negative covariance between the regressor and true residual biases the estimate of $\gamma$ in equation (11) in a negative direction. The extent of the bias depends on the magnitude of firm $i$'s price-dividend ratio. If the price dividend ratio is large, the magnitude of the bias is also large. Hence, if emissions intensity is priced ($\gamma > 0$), an estimation of equation (11) using firms with high price-dividend ratios would yield a large omitted variables bias. Conversely, the same estimation using firms with low price-dividend would be characterized by a smaller omitted variable bias.

These intuitions for measurement error and omitted variables bias are precisely what we derive for large samples if equation (11) is estimated in a cross-sectional regression:

$$\text{plim}\ \hat{\gamma} = \gamma \left(\frac{\sigma_{e_{t-1}}^2}{\sigma_{e_{t-1}}^2 + \sigma_u^2}\right) - \gamma \left(\mathbb{E}\left(\frac{P_{i,t-1}}{D_{i,t-1}}\right) \frac{\sigma_u^2}{\sigma_{e_{t-1}}^2 + \sigma_u^2}\right) \tag{15}$$

where the first term is due to classical measurement error and the second term is due to omitted variables bias. In the expression for the omitted variables bias, $\mathbb{E}\left(\frac{P_{i,t-1}}{D_{i,t-1}}\right)$ is essentially

the average price dividend ratio among the sample of firms used in the regression, and shows the omitted variable bias depends on this average.

Having established the omitted variables bias, our analysis shows how we can fix it by adding $\left(\frac{P_{i,t-1}}{D_{i,t-1}}\right)(e_{i,t} - e_{i,t-1})$ as a regressor to the "contemporaneous" equation (11).

**Five predictions.** In sum, assuming that equation (9) is the true return generating process, our five predictions can be summarized as follows:

P1. The estimate of $\gamma$ in the "lagged" equation (10) is unbiased and consistent.

P2. The estimate of $\gamma$ in the "contemporaneous" equation (11) is biased towards 0 due to classical measurement error and downward biased due to omitted variable bias.

P3. The estimate of $\gamma$ in the "contemporaneous" equation (11) increases in the subsample of observations with low (lagged) price-dividend ratios and decreases in the subsample of observations with high (lagged) price-dividend ratios.

P4. Adding $\left(\frac{P_{i,t-1}}{D_{i,t-1}}\right) \times (e_{i,t} - e_{i,t-1})$ as a regressor in the "contemporaneous" equation (11) eliminates the omitted variable bias, thus increasing the estimates of $\gamma$.

P5. The estimated coefficients in:

$$r_{i,t} - r_{f,t} = \alpha + \eta_1 e_{i,t-1} + \eta_2 \left(\frac{P_{i,t-1}}{D_{i,t-1}}\right) e_{i,t} + \eta_3 \left(\frac{P_{i,t-1}}{D_{i,t-1}}\right) e_{i,t-1}$$

are (i) $\eta_1 > 0$, (ii) $\eta_2 < 0$, (iii) $\eta_3 > 0$, and (iv) $\eta_1 = -\eta_2 = \eta_3$.

**Interpreting results in the literature.** Our theoretical framework, and the resulting testable predictions, help reconcile apparently conflicting results in the literature. We now focus on two important specification choices adopted in existing empirical studies: (i) the use of the "contemporaneous" equation (11) and (ii) the use of monthly returns.

The "contemporaneous" regression is, as discussed, affected by measurement error and omitted variable bias that shrink the estimated coefficient on emissions toward zero, and potentially to negative values. Hence, this observation helps explain the small and statistically insignificant contemporary regression coefficients in Bolton and Kacperczyk (2021) and the

often negative coefficient in Aswani et al. (2024).[8] Finally, the downward bias also helps reconcile the finding that the effect of divestment on carbon intensity does not seem to be priced even though its scale is large enough to move prices (Bolton and Kacperczyk, 2021).

Several papers (e.g., Bolton and Kacperczyk, 2021; Aswani et al., 2024) analyze whether emissions intensity (or emissions) is priced by estimating a specification where the dependent variable is *monthly* excess returns even though emissions are measured at an *annual* frequency. Specifically, the emissions variable for each month in a year is set to be (i) the same value as the emissions for that year in some specifications, (ii) the same value as the emissions for the previous year in others, or (iii) the same value as the emissions publicly released last (Zhang, 2025).[9] The higher frequency of returns compared with emissions creates two potential concerns. First, investors might receive other information about emissions at a higher frequency than annual, thus inducing a measurement error when using annual emissions *repeated* at a monthly frequency. This measurement error shrinks the estimated monthly coefficient $\gamma$ toward zero. Second, year $t$ emissions are not known to investors during year $t$ but are correlated with what investors likely learn about emissions during the year. In other words, year $t$ emissions are correlated with the emissions innovation, creating an omitted variables problem—yet another source of downward bias in $\gamma$.

In sum, measurement error and omitted variable bias help explain the often negative (or insignificant) findings in the literature on whether emissions intensity is priced in the stock market. In Section 3 and Section 4, we test the five predictions developed in this section using annual returns.[10]

[8]Specifically, Table 8 in Aswani et al. (2024) shows the estimation of several variants of the "contemporaneous" regression. Two thirds of the estimated coefficients on emissions intensity are negative, and one third are negative and statistically significant.

[9]The controls in these regressions are measured at a monthly, quarterly, or annual frequency, depending on the paper. The dating of the controls is sometimes contemporaneous with the emissions, or alternatively lagged one period. A period corresponds to the frequency with which the control is measured.

[10]In Appendix C, we formally show that the estimation of annual regressions overcomes the measurement error and omitted variable biases affecting the regressions that use monthly returns. Another reason for using annual regressions is that investors' information on climate is incorporated into returns at a lower than monthly frequency for small firms (Pástor et al., 2022).

# 3 Data and empirical facts about emissions

We now present our data and discuss some key summary statistics. Section 3.1 illustrates our main data sources and how we combine them to obtain our final data set. Section 3.2 presents a set of summary statistics, mostly about emissions intensities across firms and industries.

## 3.1 Data

Our data set is the result of combining carbon emissions intensities from S&P Global Trucost, and stock returns and firm information from CRSP and Compustat, respectively.

**Carbon emissions.** Firm-level carbon emissions are obtained from S&P Trucost.[11] Trucost provides information at an annual frequency on firms' greenhouse gas (GHG) emissions, which Trucost obtains from publicly disclosed sources (e.g., annual reports) or, in absence of disclosures, from Trucost's proprietary input-output model.[12] Emissions are reported in absolute values (tonnes of carbon dioxide equivalent emissions, or tCO2e) and normalized by the company's annual consolidated revenues in millions of U.S. dollars (tCO2e/USD 1 million revenue). As discussed, we refer to this normalized measure as emissions *intensity*.

Following the Greenhouse Gas Protocol (available at `https://ghgprotocol.org`), Trucost distinguishes between three types of emissions. The definition provided by S&P is as follows. Scope-1 emissions are from directly emitting sources that are owned or controlled by a company. For example, scope-1 emissions include the emissions produced by the internal combustion engines of a trucking company's trucking fleet. Scope-2 emissions are from the consumption of purchased electricity, steam, or other sources of energy generated upstream from a company's direct operations. Scope-3 emissions encompass all other emissions associated with a company's operations that are not directly owned or controlled by the

[11] See `www.spglobal.com/spdji/en/documents/additional-material/faq-TruCost.pdf` for details about the data coverage, data collection, and variable definitions.

[12] According to Trucost, "*Trucost's environmentally extended input-output (EEIO) model combines industry-specific environmental impact data with quantitative macroeconomic data on the flow of goods and services between different sectors in the economy.*"

company. Hence, scope-3 emissions include several sources of indirect emissions in both the company's supply chain and downstream from the company's owned or controlled operations (e.g., the emissions from the in-use phase of a company's products or services, such as the driving of a truck produced by an automobile manufacturer). We follow the literature and focus our analysis on scope-1 and scope-2 emissions intensities.

**Constructing our data.** We combine data from three sources. First, we obtain firm-year emissions intensity data from S&P Trucost. Trucost's coverage begins in 2002 for large-cap companies and expands significantly from 2016 onward to include small- and mid-cap firms. We merge this data with the S&P Company Foundation file to obtain more detailed company and industry-level information. We restrict the sample to firms headquartered in the U.S. Additionally, we link the Trucost data with the Business Entity Cross Reference Service (BECRS) to obtain a company ID variable for further merging.

Second, we obtain stock prices from the CRSP monthly stock file. Using the Capital IQ link table, we match the company ID variable from BECRS to the corresponding GVKEY in CRSP.[13] From the effective month-year end date, we aggregate stock return data over the preceding 12 months. We calculate firm-level excess returns by merging this data with the risk-free rate obtained from Kenneth French's data library. For each firm, we keep only common stocks. If a firm has multiple classes of common stocks, we keep the class with the highest number of shares outstanding. To maintain consistency in assigning stock returns to specific years, the year variable for each observation is adjusted based on the effective month-year end date. If the month falls in the first half of the calendar year, the returns are assigned to the preceding year. Otherwise, they are assigned to the same calendar year.

Third, we obtain firm-level financials from Compustat. We merge this data by matching on

[13]Note that Trucost reports emissions data based on fiscal year-end dates, which vary across firms and do not always align with the calendar year. To address this inconsistency, we define an effective month-year end date for each firm. If the fiscal year ends within the first 14 days of a month, we assign the previous month as the effective month-year end. Conversely, if the fiscal year ends within the second half of the month, we assign the current month as the effective month-year end. In our final sample, 18,418 of the 24,971 firm-year observations have the period end date in the second half of December, aligning with the calender year. This subsample represents approximately 74% of the sample.

GVKEY and aligning with the year variable assigned to each firm's stock return aggregation.

**Final data.** Our final data set consists of an unbalanced panel of 24,971 observations featuring 3,125 firms across 22 industries (NAICS 2-digit codes) at an annual frequency from 2002 to 2023. The unit of observation is firm-year. The top-5 industries in terms of number of observations are (i) "Manufacturing A" (5,960 observations; 752 firms; NAICS code 33), (ii) "Professional, Scientific, and Technical Services" (2,932 observations; 642 firms; NAICS code 54), (iii) "Manufacturing B" (2,749 observations; 405 firms; NAICS code 32), (iv) "Information" (2,534 observations; 424 firms; NAICS code 51), and (v) "Mining, Quarrying, and Oil and Gas Extraction" (1,552 observations; 181 firms; NAICS code 21).[14] As mentioned before, the Trucost coverage increases substantially starting from 2016. The number of observations jumps from an average of 739 per year in 2010–15 to an average of 2,085 in 2016–21. See Table D.1 and Table D.2 for the annual breakdown of observations and the breakdown of observations across industries, respectively.

## 3.2 Empirical facts about emissions

The distribution of emissions intensities across firms and across industries is very skewed with a few firms and a few industries responsible for a sizable share of emissions. Across industries, the most polluting ones are (i) "Utilities" (NAICS code 22), (ii) "Agriculture, Forestry, Fishing and Hunting" (NAICS code 11), (iii) "Transportation and Warehousing" (NAICS code 48), and (iv) "Mining, Quarrying, and Oil and Gas Extraction" (NAICS code 21). Specifically, the mean scope-1 emissions intensities, over the entire sample period

[14]Note that the NAICS codes 32 and 33 both correspond to "Manufacturing." The NAICS code 32 is composed of the following industries: "Wood Product Manufacturing" (NAICS 321), "Paper Manufacturing" (NAICS 322), "Printing and Related Support Activities" (NAICS 323), "Petroleum and Coal Products Manufacturing" (NAICS 324), "Chemical Manufacturing" (NAICS 325), "Plastics and Rubber Products Manufacturing" (NAICS 326), and "Nonmetallic Mineral Product Manufacturing" (NAICS 327). The NAICS code 33 is composed of the following industries: "Primary Metal Manufacturing" (NAICS 331), "Fabricated Metal Product Manufacturing" (NAICS 332), "Machinery Manufacturing" (NAICS 333), "Computer and Electronic Product Manufacturing" (NAICS 334), "Electrical Equipment, Appliance, and Component" (NAICS 335), "Transportation Equipment Manufacturing" (NAICS 336), "Furniture and Related Product Manufacturing" (NAICS 337), and "Miscellaneous Manufacturing" (NAICS 339).

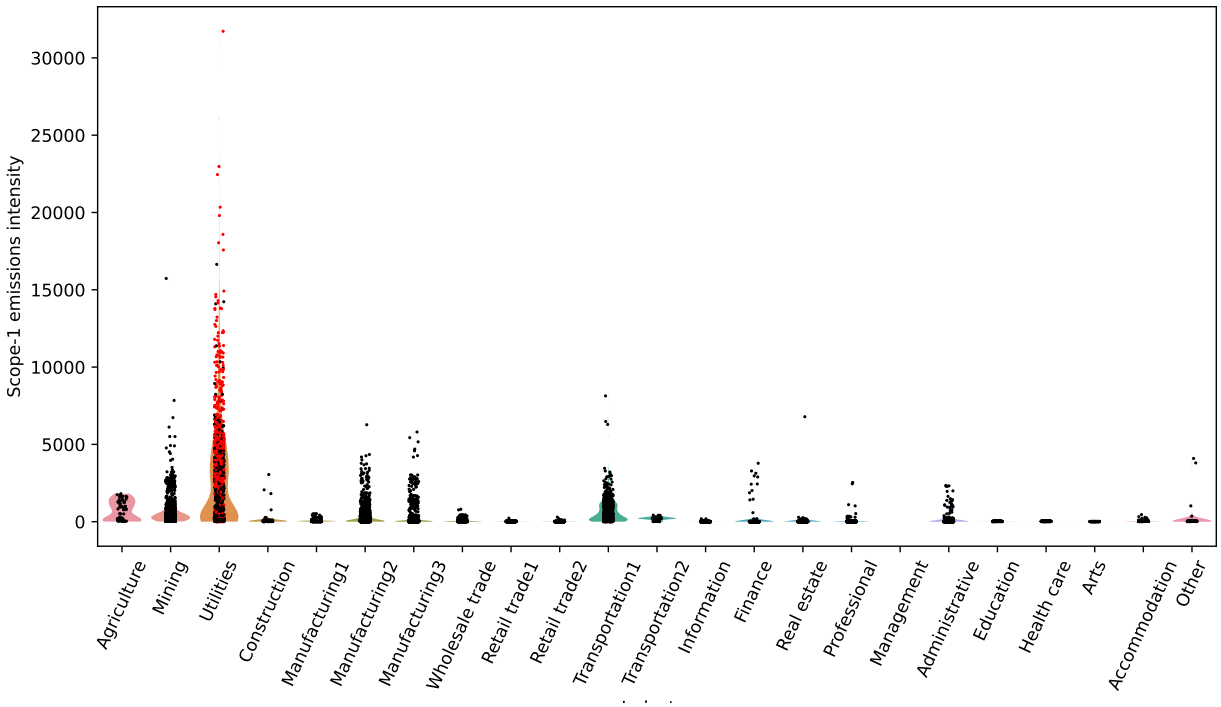



**Figure 1: Large cross-sectional variation in scope-1 emissions intensities across and within industries.** This figure shows the within-industry cross-sectional variation in scope-1 emissions intensities from 2002 to 2023. Firm-year observations are grouped by their 2-digit NAICS code on the x-axis. The violin plots show the distribution of emissions intensities within each industry, where the width of the plot at a given value reflects the relative frequency of observations at that level. Each dot represents a firm-year observation, with red dots in "Utilities" highlighting firms in the "Electric Power Generation, Transmission and Distribution" subsector (NAICS code 2211).

for these four industries are 2,866, 725, 657, and 561, respectively. The contrast with the least polluting industries is staggering: "Information" (NAICS code 51) and "Finance and Insurance" (NAICS code 52) have mean scope-1 emissions intensities equal to 4.16 and 10.33, respectively. In the cross-section of industries, the distribution of mean industry-level scope-1 emissions intensities has a mean of 265, a median of 55, and a skewness of 3.6.

The large variation in emissions intensities is present also *within* industries, as documented in Figure 1. The figure shows, for each industry (2-digit NAICS code) on the x-axis, the distribution of firm-year observations in terms of their scope-1 emissions intensities. Utilities (NAICS code 22) has by far the largest cross-sectional variation in scope-1 emissions intensities. In addition to a few firm-year observations with emissions intensities above 20,000, this industry is characterized by both firms with high and low emissions intensities. Note that this industry is ranked only sixth in our data in terms of firm-year observations (1,220 observations), but is likely an important driver of any cross-sectional analysis of emissions

intensity, even within industries. This observation is logical: "Utilities" is inherently an heterogenous industry, which includes "Water, Sewage and Other Systems" (NAICS code 2213) with median scope-1 emissions intensity of 100, "Natural Gas Distribution" (NAICS code 2212) with median scope-1 emissions intensity of 646, and "Electric Power Generation, Transmission and Distribution" (NAICS code 2211) with a staggering median scope-1 emissions intensity of 4,269. The red dots in the figure indicate the emissions intensities of firms operating in "Electric Power Generation, Transmission and Distribution."

# 4 Empirical evidence

We now show empirical evidence suggesting that carbon emissions intensity is priced in equity markets. Section 4.1 presents the estimation of our preferred specification. Section 4.2 shows that this estimation is highly sensitive to the inclusion of a few observations characterized by very high values of emissions intensity—mostly by firms operating in "Electric Power Generation, Transmission, and Distribution." Section 4.3 presents additional results based on testing our theoretical predictions. Section 4.4 presents some additional results.

## 4.1 Our preferred specification

Following our first prediction (P1), our preferred specification is based on the "lagged" equation (11) as follows:

$$R_{it} = \alpha + \boldsymbol{\beta}' \boldsymbol{X}_{it-1} + \mu_t + \epsilon_{it} \tag{16}$$

where $i$ is a firm and $t$ is a year. The independent variable is the annual stock return of firm $i$, from the end of year $t-1$ to the end of year $t$. The vector $\boldsymbol{X}_{it-1}$ includes a set of firm-level variables, lagged by one year. The regression also includes time fixed effects ($\mu_t$) for all specifications, and industry fixed effects (based on 2-digit NAICS codes) in some specifications.

The firm-level variables include firm-level emissions intensity, defined (i) as scope-1 emissions intensity or (ii) as the sum of scope-1 and scope-2 emissions intensities. The other

firm-level variables are meant to capture the influence of other characteristics potentially correlated with both emissions intensity and returns. These firm-level controls included in the vector $\boldsymbol{X}_{it-1}$ are (i) the log of firm's market capitalization, (ii) firm's leverage (defined as total debt divided by total assets), (iii) firm's investments normalized by total assets, (iv) firm's return on equity (defined as net income divided by shareholders' equity), (v) the volatility of the firm stock (defined as the standard deviation of monthly returns over a 12-month period), (vi) firm beta (defined as the CAPM beta calculated over a 12-month period), and (vii) firm book-to-market ratio. While informed by economic theory, there is, of course, a degree of judgment in deciding which control variables to include in this regression. For this reason, we check how our estimated coefficients of interest are robust to the inclusion of different control variables below.

We now estimate this Specification (16) in the sample of firms excluding firms operating in "Electric Power Generation, Transmission and Distribution." As shown in Figure 1, these firms tend to have extremely high emissions intensities that would be challenging to fit in the same regression model with firms with much lower emissions intensities. We discuss the role of these "super emitters" in Section 3.2. The estimation results in Table 1 are structured as follows. The first three columns only include year fixed effects, while the last three columns include industry and year fixed effects. Columns (2) and (5) use scope-1 emissions intensity as a measure of firm-level emissions. Columns (3) and (6) use the sum of scope-1 and scope-2 emissions intensity as a measure of firm-level emissions. Finally, Columns (1) and (4) are estimated without firm-level emissions intensity.

The estimation results provide strong and robust evidence that emissions intensity is priced. This result is robust to including, or not including, industry fixed effects. Table D.3 shows that this result survives in the subsample that excludes emissions estimated by Trucost. Table D.4 and Table D.5 show that the estimated coefficients are remarkably stable as we progressively saturate the specification with control variables, adding them one by one.[15]

[15]Specifically, Table D.4 shows the estimation results with industry-year fixed effects and Table D.5 shows the estimation results with year fixed effects. In each table, Panel A shows the coefficient stability for scope-1 emissions intensity and Panel B shows the coefficient stability for the sum of scope-1 and scope-2

| | $R_{it}$ | | | | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Scope-1 emission$_{it-1}$ | | 0.0023** | | | 0.0036*** | |
| | | (0.0009) | | | (0.0011) | |
| Scope-1+Scope-2 emission$_{it-1}$ | | | 0.0023*** | | | 0.0036*** |
| | | | (0.0009) | | | (0.0010) |
| MCAP$_{it-1}$ | -0.9445*** | -0.9682*** | -0.9703*** | -1.028*** | -1.041*** | -1.044*** |
| | (0.2241) | (0.2243) | (0.2243) | (0.2291) | (0.2290) | (0.2290) |
| LEV$_{it-1}$ | -0.0005 | -0.0015 | -0.0015 | -0.0003 | -0.0007 | -0.0008 |
| | (0.0022) | (0.0022) | (0.0022) | (0.0025) | (0.0025) | (0.0025) |
| INVEST/A$_{it-1}$ | -0.4576*** | -0.4904*** | -0.4933*** | -0.4550*** | -0.4585*** | -0.4593*** |
| | (0.0781) | (0.0792) | (0.0793) | (0.0918) | (0.0918) | (0.0918) |
| ROE$_{it-1}$ | 0.0271*** | 0.0271*** | 0.0271*** | 0.0254*** | 0.0253*** | 0.0253*** |
| | (0.0053) | (0.0053) | (0.0053) | (0.0053) | (0.0053) | (0.0053) |
| VOL$_{it-1}$ | -0.5448 | -0.5307 | -0.5334 | -0.4761 | -0.4826 | -0.4838 |
| | (0.4303) | (0.4303) | (0.4303) | (0.4351) | (0.4350) | (0.4350) |
| BETA$_{it-1}$ | 0.4675** | 0.4700** | 0.4685** | 0.4388** | 0.4380** | 0.4369** |
| | (0.1905) | (0.1905) | (0.1905) | (0.1916) | (0.1916) | (0.1916) |
| B/M$_{it-1}$ | 0.8577 | 0.5224 | 0.5066 | 0.7204 | 0.4727 | 0.4534 |
| | (0.7123) | (0.7246) | (0.7251) | (0.7381) | (0.7415) | (0.7419) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | ✓ | ✓ | ✓ |
| Observations | 22,225 | 22,225 | 22,225 | 22,225 | 22,225 | 22,225 |
| $R^2$ | 0.11787 | 0.11813 | 0.11814 | 0.11962 | 0.12009 | 0.12011 |

**Table 1: Effect of lagged emissions on returns.** This table shows the estimation results of equation (16). The unit of observation is firm-year. The sample runs at an annual frequency from 2002 to 2022. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211). Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities lagged by one-year. Emissions intensities are defined in Section 3.1. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of monthly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

These results contrast with the empirical literature suggesting that evidence for pricing is fragile to whether emissions are reported by firms or estimated by data vendors and to whether industry fixed effects are included in the estimation (Aswani et al., 2024; Zhang,

emissions intensities. The number of observations in these tables diminishes as we add more control variables due to some missing values for the control variables. In unreported results, we confirm that the estimated coefficients on scope-1 emissions intensity and scope-1+scope-2 emissions intensity are virtually unchanged if we re-estimate these regressions in the subsample of observations where all control variables are non-missing.

2025). This contrasting evidence might be related to our exclusion of "super emitters" from the estimation.

## 4.2 Dealing with "super emitters"

We now show that the regression results discussed above are highly sensitive to the inclusion of observations of firms with very high emissions, which tend to operate in "Electric Power Generation, Transmission and Distribution." As prima facie evidence, Table D.6 shows a version of Table 1 estimated over the full sample of firms. The coefficients of interest are significant only with the inclusion of industry fixed effects—with these magnitudes being around 25% smaller compared to Table 1.

Table 2 analyses this sensitivity in more a systematic way by showing the estimated coefficients on scope-1 emissions intensities as the level of winsorization of this variable changes. Panel A focuses on the regressions with year fixed effects and Panel B focuses on the regressions with both year and industry fixed effects. The control variables are included in the estimation but omitted from the table for brevity. In each panel, Column (1) shows the results with a winsorization at the 99.5 percent level. Columns (2) to (4) consider winsorization levels at the 99 percent, 98 percent, and 90 percent level, respectively. The estimated coefficients, as well as their statistical significance, increase as the winsorization becomes more restrictive. Table D.7 shows consistent results for the sum of scope-1 and scope-2 emissions intensities.

Taken together, the results presented so far suggest that emissions intensity is likely priced in equity markets but the magnitude of such pricing is highly dependent on how "super emitters" are modeled.

## 4.3 Testing more model predictions

We now test the last four predictions from our theoretical framework.

**P2: Attenuated coefficient in a contemporaneous regression.** Our second prediction is based on the "contemporaneous" equation (11), i.e., the regression of period-$t$ returns on period-$t$ emissions intensity. Our theoretical discussion pointed out that this specification

| PANEL A | $R_{it}$ (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Scope-1 emission$_{it-1}$ | 0.0002 | 0.0004 | 0.0006 | 0.0031* |
| | (0.0004) | (0.0004) | (0.0005) | (0.0016) |
| Winsorization | 99.5 | 99 | 98 | 90 |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Observations | 22,693 | 22,693 | 22,693 | 22,693 |
| $R^2$ | 0.11729 | 0.11731 | 0.11732 | 0.11741 |

| PANEL B | $R_{it}$ (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Scope-1 emission$_{it-1}$ | 0.0008* | 0.0012** | 0.0016** | 0.0075*** |
| | (0.0005) | (0.0005) | (0.0006) | (0.0021) |
| Winsorization | 99.5 | 99 | 98 | 90 |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | ✓ | ✓ | ✓ | ✓ |
| Observations | 22,693 | 22,693 | 22,693 | 22,693 |
| $R^2$ | 0.11918 | 0.11925 | 0.11931 | 0.11956 |

**Table 2: Effect of lagged emissions on returns, sensitivity with respect to winsorization of emissions intensity.** This table shows the estimation results of specification (16). The unit of observation is firm-year. The sample runs annually from 2002 to 2022. Panel A only includes year fixed effects. Panel B includes both year and industry fixed effects. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Emissions intensities are defined in Section 3.1 and are winsorized at the 99.5 percent level in Column (1), 99 percent level in Column (2), 98 percent level in Column (3), and 90 percent level in Column (4). The set of control variables included in our baseline specification are included in these two panels but omitted for brevity. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

is affected by measurement error and omitted variable bias. The former attenuates the estimated coefficient on emissions toward zero. The latter is negative, pulling the estimated coefficient on emissions toward zero, and even potentially to a negative value.

Table 3 show the estimation of this "contemporaneous" specification widely used in the

empirical literature.[16] The estimated coefficients on emissions intensity are small and not statistically significant, a result holding regardless of the level of fixed effects and regardless of the definition used to measure firm-level emissions (scope-1 vs. sum of scope-1 and scope-2). This result is in line with the small and statistically insignificant estimates in Bolton and Kacperczyk (2021) and the often negative estimates in Aswani et al. (2024).

**P3: The attenuation varies across firms' price-dividend ratios.** Our third test is based on the prediction that, if emissions intensity is priced, the attenuation bias discussed above is more severe in the subsample of firms with larger price-dividend ratios, as these stocks are more sensitive to a permanent change in the required rate of return compared to stocks with low price-dividend ratios. Note that this prediction relies on the Gordon Growth model—or generalizations in the spirit of Campbell (1991) and Campbell and Shiller (1988)—to produce reasonable approximations of the sensitivity of prices to required returns.

To test this prediction, we compute price-dividend ratios for each of our firm-year observations using data on dividends paid on common shares. Specifically, to limit the importance of outliers, for each firm $i$ at each date $t$, we compute the price-dividend ratio as the average of the price-dividend ratios at times $t-1$, $t-2$, and $t-3$.[17] We can compute such ratios for around half of our observations as a large number of firm-year observations are characterized by zero dividends (and a much smaller number of observations have missing dividends).

We refer to the subsample with firm-year observations that allow the calculation of price-dividend ratios as the "price-dividend" sample. We divide this sample into (i) a subsample of observations with below median price-dividend ratios and (ii) a subsample of observations with above median price-dividend ratios, where medians are calculated in the cross-section

[16] The number of observations is smaller in Table 1 compared with Table 3 as the the sample period starts in 2003 in the former (to accommodate lagged control variables) and in 2002 in the latter.

[17] There is an alternative justification for this approach. In our most general derivation of equation (9), the Campbell and Shiller (1988) log-linearization requires the use of the long-run average price-dividend ratio for each firm in our regressions. However, the use all our data to estimate this quantity would generate look-ahead bias (since some regressors for returns at time $t$ would be based on information dated after time $t$). To avoid such bias, we estimate the price-dividend ratio for predicting returns at time $t$ as a weighted average of price-dividend ratios dated before date $t$.

| | $R_{it}$ | | | | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Scope-1 emission$_{it}$ | | 0.0006 | | | 0.0012 | |
| | | (0.0010) | | | (0.0011) | |
| Scope-1+Scope-2 emission$_{it}$ | | | 0.0006 | | | 0.0013 |
| | | | (0.0009) | | | (0.0011) |
| MCAP$_{it-1}$ | -1.135*** | -1.141*** | -1.142*** | -1.212*** | -1.217*** | -1.218*** |
| | (0.2307) | (0.2309) | (0.2310) | (0.2360) | (0.2361) | (0.2361) |
| LEV$_{it-1}$ | -0.0007 | -0.0010 | -0.0010 | -0.0006 | -0.0008 | -0.0008 |
| | (0.0023) | (0.0023) | (0.0023) | (0.0026) | (0.0026) | (0.0026) |
| INVEST/A$_{it-1}$ | -0.4141*** | -0.4225*** | -0.4238*** | -0.4090*** | -0.4109*** | -0.4114*** |
| | (0.0811) | (0.0823) | (0.0824) | (0.0951) | (0.0952) | (0.0952) |
| ROE$_{it-1}$ | 0.0270*** | 0.0270*** | 0.0270*** | 0.0259*** | 0.0259*** | 0.0259*** |
| | (0.0055) | (0.0055) | (0.0055) | (0.0055) | (0.0055) | (0.0055) |
| VOL$_{it-1}$ | -0.2704 | -0.2676 | -0.2681 | -0.2598 | -0.2642 | -0.2648 |
| | (0.4477) | (0.4478) | (0.4478) | (0.4529) | (0.4529) | (0.4529) |
| BETA$_{it-1}$ | 0.4805** | 0.4808** | 0.4804** | 0.4696** | 0.4687** | 0.4681** |
| | (0.1942) | (0.1942) | (0.1942) | (0.1953) | (0.1953) | (0.1953) |
| B/M$_{it-1}$ | 0.7120 | 0.6300 | 0.6204 | 0.5703 | 0.4900 | 0.4795 |
| | (0.7388) | (0.7507) | (0.7512) | (0.7645) | (0.7679) | (0.7683) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | ✓ | ✓ | ✓ |
| Observations | 21,034 | 21,034 | 21,034 | 21,034 | 21,034 | 21,034 |
| $R^2$ | 0.12021 | 0.12022 | 0.12023 | 0.12153 | 0.12158 | 0.12159 |

**Table 3: Effect of contemporaneous emissions on returns.** This table shows the estimation results of equation (16) but with contemporaneous not lagged emissions intensity. The unit of observation is firm-year. The sample runs at at annual frequency from 2002 to 2022. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211). Scope-1 emission$_{it}$ is the contemporaneous scope-1 emissions intensity. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities. Emissions intensity is defined in Section 3.1 and are winsorized at the 95 percent level. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

every year. Since we are forced to analyze a small subsample of our data, we confirm in Table D.8 that the estimated coefficients of our preferred "lagged" specification estimated in this subsample are similar to those in Table 1. We then estimate the "contemporaneous" regression specifications (returns on emissions intensities and controls) in the two subsamples.

Recall that the theory predicts that, if emissions intensity is priced, the regression estimated in the full sample suffers from omitted variables bias. The theory also predicts that this bias is more severe for the above median price-dividend subsample. The estimation results in Table 4 confirm this prediction. Every coefficient in Panel A is greater than the

| | $R_{it}$ | | | |
|---|---|---|---|---|
| PANEL A: Below median PD | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it}$ | 0.0017* | | 0.0015 | |
| | (0.0010) | | (0.0011) | |
| Scope-1+Scope-2 emission$_{it}$ | | 0.0019* | | 0.0016 |
| | | (0.0010) | | (0.0011) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | ✓ | ✓ |
| Observations | 5,444 | 5,444 | 5,444 | 5,444 |
| $R^2$ | 0.15127 | 0.15135 | 0.15438 | 0.15444 |

| | $R_{it}$ | | | |
|---|---|---|---|---|
| PANEL B: Above median PD | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it}$ | -0.0022* | | -0.0021 | |
| | (0.0013) | | (0.0015) | |
| Scope-1+Scope-2 emission$_{it}$ | | -0.0022* | | -0.0021 |
| | | (0.0013) | | (0.0014) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | ✓ | ✓ |
| Observations | 5,444 | 5,444 | 5,444 | 5,444 |
| $R^2$ | 0.18995 | 0.18998 | 0.19419 | 0.19421 |

| PANEL C: Test for statistically different coefficients<br>$H_A : \beta_{\text{below median PD}} - \beta_{\text{above median PD}} > 0$ | | | | |
|---|---|---|---|---|
| Z-statistic no clustering | 1.3194* | 1.3817* | 1.2628 | 1.3480* |
| p-value no clustering | (0.0935) | (0.0835) | (0.1033) | (0.0888) |
| Z-statistic time clustering | 1.2644 | 1.5188* | 1.2254 | 1.3340* |
| p-value time clustering | (0.1030) | (0.0644) | (0.1102) | (0.0911) |
| Z-statistic time-industry clustering | 1.5254* | 1.5697* | 1.5701* | 1.6553** |
| p-value time-industry clustering | (0.0636) | (0.0582) | (0.0582) | (0.0489) |

**Table 4: Effect of contemporaneous emissions intensity on returns, subsamples of below median and above median price-dividend ratio.** This table shows the estimation results of specification (16). The unit of observation is firm-year. The sample runs annually from 2002 to 2022. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211). Panel A only includes firms with a below median price-dividend ratio. Panel B only includes firms with an above median price-dividend ratio. The price-dividend ratio of firm $i$ at time $t$ is calculated as the average of the price-dividend ratios at time $t-1$, $t-2$, and $t-3$, respectively. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Emissions intensities are winsorized at the 95 percent level. The set of control variables included in our baseline specification are included in these two panels but omitted for brevity. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

corresponding coefficient in Table D.8 which, in turn, is greater than the corresponding coefficient in Panel B. Furthermore, the theory predicts that a severe omitted variable bias can cause the estimated coefficients on emissions intensity to turn negative, as we observe in Panel B. Taken together, these comparisons are consistent with our theory, supporting the interpretation that emissions intensity is priced.

Panel C shows that the difference between the coefficients in Panel A and Panel B is statistically greater than zero. To do so, we compute Z-statistics for the difference between the two sets of coefficients. This calculation requires estimating the covariance between the coefficients in Panels A and B, which we do for three cases. In the first case, the coefficients are uncorrelated (labeled "no-clustering"), which is unrealistic since the residuals in the two sets of regressions are likely driven by correlated unmodeled variables. In the second and third cases, we allow for correlation of observations by time or time and industry (labeled "time clustering" or "time-industry clustering").[18] The test results show that the difference in the coefficients is statistically significant at the 10 percent level in almost all cases, further supporting our previous results.[19]

**P4: Addressing the omitted variable bias.** We now test the fourth prediction of our model: if emissions intensity is priced, the omitted variables bias (but not the measurement error) in the "contemporaneous" regression is addressed by adding, as regressor, the lagged

[18] In these last two cases, we also use clustering to compute the variances for consistency.

[19] Note that, by using the price-dividend ratios only to assign firms to the subsamples in Panels A and B, our Z-tests are unlikely to be influenced by our price-dividend ratios being necessarily a noisy estimate of the long-run average price-dividend ratio that theory suggests we should use to sort firms into above and below the median price-dividend ratio subsamples. To provide intuition for this robustness, the difference in the regression coefficients on emissions intensity from data subsample-A and data subsample-B is driven by the difference in the long-run average price-dividend ratios in each of the subsamples. If there is no noise in the estimated price-dividend ratios, the data are properly sorted into the below and above the median subsamples. Hypothetical noise can be problematic if it causes the composition of the subsamples to change in ways that substantially alter the true long-run average price-dividend ratio in each subsample. This possibility is unlikely because the firms that have the most influence on the average price-dividend ratios in each sub-sample are those with price-dividend ratios far from the median. Hence, these firms are the least likely to be reassigned to the other group due to noise. Conversely, the firms that are most likely to be reassigned because of noise are those with price-dividend ratios close to the median. But, again, price-dividend ratios close to the median are close to each other, making an eventual mis-assignment unlikely to significantly change the average price-dividend ratios in either group.

| | $R_{it}$ | | | |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it}$ | 0.0009 | 0.0006 | | |
| | (0.0009) | (0.0010) | | |
| Scope-1 emission$_{it}$ × PD Ratio$_{it-1}$ | -0.0022 | -0.0022 | | |
| | (0.0014) | (0.0014) | | |
| Scope-1 emission$_{it-1}$ × PD Ratio$_{it-1}$ | 0.0028** | 0.0028** | | |
| | (0.0013) | (0.0013) | | |
| Scope-1+Scope-2 emission$_{it}$ | | | 0.0009 | 0.0006 |
| | | | (0.0008) | (0.0009) |
| Scope-1+Scope-2 emission$_{it}$ × PD Ratio$_{it-1}$ | | | -0.0021 | -0.0021 |
| | | | (0.0013) | (0.0013) |
| Scope-1+Scope-2 emission$_{it-1}$ × PD Ratio$_{it-1}$ | | | 0.0027** | 0.0027** |
| | | | (0.0013) | (0.0013) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | ✓ | | ✓ |
| Observations | 10,637 | 10,637 | 10,637 | 10,637 |
| $R^2$ | 0.16065 | 0.16304 | 0.16066 | 0.16304 |

**Table 5: Estimation of equation (9) to address the omitted variable bias.** This table shows the estimation results of equation (9), where the uninteracted emissions intensity is contemporaneous. The unit of observation is firm-year. The sample runs annually from 2002 to 2022. The sample runs annually from 2002 to 2022. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211). The price-dividend ratio of firm $i$ at time $t$ (PD Ratio) is calculated as the average of the price-dividend ratios at time $t-1$, $t-2$, and $t-3$, respectively. We divide PD Ratio by 100 for readability. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one-year. Emissions intensities are winsorized at the 95 percent level. The set of control variables included in our baseline specification are included in these two panels but omitted for brevity. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of monthly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

price-dividend ratio interacted with the innovation in emissions intensity. The estimated coefficient on emissions intensity should increase with this "fix."

Table 5 shows the estimation results, which should be compared with those in Table D.8 (affected by the omitted variable bias). Consistent with the theory, the inclusion of the omitted variables raises the coefficients on emissions intensity in all cases, although they do not reach statistical significance. We also observe that the price-dividend interaction terms have the predicted signs (more on this in our test of P5)—and are statistically significant when emissions are lagged.

| | $R_{it}$ | | | |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it-1}$ | 0.0018** | 0.0019* | | |
| | (0.0009) | (0.0010) | | |
| Scope-1 emission$_{it}$ × PD Ratio$_{it-1}$ | -0.0020 | -0.0020 | | |
| | (0.0014) | (0.0014) | | |
| Scope-1 emission$_{it-1}$ × PD Ratio$_{it-1}$ | 0.0024* | 0.0024* | | |
| | (0.0013) | (0.0013) | | |
| Scope-1+Scope-2 emission$_{it-1}$ | | | 0.0019** | 0.0019** |
| | | | (0.0008) | (0.0009) |
| Scope-1+Scope-2 emission$_{it}$ × PD Ratio$_{it-1}$ | | | -0.0019 | -0.0019 |
| | | | (0.0013) | (0.0013) |
| Scope-1+Scope-2 emission$_{it-1}$ × PD Ratio$_{it-1}$ | | | 0.0023* | 0.0023* |
| | | | (0.0013) | (0.0013) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | ✓ | | ✓ |
| Observations | 10,637 | 10,637 | 10,637 | 10,637 |
| $R^2$ | 0.16094 | 0.16331 | 0.16098 | 0.16333 |

**Table 6: Estimation of equation (9) to address the omitted variable bias and measurement error.** This table shows the estimation results of specification (9). The unit of observation is firm-year. The sample runs annually from 2002 to 2022. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211). The price-dividend ratio of firm $i$ at time $t$ (PD Ratio) is calculated as the average of the price-dividend ratios at time $t-1$, $t-2$, and $t-3$, respectively. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one-year. Emissions intensities are winsorized at the 95 percent level. We divide the PD Ratio by 100 for readability. The set of control variables included in our baseline specification are included in these two panels but omitted for brevity. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of monthly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

**P5: Addressing the omitted variable bias and measurement error.** Our final test mimics the previous estimation with one difference: we replace the contemporaneous un-interacted emissions intensity with the lagged emissions intensity. Our model suggests that, if emissions intensity is priced, this estimation solves both the omitted variables bias and the measurement error. In other words, we estimate equation (9).

Table 6 shows the estimation results. Consistent with the theory, the coefficient on the (now lagged) emissions intensity variable increases even more compared with the previous table and is now statistically significant in all cases at the 5 or 10 percent level. Additionally, the

coefficients on the interaction terms between price-dividend ratio and the contemporaneous and lagged emissions intensities continue to have the correct signs and are often statistically significant. Finally, the magnitude of the coefficients on the emissions intensity variables and the interaction terms are the same, consistent with the fifth and last prediction of the model.

Taken together, the results in this section strongly support our theoretical predictions, suggesting that emissions intensity is a priced characteristics in the U.S. stock market.

## 4.4 Additional results

We now present two additional results. First, we show that our results are driven by the post-Climate Accord period (supporting the interpretation that our results are driven by pricing factor related to $CO_2$). Second, we show how our results vary across the firm size distribution, reconciling our findings with Zhang (2025).

The first analysis examines whether emissions intensity is priced due to a potential correlation with some other non-$CO_2$ related priced factor (or characteristic) that is omitted from our regression. In that case, its pricing should be unrelated to an event that focused investors' attention on carbon emissions such as the 2015 Paris Climate Accord. To this end, we estimate equation (9) using data from the pre- and post-Paris Climate Accord period. Table 7 shows that the pricing for emissions intensity using our full sample is driven by the post-Paris Accord data. During this most recent period, the effect of emissions intensity is larger than during the pre-Paris Accord period, and statistically significant for all of our specifications. In sum, these results suggest that emissions intensity is priced because related to climate and $CO_2$, and not because correlated with some omitted factor.

The second analysis examines how the pricing varies across the firm size distribution, reconciling our findings with Zhang (2025), which estimates a specification similar to equation (16) (e.g., Table 6 in Zhang (2025)) but finds that emissions intensity is not priced, or is priced negatively. Our different results are likely driven by two important differences in our specifications. First, we use lagged emissions intensity instead of lagged *log* emissions

| | $R_{it}$ | | | |
|---|---|---|---|---|
| PANEL A: Period 2002-15 | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it-1}$ | 0.0009 | | 0.0007 | |
| | (0.0010) | | (0.0012) | |
| Scope-1+Scope-2 emission$_{it-1}$ | | 0.0009 | | 0.0008 |
| | | (0.0009) | | (0.0011) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | ✓ | ✓ |
| Observations | 8,444 | 8,444 | 8,444 | 8,444 |
| $R^2$ | 0.22330 | 0.22330 | 0.22720 | 0.22720 |

| | $R_{it}$ | | | |
|---|---|---|---|---|
| PANEL B: Period 2016-23 | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it-1}$ | 0.0042*** | | 0.0063*** | |
| | (0.0015) | | (0.0017) | |
| Scope-1+Scope-2 emission$_{it-1}$ | | 0.0041*** | | 0.0062*** |
| | | (0.0014) | | (0.0016) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | ✓ | ✓ |
| Observations | 13,743 | 13,743 | 13,743 | 13,743 |
| $R^2$ | 0.08489 | 0.08489 | 0.08774 | 0.08776 |

**Table 7: Effect of lagged emissions intensity on returns, pre- vs. post-Paris Accord.** This table shows the estimation results of specification (16) in the sample period from 2002 to 2015 (Panel A) and the sample period from 2016 to 2022 (Panel B). The unit of observation is firm-year. The sample runs at at annual frequency from 2002 to 2022. Scope-1 emission$_{it-1}$ is the lagged scope-1 emissions intensity. Scope-1+scope-2 emission$_{it-1}$ is the sum of lagged scope-1 and scope-2 emissions intensities. Emissions intensity is defined in Section 3.1 and are winsorized at the 95 percent level. The control variables are included in the regression but omitted in this table for brevity. They are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

intensity as a regressor.[20] Logs place a particular functional form on how emissions intensity is related to required returns for both low and very high emissions intensity firms. Given

[20]We know Table 6 in Zhang (2025) uses *log* emissions intensity from communications with the author.

| | $R_{it}$ | | | |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| Scope-1 emission$_{it-1}$ × Asset Q1$_{it-1}$ | 0.0051** | | 0.0070*** | |
| | (0.0021) | | (0.0022) | |
| Scope-1 emission$_{it-1}$ × Asset Q2$_{it-1}$ | 0.0026 | | 0.0037* | |
| | (0.0019) | | (0.0019) | |
| Scope-1 emission$_{it-1}$ × Asset Q3$_{it-1}$ | 0.0016 | | 0.0028 | |
| | (0.0018) | | (0.0019) | |
| Scope-1 emission$_{it-1}$ × Asset Q4$_{it-1}$ | 0.0028 | | 0.0040** | |
| | (0.0019) | | (0.0019) | |
| Scope-1 emission$_{it-1}$ × Asset Q5$_{it-1}$ | 0.0005 | | 0.0017 | |
| | (0.0017) | | (0.0018) | |
| Scope-1+Scope-2 emission$_{it-1}$ × Asset Q1$_{it-1}$ | | 0.0048** | | 0.0068*** |
| | | (0.0021) | | (0.0021) |
| Scope-1+Scope-2 emission$_{it-1}$ × Asset Q2$_{it-1}$ | | 0.0026 | | 0.0037** |
| | | (0.0018) | | (0.0018) |
| Scope-1+Scope-2 emission$_{it-1}$ × Asset Q3$_{it-1}$ | | 0.0016 | | 0.0028 |
| | | (0.0017) | | (0.0018) |
| Scope-1+Scope-2 emission$_{it-1}$ × Asset Q4$_{it-1}$ | | 0.0028 | | 0.0040** |
| | | (0.0018) | | (0.0018) |
| Scope-1+Scope-2 emission$_{it-1}$ × Asset Q5$_{it-1}$ | | 0.0008 | | 0.0019 |
| | | (0.0017) | | (0.0018) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | ✓ | ✓ |
| Observations | 22,225 | 22,225 | 22,225 | 22,225 |
| $R^2$ | 0.11825 | 0.11825 | 0.12025 | 0.12026 |

**Table 8: Effect of lagged emissions intensity on returns, firm asset size quintile interactions.** This table shows the estimation results of specification (16), augmented with interactions with size quintiles. Firm size quintiles are calculated yearly in the cross-section of firms using asset size (act in Compustat). Asset Q1$_{it}$ is the lowest quintile and Asset Q5$_{it}$ is the highest quintile. The sample runs at at annual frequency from 2002 to 2022. Scope-1 emission$_{it-1}$ is the lagged scope-1 emissions intensity. Scope-1+scope-2 emission$_{it-1}$ is the sum of lagged scope-1 and scope-2 emissions intensities. Emissions intensity is defined in Section 3.1 and are winsorized at the 95 percent level. The control variables are included in the regression but omitted in this table for brevity. They are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

that the theoretical motivation for using log as a functional form is unclear, we use a more flexible approach. Second, regressions are weighted by firm size in Zhang (2025), effectively down-weighting the effects of small firms. We do not weigh by firm size (i) as we are interested in understanding how emissions intensity affects the cost of capital for firms of *all* sizes, (ii) as doing so may reduce the precision of the regression estimates (e.g., weighting increases standard errors in the case of homoskedasticity), and (iii) as pricing effects are more likely to be found in thinly traded and less widely held stocks.

To investigate the role of firm size on pricing, we regress returns on emissions intensity interacted with firm size quintile dummies, dropping again firms operating in "Electric Power Generation, Transmission and Distribution" from the sample. This specification allows us to examine whether firms of different sizes face different costs of capital due to their emissions intensity. Table 8 shows that emissions intensity is priced (i) in the smallest quintile in all specifications and (ii) in the second smallest and second largest size quintiles with time and industry fixed effects. In addition, the effect of emissions intensity is larger for smaller firms. These results suggest that the regressions in Zhang (2025) are likely weighted toward firms with weaker pricing of emissions.

Overall, the two additional results presented in this section suggest that emissions intensity is not spuriously priced due to a correlation with an omitted factor and that such pricing is more pronounced for smaller firms—which, to our knowledge, is a new stylized fact.

# 5 Conclusion

Financial markets can play an important role in helping the productive sector reduce its carbon emissions. The idea is simple. Polluting firms that pay high financing costs due to their emissions have an incentive to become greener. While this theoretical argument is sound, its empirical relevance is still debated. Specifically, the evidence on whether carbon emissions lead to higher financing costs (across various asset classes) is mixed.

In this paper, we ask whether carbon emissions intensity, a measure of carbon emissions watched closely by ESG investors, is priced in equity markets. To this end, we develop a theoretical framework, based on the stochastic properties of emissions intensity and asset

pricing theory, to analyze how emissions intensity should affect required returns if emissions intensity is a priced characteristic. Using this framework, we show that studies in the current empirical literature that regress stock returns on contemporaneous emissions intensity likely suffer from measurement error and an omitted variables bias—and that both forces bias the coefficient on emissions intensity downward and potentially below zero.

Our theoretical framework makes new predictions about (i) the form of the correct regression specification and (ii) how the biases in the existing literature vary across specifications run in different subsamples, across specifications run using different variable timing, or across specifications that add regressors defined as "omitted" by our theory. Virtually all predictions of our theory are confirmed in the data. In sum, our findings provide convincing evidence that emissions intensity is priced in equity markets.

The magnitude of the pricing is heavily dependent on how we treat "super emitters", consistent with the extremely skewed distribution of firm-level emissions intensity. This observation suggests that the market might treat "super emitters" differently—or that the assumption that required returns are linear in emissions intensity is not a good approximation for these firms.

Future research should, in our view, focus on finding the driver of the pricing of emissions. One logical direction is to examine whether the pricing originates from ESG preferences shifting investors' portfolios away from firms with high carbon emissions intensity towards greener firms. We believe this is a promising direction because the asset holdings of some institutional investors are strongly declining in firms' emissions intensity (Bolton and Kacperczyk, 2021). Another direction is the analysis of whether the pricing for emissions intensity simply reflects compensation for holding transition risk. This hypothesis can be tested using measures of transition risk, calling for the development of such measures at the firm-level.[21] This type of work is, in our view, a promising avenue for future research.

[21] Goulder and Hafstead (2018), Jorgenson et al. (2018), and NFGS (2022) provide industry-level estimates of transition risk generated using equilibrium models.

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# Appendix

## A The process for emissions intensity as a random walk

For parsimony in our analysis we derive equation (9) while approximating emissions intensity as a random walk. To justify this simplification, in this section we maintain all assumptions in Section 2.2 except we replace Assumption 2 by the assumption that annual emissions intensity for each firm $i$ is a very slowly mean reverting AR(1) process, and then using a Taylor series show the random walk specification produces a reasonable approximation to the residual in equation (9). The AR(1) process for emissions intensity is given by:

$$(e_{i,t+1} - \mu_i) = \theta_i(e_{i,t} - \mu_i) + u_{i,t} \tag{A1}$$

where $\mu_i$ is the long-run mean of emissions intensity for firm $i$, and $\theta_i$ is close to but less than 1. If emissions intensity is on the only priced characteristic, because it is mean-reverting, $\rho_i$ in the Campbell and Shiller (1988) log-linearization is well defined and given by $\rho_i = e^{g_i - (r_f + \gamma\mu_i)}$.

Furthermore, using the properties of the autoregressive process, it is straightforward to show that

$$[\mathbb{E}_{t+1} - \mathbb{E}_t]e_{i,t+k} = \theta^{k-1}[(e_{i,t+1} - \mu_i) - \theta_i(e_{i,t} - \mu_i)] \tag{A2}$$

Plugging this expression in the Campbell (1991) log-linearization and simplifying then shows

$$(\mathbb{E}_{t+1} - \mathbb{E}_t)[r_{i,t+1} - r_f] \approx -\gamma \left(\frac{\rho_i}{1 - \rho_i\theta_i}\right)[(e_{i,t+1} - \mu_i) - \theta_i(e_{i,t} - \mu_i)] \tag{A3}$$

The right hand side can be approximated as a Taylor series around $\theta_i = 1$. When doing so the leading term on the right is the same as in equation (9), and the size of the residual term in the approximation vanishes when $\theta_i = 1$ and is small when $\theta_i$ is in a neighborhood close to 1. This shows our use of the random walk approximation for emissions intensity and the equation we derive is a reasonable approximation for the true return innovation term in equation (9) if emissions intensity is a highly persistent AR(1) process with $\theta_i < 1$.

## B Alternative derivation of equation (9)

To motivate our empirical analysis, we consider the two types of regression specifications that are used in the literature on climate and asset pricing. The first are contemporaneous regressions in which all variables are in the same time period. These take the form:

$$r_{i,t} - r_{f,t} = \alpha + X_{i,t}\theta + ei_{i,t}\gamma + u_{i,t}, \tag{B1}$$

where $X_{i,t}$ is a set of control variables and $ei_{i,t}$ denotes emissions intensity for firm $i$ at time $t$. Note in this regression the emissions intensity during time $t$ is not known during period

$t-1$ when investors are forming expectations about $P_{i,t-1}$, one of the inputs in the definition of $r_{i,t}$. To interpret the regression theoretically, it is useful to express $e_{i,t}$ as the sum of two components, its expectation as of time $t-1$ and an innovation component:

$$e_{i,t} = \mathbb{E}(e_{i,t}|I_{t-1}) + [e_{i,t} - \mathbb{E}(e_{i,t}|I_{t-1})] \tag{B2}$$

The question we examine in this section is whether firms having higher emissions intensity—and thus higher required returns—necessarily implies that the estimated $\gamma$ in the regression (B1) is greater than 0. The answer is not necessarily.

To better interpret the regression equation (B1), we analyze it in the context of a stylized theoretical model linking asset prices to required returns.

In the model, the only variable related to required returns is emissions intensity. The true data generating process for excess returns is assumed to be:

$$r_{i,t} - r_{f,t} = \mathbb{E}(ei_{i,t}|I_{t-1})\gamma + \epsilon_{i,t}, \tag{B3}$$

where $\gamma > 0$ and $\mathbb{E}(ei_{i,t}|I_{t-1})$ is the expected emissions intensity at time $t$ given the publicly available information at time $t-1$. In the equation, the required returns during each period can only depend on the information known at the beginning of the period.

The term $\epsilon_{i,t}$ is the residual of the regression equation. It is determined from the rest of the economic model below, and then utilized to interpret the regression equation (B1).

Let $P_{i,t}$ be the price of stock $i$ at the end of year $t$ and $D_{i,t}$ be the dividend paid by stock $i$ at the end of year $t$. Furthermore, $r_{i,t}$ is given by:

$$r_{i,t} = \frac{P_{i,t} + D_{i,t}}{P_{i,t-1}} \tag{B4}$$

We make the following additional assumptions in the example.

**Assumption 4.** *Asset prices at each time $t$ satisfy the dividend discount model:*

$$P_{i,t} = \frac{\mathbb{E}(D_{i,t+1}|I_t) + \mathbb{E}(P_{i,t+1}|I_t)}{1 + r_f + \gamma\mathbb{E}(ei_{i,t+1}|I_t)} \tag{B5}$$

Because dividends and the risk-free rate do not play an essential role in the analysis, it is assumed:

**Assumption 5.** *Dividends for each stock $i$ are non-stochastic and grow at a constant growth rate $g_i$.*

**Assumption 6.** *The risk-free rate in all periods is constant and given by $r_f$.*

**Assumption 7.** *For each firm $i$, and each time period $t$, and for each possible realization of emissions intensity $r_f + \gamma ei_{i,t+1} > g_i$.*

The above assumption ensures that required returns in each period are greater than dividend growth rates. This condition is necessary to ensure stock prices in the model are finite.

We also make the following assumptions on earnings intensities. These assumptions help in interpreting the regression equation (B1).

**Assumption 8.** *Emissions intensities in periods* 1, 2 *and* $t > 2$ *are distributed as follows:*

$$ei_{i,1} \sim i.i.d.(\mu_i, \sigma_1^2) \tag{B6}$$
$$ei_{i,2} = ei_{i,1} + u_{i,2} \quad where\ u_{i,2} \sim (0, \sigma_u^2) \tag{B7}$$
$$ei_{i,t} = ei_{i,2}\ for\ all\ t > 2. \tag{B8}$$

Equation (B7) ensures there is a broad cross-section of emissions intensities in period 1. Equation (B8) implies the required return in period 2 for each firm $i$ is $r_f + \gamma ei_{i,1}$ since $ei_{i,1}$ is $i$'s expected emissions intensity in period 2. The $\sigma_u^2$ term ensures that $e_{i,2}$ is not perfectly correlated with required returns during period 2. This is realistic since investors do not have perfect foresight, and $ei_{i,2}$ is not known at the beginning of period 2. In addition, note that $\sigma_u^2$ is not restricted to be the same as $\sigma_1^2$ and could be much smaller. Such difference would be consistent with emissions intensities in period 1 being determined by firms' choices of industry by firms choices of technology within their industry in period 2. Finally, equation (B8) guarantees that firms' required returns after period 2 are constant. This vastly simplifies the model. In addition, it is consistent with required returns being persistent, which is, again, realistic.

Under the assumptions of the model, at the end of period 2, the asset pricing setting satisfies the Gordon Growth Model. Hence:

$$P_{i,2} = \frac{D_{i,2}(1+g_i)}{r_f + \gamma ei_{i,2} - g_i} \tag{B9}$$

In period 1, investors do not know $ei_{i,2}$ but asset prices will satisfy the dividend discount model. Given our assumptions that dividends are non-stochastic and grow at a constant rate, this implies:

$$P_{i,1} = \frac{D_{i,2} + \mathbb{E}(P_{i,2}|I_1)}{1 + r_f + \gamma ei_{i,1}} \tag{B10}$$

It is convenient to substitute for $\mathbb{E}(P_{i,2}|I_1)$ in the algebra. To do so, we define $ei_{i,2}^*$ as the value of $ei_{i,2}$ that, if it occurred with certainty, would set $P_{i,2}$ at time 2 to its expectation conditional on date 1 information.

$$\mathbb{E}(P_{i,2}|I_1) = E\left(\frac{D_{i,2}(1+g_i)}{r_f + \gamma ei_{i,2} - g_i}|I_1\right) \tag{B11}$$
$$= \frac{D_{i,2}(1+g_i)}{r_f + \gamma ei_{i,2}^* - g_i} \tag{B12}$$

Substituting for $\mathbb{E}(P_{i,2}|I_1)$ with the expression on the right hand side of equation B12 we get:

$$r_{i,2} - r_f = \gamma ei_{i,1} + \left[\frac{1 + r_f + \gamma ei_{i,1}}{1 + r_f + \gamma ei_{i,2}^*}\right]\left[(1+g_i)\left(\frac{r_f + \gamma ei_{i,2}^* - g_i}{r_f + \gamma ei_{i,2} - g_i} - 1\right)\right] \tag{B13}$$

The equation shows that the excess return decomposes into its time 1 expectation $\gamma e_{i,1}$

and into a residual component that has mean zero conditional on time 1 information.[22] To make further progress with the expression for excess returns, we need to approximate $e^*_{i,2}$. We do so to first order in a neighborhood when $\sigma_u^2$ is close to zero; this yields $e^*_{i,2} \approx e_{i,1}$. A second order approximation produces qualitatively similar results in our analysis but does not add further insight.[23]

With the first order approximation, the expression for excess returns becomes:

$$r_{i,2} - r_f = \gamma ei_{i,1} + \left[(1+g_i)\left(\frac{r_f + \gamma ei_{i,1} - g_i}{r_f + \gamma ei_{i,2} - g_i} - 1\right)\right] \tag{B14}$$

To simplify further, we express the term in braces using a first order Taylor series around $ei_{i,2} = ei_{i,1}$. Doing so yields:

$$r_{i,2} - r_f = \gamma ei_{i,1} - \frac{1+g_i}{r_f + \gamma ei_{i,1} - g_i} \times \gamma(ei_{i,2} - ei_{i,1}) \tag{B15}$$

Using $ei_{i,2} - ei_{i,1} = u_{i,2}$, and noting from the Gordon Growth Model that $\frac{1+g_i}{r_f+\gamma ei_{i,1}-g_i} = \frac{P_{i,1}}{D_{i,1}}$, which is the price-dividend ratio for stock $i$ at time 1, we get:

$$r_{i,2} - r_f = \gamma\ e_{i,1} - \gamma\left(\frac{P_{i,1}}{D_{i,1}}\right)\ u_{i,2} \tag{B16}$$

The second term in the above equation is a first order approximation of how returns during period 2 respond to a permanent change in required returns at the end of period 2 in the Gordon Growth model. The term $-\frac{P_{i,1}}{D_{i,1}}$ is the first order sensitivity of returns during time 2 to the change in required returns. It multiplies $\gamma u_{i,2}$, which is the innovation in required returns.[24] The equation shows that, in the model, firms with higher price-dividend ratios have higher sensitivity of their date 2 returns to changes in required returns. This is intuitive since firms with higher price-dividend ratios either have high dividend growth, low discount factors or both—and, in dividend discount models, price and return sensitivities are larger when firms have higher dividends or lower discount factors.

# C Estimation frequency and measurement error

In this section, we analyze how measurement error may be related to estimation frequency. To do so, we modify the framework slightly to let $t$ denote time measured in years and to let $m$ denote time measured in months, with $m = 0$ denoting the end of year $t-1$, and

[22] To see this, note that the second term is the product of a term in parenthesis and a term in braces. The term in parenthesis is known at time 1. The term in braces is the product of the constant $(1+g_i)$ times a second random term that has expectation 0.

[23] Doing a second order approximation produces $e^*_{i,2} \approx e_{i,1} - .5\gamma\frac{\sigma_u^2}{r_f+\gamma e_{i,1}-g_i}$

[24] The expression for the sensitivity is $\frac{1}{P_{i,1}}\frac{\partial P_{i,2}}{\partial ei_{i,2}}$ evaluated at $ei_{i,2} = ei_{i,1}$.

$m = 1, 2, ...12$ denoting the ends of months 1 through 12 of year $t$. For simplicity, we focus on a cross-sectional regression using one-year of return data, measured at an annual or a monthly frequency. In addition, to simplify aggregation, we measure returns in logs, i.e., in this appendix $r_{i,t}$ is the log gross annual return during year $t$ and $r_{i,m}$ is the log gross monthly return in month $m$ of year $t$. Given that we switched to log returns, we have:

$$r_{i,t} = \sum_{m=1}^{12} r_m. \tag{C1}$$

To further simplify, we assume the log gross risk-free rate is zero both annually and monthly, so we do not have to keep track of the risk free rate in the derivation.

In the text, we modeled returns at an annual frequency. This modeling approach implicitly assumed that information arrived only at the ends of each year. To analyze estimation frequency, we now model returns monthly and then aggregate up to an annual frequency. To do so, we assume returns are monthly, and continue to maintain that beliefs about emissions intensity drive returns. Specifically, we assume returns in each month $m$ follow the process:

$$r_{i,m} = \gamma_m \mathbb{E}(e_{i,t}|I_{m-1}) - \gamma_m \frac{P_{i,m}}{D_{i,m}} \left[\mathbb{E}(e_{i,t}|I_m) - \mathbb{E}(e_{i,t}|I_{m-1})\right]. \tag{C2}$$

This equation is simply the expression we would have derived for returns at a monthly frequency if annual emissions intensity is priced. The equation is the monthly equivalent of equation (9).

In equation (C2), $\gamma_m = \frac{\gamma}{12}$ and $\frac{P_{i,m}}{D_{i,m}} = \frac{\rho_{i,m}}{1-\rho_{i,m}} = \frac{e^{\frac{\bar{g}_i}{12}}}{e^{\frac{\bar{r}_i}{12}} - e^{\frac{g_i}{12}}}$ are monthly equivalents of $\gamma$ and the price to dividend ratio in the Gordon Growth model, respectively. In turn, $\frac{\bar{r}_i}{12}$ and $\frac{g_i}{12}$ are the long-run average monthly returns and dividend growth rates for firm $i$.

Equation (C2) shows that, at the beginning of each month $m$ during year $t$, required returns $r_{i,m}$ depend on expected emissions intensity during year $t$ conditional on investors information sets at the end of month $m-1$, $\gamma_m \mathbb{E}(e_{i,t}|I_{m-1})$ . In addition, the unexpected part of returns during month $m$ depends on the change in expectations about emissions intensity between months $m-1$ and $m$, $-\gamma_m \frac{P_{i,m}}{D_{i,m}} [\mathbb{E}(e_{i,t}|I_m) - \mathbb{E}(e_{i,t}|I_{m-1})]$.

Consider an empirical analysis of the monthly data estimates regressions that take the form:

$$r_{i,m} = \gamma_m e_{i,s} + u_{i,s}, \tag{C3}$$

where $e_{i,s}$ is emissions intensity measured at either $s = t$ or $s = t-1$. These regressions will suffer from measurement error in monthly data because required returns during the month depend on $\mathbb{E}(e_{i,t}|_{m-1})$, which may be different from $e_{i,t}$ and $e_{i,t-1}$ if investors gather information during the year to predict emissions intensities.

To investigate if regressions from annual data might perform better, we first aggregate to derive the process for annual returns implied by monthly returns. This yields:

$$
\begin{aligned}
r_{i,t} &= \sum_{m=1}^{12} r_{i,m} = \gamma_m \sum_{m=1}^{12} \mathbb{E}(e_{i,t}|I_{m-1}) - \sum_{m=1}^{12} \gamma_m \frac{P_{i,m}}{D_{i,m}} \left[\mathbb{E}(e_{i,t}|I_m) - \mathbb{E}(e_{i,t}|I_{m-1})\right] \\
&= \gamma_m \sum_{m=1}^{12} \mathbb{E}(e_{i,t}|I_{m-1}) - \gamma_m \frac{P_{i,m}}{D_{i,m}} \sum_{m=1}^{12} \left[\mathbb{E}(e_{i,t}|I_m) - \mathbb{E}(e_{i,t}|I_{m-1})\right] \\
&= \gamma_m \sum_{m=1}^{12} \mathbb{E}(e_{i,t}|I_{m-1}) - \gamma_m \frac{P_{i,m}}{D_{i,m}} \left[\mathbb{E}(e_{i,t}|I_{12}) - \mathbb{E}(e_{i,t}|I_0)\right], \qquad \text{(C4)}
\end{aligned}
$$

where we pull $\gamma_m$ and $pd_{i,m}$ outside the summation because they are constants that do not change with month $m$.

We assume the emissions intensity for each year $t$ is learned by the end of year $t$. This assumption, together with the assumption that emissions intensity follows a random walk implies

$$
r_{i,t} = \gamma_m \sum_{m=1}^{12} \mathbb{E}(e_{i,t}|I_{m-1}) - \gamma_m \frac{P_{i,m}}{D_{i,m}}(e_{i,t} - e_{i,t-1}) \approx \gamma_m \sum_{m=1}^{12} \mathbb{E}(e_{i,t}|I_{m-1}) - \gamma \frac{P_i}{D_i}(e_{i,t} - e_{i,t-1}), \qquad \text{(C5)}
$$

where the approximation follows from noting that $\frac{P_{i,m}}{D_{i,m}}$ is the monthly price-dividend ratio. Using the approximation that the monthly dividend is the annual dividend $D$ divided by 12, we have $\frac{P_{i,m}}{D_{i,m}} \approx \frac{P_i}{D_i/12} = 12\frac{P_i}{D_i}$, where $\frac{P_i}{D_i}$ is the long-run price to annual dividend ratio for firm $i$. A little algebra then shows $\gamma_m \frac{P_{i,m}}{D_{i,m}} = \gamma \frac{P_i}{D_i}$.

Taking expectations of both sides of the equation conditional on information at time $t-1$ (which is equivalent to conditioning on month 0) yields:

$$
\begin{aligned}
\mathbb{E}(r_{i,t}|I_{t-1}) &= \gamma_m \sum_{m=1}^{12} \mathbb{E}[\mathbb{E}(e_{i,t}|I_{m-1})|I_{t-1}] - \gamma \frac{P_i}{D_i} \mathbb{E}[(e_{i,t} - e_{i,t-1})|I_{t-1}] \\
&= \gamma_m \times 12 \times e_{i,t-1} \\
&= \gamma e_{i,t-1} \qquad \text{(C6)}
\end{aligned}
$$

Therefore, aggregating up from monthly returns and combining equations (C6) and (C5), annual returns can be decomposed into an expected returns component followed by two innovation terms as follows, all in square braces:

$$
r_{i,t} = [\gamma e_{i,t-1}] - \left[\gamma \frac{P_i}{D_i}(e_{i,t} - e_{i,t-1})\right] + \left[\gamma_m \sum_{m=1}^{12} \left(\mathbb{E}(e_{i,t}|I_{m-1}) - e_{i,t-1}\right)\right], \qquad \text{(C7)}
$$

Recalling that the risk-free rate is set to zero for simplicity, the left hand side of the above equation and the first two terms on the right hand side are reminiscent of those equation (9), but it has been derived by aggregating up from monthly returns. The third term in the right hand side captures the learning about emissions that occurs each month of the year

and alters required returns in the following month. Because emissions intensity is a random walk, both the second and third terms in the right hand side are uncorrelated with $e_{i,t-1}$. Therefore, the cross-sectional regression

$$r_{i,t} = \gamma e_{i,t-1} + u_{i,t} \tag{C8}$$

using annual return data, will produce unbiased and consistent estimates for $\gamma$ provided emissions intensity for each year $t$ is known by the end of the year. This may be a reasonable approximation provided that investors learn about emissions intensity through the year but before it is publicly released.

Finally, the third term in the right hand side of equation (C7) can be simplified as

$$\gamma_m \sum_{m=1}^{12} (\mathbb{E}(e_{i,t}|I_{m-1} - e_{i,t-1}) = \gamma \frac{1}{12} \sum_{m=1}^{12} (\mathbb{E}(e_{i,t}|I_{m-1} - e_{i,t-1}) \approx \gamma(e_{i,t} - e_{i,t-1}) + \gamma\zeta_{i,t} \tag{C9}$$

where the approximation follows by recognizing that $\frac{1}{12}\sum_{m=1}^{12} \mathbb{E}(e_{i,t}|I_{m-1})$ is an average of forecasts of $e_{i,t}$, which can be represented as the quantity being forecasted, $e_{i,t}$, plus an average forecast error $\zeta_{i,t}$ that has a mean of 0 if forecasts are unbiased.

Using equation (C9)ref, equation (C7) can be rewritten as:

$$r_{i,t} \approx \gamma e_{i,t-1} - \gamma \left( \frac{P_i}{D_i} - 1 \right) (e_{i,t} - e_{i,t-1}) + \gamma\zeta_{i,t} \tag{C10}$$

This equation, based on time-aggregation from monthly to annual return data is very similar to equation (9) based on annual returns, with the exception that the price-dividend ratio interaction term is modified slightly, and there is an expectational error-term $\zeta_{i,t}$. Because the differences from equation (9) are so slight, the analytical and empirical results on omitted variables biases and measurement error biases that were derived in annual return setting also work in this richer setting aggregated up from monthly data.

To summarize, in this appendix, we have shown three results: i) if annual emissions intensity is priced and follows a random walk, and if investors learn about it during the year, then monthly return regressions will suffer from measurement error if the variable used to measure beliefs about emissions intensity is the actual or lagged emissions intensity for the year; ii) if emissions intensity follows a random walk and if emissions intensity for each year $t$ is known by investors by the end of year $t$, then a regressions of annual returns on one-year lagged emissions intensity produces unbiased and consistent estimates for $\gamma$; iii) the equation relating annual returns to lagged emissions intensity when aggregated up from our return model at a monthly frequency very closely resembles the equation for returns from our model at a annual frequency. Therefore, the results that we derived in our annual return model for regressions using annual data are essentially unchanged for our model derived from monthly returns with learning that are aggregated up to an annual level.

# D Estimation frequency and measurement error

To illustrate the measurement error and omitted variables biases together, if $\gamma$ is estimated via OLS in equation (11) (and excess returns are generated by equation (9)), we have:

$$\hat{\gamma} = \frac{\widehat{\text{CSCov}}(r_{i,t} - r_{f,t}, e_{i,t})}{\widehat{\text{CSVar}}(e_{i,t})} \tag{D1}$$

where CSCov and CSVar are estimates of the covariance and the variance in the cross-section and "$\widehat{z}$" denotes the sample estimate of $z$. Substituting for $r_{i,t} - r_{f,t}$ from equation (9), the probability limit for $\gamma$ is:

$$\text{plim } \hat{\gamma} = \frac{\text{plim } \widehat{\text{CSCov}}(\gamma e_{i,t-1} - \gamma \frac{P_{i,t-1}}{D_{i,t-1}} u_{i,t}, e_{i,t})}{\text{plim}\widehat{\text{CSVar}}(e_{i,t})}$$

Finally, using $\text{Cov}(x, y) = \text{Cov}(\mathbb{E}(x|I), \mathbb{E}(y|I)) + \mathbb{E}(\text{Cov}(x, y|I))$, we obtain the result in equation (D2). More specifically, to obtain the result we use $\mathbb{E}(r_{i,t} - r_f|I_{t-1}) = \gamma e_{i,t-1}$, and $\mathbb{E}(e_{i,t}|I_{t-1}) = e_{i,t-1}$. Therefore, $\text{Cov}[\mathbb{E}(r_{i,t} - r_f|I_{t-1}), \mathbb{E}(e_{i,t}|I_{t-1})] = \gamma\sigma^2_{e_{t-1}}$. Furthermore, $\text{Cov}(r_{i,t} - r_f, e_{i,t}|I_{t-1}) = \text{Cov}(-\gamma\frac{P_{i,t-1}}{D_{i,t-1}}u_{i,t},\ e_{i,t}|I_{t-1}) = -\gamma\frac{P_{i,t-1}}{D_{i,t-1}}\sigma^2_u$. Hence, $\mathbb{E}(\text{Cov}(r_{i,t} - r_f, e_{i,t}|I_{t-1}) = -\gamma\mathbb{E}(\frac{P_{i,t-1}}{D_{i,t-1}})\sigma^2_u$. Finally $\text{Var}(e_{i,t}) = \sigma^2_{e_{i,t-1}} + \sigma^2_u$. These expressions yield the following equation:

$$\text{plim } \hat{\gamma} = \gamma\left(\frac{\sigma^2_{e_{t-1}}}{\sigma^2_{e_{t-1}} + \sigma^2_u}\right) - \gamma\left(\mathbb{E}(\frac{P_{i,t-1}}{D_{i,t-1}})\frac{\sigma^2_u}{\sigma^2_{e_{t-1}} + \sigma^2_u}\right). \tag{D2}$$

As discussed in the main body, the first term is due to classical measurement error and thus causes shrinkage of $\gamma$ towards zero. The second term is the result of omitted variables bias. This bias is negative because when emissions intensity is unexpectedy high, it causes the return innovation to be unexpectedly low, i.e. the omitted variable is negatively correlated with the regressor. If $\gamma$ is positive, the omitted variable bias could cause the estimated $\gamma$ to become negative.

# E Additional tables

| Year | No. of Firms |
|---|---|
| 2001 | 38 |
| 2002 | 320 |
| 2003 | 442 |
| 2004 | 513 |
| 2005 | 665 |
| 2006 | 654 |
| 2007 | 648 |
| 2008 | 661 |
| 2009 | 679 |
| 2010 | 675 |
| 2011 | 677 |
| 2012 | 680 |
| 2013 | 744 |
| 2014 | 724 |
| 2015 | 886 |
| 2016 | 1951 |
| 2017 | 2029 |
| 2018 | 2066 |
| 2019 | 2047 |
| 2020 | 2150 |
| 2021 | 2242 |
| 2022 | 2212 |
| 2023 | 1268 |

**Table D.1: Number of observations by year.** This table shows the number of firm-year observations in Trucost by year.

| NAICS2 | Industry | Observations | No. Firms |
|---|---|---|---|
| 11 | Agriculture, forestry, fishing and hunting | 70 | 14 |
| 21 | Mining, quarrying, and oil and gas extraction | 1552 | 181 |
| 22 | Utilities | 1220 | 110 |
| 23 | Construction | 227 | 46 |
| 31 | Manufacturing | 962 | 115 |
| 32 | Manufacturing | 2749 | 405 |
| 33 | Manufacturing | 5960 | 752 |
| 42 | Wholesale trade | 862 | 132 |
| 44 | Retail trade | 1018 | 114 |
| 45 | Retail trade | 575 | 85 |
| 48 | Transportation and warehousing | 807 | 115 |
| 49 | Transportation and warehousing | 51 | 7 |
| 51 | Information | 2534 | 424 |
| 52 | Finance and insurance | 552 | 86 |
| 53 | Real estate and rental and leasing | 825 | 216 |
| 54 | Professional, scientific, and technical services | 2932 | 642 |
| 56 | Management of companies and enterprises | 515 | 79 |
| 61 | Educational services | 154 | 21 |
| 62 | Health care and social assistance | 512 | 79 |
| 71 | Arts, entertainment, and recreation | 154 | 31 |
| 72 | Accomodation and food services | 591 | 75 |
| 81 | Other services | 149 | 33 |

**Table D.2: Number of observations by industry.** This table shows the number of firm-year observations and the number of unique firms in Trucost by industry (2-digit NAICS code). Firms that change industries across years are included in the count for each industry they belong to during the sample period. Among the final sample of unique firms, 2,550 remain in the same industry for the whole sample period, 518 are observed in two industries, 53 in 3 industries, 3 in 4 industries, and 1 firm is counted in 5 industries.

| | $R_{it}$ | | | | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Scope-1 emission$_{it-1}$ | | 0.0016* | | | 0.0022** | |
| | | (0.0009) | | | (0.0011) | |
| Scope-1+Scope-2 emission$_{it-1}$ | | | 0.0015* | | | 0.0020* |
| | | | (0.0009) | | | (0.0011) |
| MCAP$_{it-1}$ | 0.9720*** | 1.039*** | 1.039*** | 1.039*** | 1.117*** | 1.117*** |
| | (0.3455) | (0.3476) | (0.3478) | (0.3581) | (0.3602) | (0.3605) |
| LEV$_{it-1}$ | 0.0016 | -0.0002 | -0.0001 | 0.0003 | -0.0005 | -0.0005 |
| | (0.0031) | (0.0032) | (0.0033) | (0.0036) | (0.0036) | (0.0036) |
| INVEST/A$_{it-1}$ | -0.5466*** | -0.5867*** | -0.5867*** | -0.5020*** | -0.5211*** | -0.5217*** |
| | (0.1183) | (0.1205) | (0.1207) | (0.1344) | (0.1347) | (0.1348) |
| ROE$_{it-1}$ | 0.0113 | 0.0114 | 0.0114 | 0.0123 | 0.0123 | 0.0123 |
| | (0.0085) | (0.0085) | (0.0085) | (0.0085) | (0.0085) | (0.0085) |
| VOL$_{it-1}$ | 13.69*** | 13.84*** | 13.82*** | 14.19*** | 14.18*** | 14.18*** |
| | (1.251) | (1.254) | (1.254) | (1.296) | (1.296) | (1.296) |
| BETA$_{it-1}$ | -1.117** | -1.115** | -1.119** | -1.315** | -1.329** | -1.332** |
| | (0.5145) | (0.5144) | (0.5144) | (0.5176) | (0.5175) | (0.5176) |
| B/M$_{it-1}$ | 4.442*** | 4.065*** | 4.074*** | 4.599*** | 4.454*** | 4.444*** |
| | (1.102) | (1.123) | (1.124) | (1.152) | (1.154) | (1.155) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | ✓ | ✓ | ✓ |
| Observations | 6,623 | 6,623 | 6,623 | 6,623 | 6,623 | 6,623 |
| $R^2$ | 0.17429 | 0.17467 | 0.17463 | 0.18072 | 0.18121 | 0.18115 |

**Table D.3: Effect of lagged emissions on returns, subsample of firms with disclosed emissions.** This table shows the estimation results of equation (16). The unit of observation is firm-year. The sample runs at an annual frequency from 2002 to 2023. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211) or observations with Trucost-estimated emissions. Following Aswani et al. (2024), we define "estimated" emissions as those for which the Trucost carbon information source includes the keyword "estimate." Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities lagged by one-year. Emissions intensities are defined in Section 3.1. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of monthly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

| | | | | $R_{it}$ | | | |
|---|---|---|---|---|---|---|---|
| PANEL A | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| Scope-1 emission$_{it-1}$ | 0.0036*** | 0.0036*** | 0.0037*** | 0.0037*** | 0.0037*** | 0.0037*** | 0.0036*** |
| | (0.0010) | (0.0010) | (0.0010) | (0.0010) | (0.0010) | (0.0010) | (0.0010) |
| LEV$_{it-1}$ | | -0.0029 | -0.0017 | -0.0018 | -0.0018 | -0.0019 | -0.0007 |
| | | (0.0025) | (0.0025) | (0.0025) | (0.0025) | (0.0025) | (0.0025) |
| INVEST/A$_{it-1}$ | | | -0.4532*** | -0.4597*** | -0.4633*** | -0.4635*** | -0.4720*** |
| | | | (0.0915) | (0.0915) | (0.0915) | (0.0915) | (0.0915) |
| ROE$_{it-1}$ | | | | 0.0217*** | 0.0234*** | 0.0236*** | 0.0270*** |
| | | | | (0.0052) | (0.0052) | (0.0052) | (0.0053) |
| VOL$_{it-1}$ | | | | | 0.4737 | 0.3562 | -0.3715 |
| | | | | | (0.4049) | (0.4089) | (0.4347) |
| BETA$_{it-1}$ | | | | | | 0.3932** | 0.4082** |
| | | | | | | (0.1910) | (0.1910) |
| MCAP$_{it-1}$ | | | | | | | -1.084*** |
| | | | | | | | (0.2206) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Observations | 22,498 | 22,459 | 22,453 | 22,453 | 22,448 | 22,448 | 22,445 |
| $R^2$ | 0.11732 | 0.11736 | 0.11823 | 0.11892 | 0.11914 | 0.11931 | 0.12022 |

| | | | | $R_{it}$ | | | |
|---|---|---|---|---|---|---|---|
| PANEL B | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| Scope-1+Scope-2 emission$_{it-1}$ | 0.0035*** | 0.0036*** | 0.0036*** | 0.0036*** | 0.0036*** | 0.0036*** | 0.0036*** |
| | (0.0010) | (0.0010) | (0.0010) | (0.0010) | (0.0010) | (0.0010) | (0.0010) |
| LEV$_{it-1}$ | | -0.0030 | -0.0017 | -0.0019 | -0.0018 | -0.0020 | -0.0007 |
| | | (0.0025) | (0.0025) | (0.0025) | (0.0025) | (0.0025) | (0.0025) |
| INVEST/A$_{it-1}$ | | | -0.4539*** | -0.4605*** | -0.4641*** | -0.4642*** | -0.4728*** |
| | | | (0.0915) | (0.0915) | (0.0915) | (0.0915) | (0.0915) |
| ROE$_{it-1}$ | | | | 0.0217*** | 0.0234*** | 0.0236*** | 0.0270*** |
| | | | | (0.0052) | (0.0052) | (0.0052) | (0.0053) |
| VOL$_{it-1}$ | | | | | 0.4722 | 0.3552 | -0.3732 |
| | | | | | (0.4049) | (0.4089) | (0.4347) |
| BETA$_{it-1}$ | | | | | | 0.3919** | 0.4069** |
| | | | | | | (0.1910) | (0.1910) |
| MCAP$_{it-1}$ | | | | | | | -1.085*** |
| | | | | | | | (0.2206) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Observations | 22,498 | 22,459 | 22,453 | 22,453 | 22,448 | 22,448 | 22,445 |
| $R^2$ | 0.11733 | 0.11738 | 0.11825 | 0.11894 | 0.11916 | 0.11933 | 0.12024 |

**Table D.4: Effect of lagged emissions intensity on returns, subsample from 2016 to 2022.** This table shows the estimation results of specification (16). The unit of observation is firm-year. The sample runs at an annual frequency from 2016 to 2022. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities lagged by one-year. Emissions intensities are defined in Section 3.1 and are winsorized at the 95 percent level. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

| PANEL A | $R_{it}$ (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|
| Scope-1 emission$_{it-1}$ | 0.0009 | 0.0014 | 0.0024*** | 0.0024*** | 0.0024*** | 0.0024*** | 0.0024*** |
| | (0.0009) | (0.0009) | (0.0009) | (0.0009) | (0.0009) | (0.0009) | (0.0009) |
| LEV$_{it-1}$ | | -0.0053** | -0.0023 | -0.0024 | -0.0023 | -0.0024 | -0.0013 |
| | | (0.0022) | (0.0022) | (0.0022) | (0.0022) | (0.0022) | (0.0022) |
| INVEST/A$_{it-1}$ | | | -0.4633*** | -0.4708*** | -0.4814*** | -0.4859*** | -0.4929*** |
| | | | (0.0791) | (0.0791) | (0.0791) | (0.0791) | (0.0791) |
| ROE$_{it-1}$ | | | | 0.0233*** | 0.0250*** | 0.0252*** | 0.0287*** |
| | | | | (0.0051) | (0.0052) | (0.0052) | (0.0052) |
| VOL$_{it-1}$ | | | | | 0.4279 | 0.2893 | -0.4111 |
| | | | | | (0.3987) | (0.4033) | (0.4300) |
| BETA$_{it-1}$ | | | | | | 0.4315** | 0.4416** |
| | | | | | | (0.1899) | (0.1899) |
| MCAP$_{it-1}$ | | | | | | | -1.013*** |
| | | | | | | | (0.2167) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | | | | |
| Observations | 22,498 | 22,459 | 22,453 | 22,453 | 22,448 | 22,448 | 22,445 |
| $R^2$ | 0.11479 | 0.11497 | 0.11622 | 0.11703 | 0.11724 | 0.11745 | 0.11827 |

| PANEL B | $R_{it}$ (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|
| Scope-1+Scope-2 emission$_{it-1}$ | 0.0009 | 0.0014* | 0.0024*** | 0.0024*** | 0.0024*** | 0.0024*** | 0.0024*** |
| | (0.0008) | (0.0009) | (0.0009) | (0.0009) | (0.0009) | (0.0009) | (0.0009) |
| LEV$_{it-1}$ | | -0.0053** | -0.0024 | -0.0025 | -0.0024 | -0.0024 | -0.0014 |
| | | (0.0022) | (0.0022) | (0.0022) | (0.0022) | (0.0022) | (0.0022) |
| INVEST/A$_{it-1}$ | | | -0.4666*** | -0.4740*** | -0.4846*** | -0.4890*** | -0.4961*** |
| | | | (0.0792) | (0.0792) | (0.0792) | (0.0792) | (0.0792) |
| ROE$_{it-1}$ | | | | 0.0233*** | 0.0250*** | 0.0252*** | 0.0287*** |
| | | | | (0.0051) | (0.0052) | (0.0052) | (0.0052) |
| VOL$_{it-1}$ | | | | | 0.4250 | 0.2870 | -0.4140 |
| | | | | | (0.3986) | (0.4032) | (0.4300) |
| BETA$_{it-1}$ | | | | | | 0.4298** | 0.4398** |
| | | | | | | (0.1899) | (0.1899) |
| MCAP$_{it-1}$ | | | | | | | -1.014*** |
| | | | | | | | (0.2167) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | | | | |
| Observations | 22,498 | 22,459 | 22,453 | 22,453 | 22,448 | 22,448 | 22,445 |
| $R^2$ | 0.11479 | 0.11497 | 0.11624 | 0.11705 | 0.11726 | 0.11746 | 0.11829 |

**Table D.5: Effect of lagged emissions intensity on returns, sensitivity with respect to winsorization of emissions intensity, scope-1+scope-2 emissions intensity.** This table shows the estimation results of specification (16). The unit of observation is firm-year. The sample runs at annual frequency from 2002 to 2022. Panel A only includes year fixed effects. Panel B includes both year and industry fixed effects. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities lagged by one year. Emissions intensities are defined in Section 3.1 and are winsorized at the 99.5 percent level in Column (1), 99 percent level in Column (2), 98 percent level in Column (3), and 90 percent level in Column (4). The set of control variables included in our baseline specification are included in these two panels but omitted for brevity. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of monthly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

| | $R_{it}$ | | | | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Scope-1 emission$_{it-1}$ | | 0.0011 | | | 0.0027*** | |
| | | (0.0008) | | | (0.0009) | |
| Scope-1+Scope-2 emission$_{it-1}$ | | | 0.0012 | | | 0.0027*** |
| | | | (0.0007) | | | (0.0009) |
| MCAP$_{it-1}$ | -0.9218*** | -0.9410*** | -0.9429*** | -0.9983*** | -1.019*** | -1.021*** |
| | (0.2208) | (0.2212) | (0.2212) | (0.2257) | (0.2257) | (0.2257) |
| LEV$_{it-1}$ | -0.0008 | -0.0015 | -0.0016 | $-5.82 \times 10^{-5}$ | -0.0004 | -0.0004 |
| | (0.0021) | (0.0022) | (0.0022) | (0.0024) | (0.0024) | (0.0024) |
| INVEST/A$_{it-1}$ | -0.4533*** | -0.4677*** | -0.4699*** | -0.4487*** | -0.4484*** | -0.4492*** |
| | (0.0771) | (0.0778) | (0.0779) | (0.0906) | (0.0906) | (0.0906) |
| ROE$_{it-1}$ | 0.0265*** | 0.0266*** | 0.0266*** | 0.0247*** | 0.0248*** | 0.0248*** |
| | (0.0052) | (0.0052) | (0.0052) | (0.0053) | (0.0053) | (0.0053) |
| VOL$_{it-1}$ | -0.4613 | -0.4419 | -0.4425 | -0.4120 | -0.4214 | -0.4223 |
| | (0.4259) | (0.4261) | (0.4260) | (0.4309) | (0.4308) | (0.4308) |
| BETA$_{it-1}$ | 0.4958*** | 0.5028*** | 0.5023*** | 0.4581** | 0.4576** | 0.4567** |
| | (0.1882) | (0.1882) | (0.1882) | (0.1894) | (0.1894) | (0.1894) |
| B/M$_{it-1}$ | 0.7224 | 0.5022 | 0.4849 | 0.6668 | 0.4513 | 0.4340 |
| | (0.6976) | (0.7133) | (0.7138) | (0.7263) | (0.7299) | (0.7303) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | ✓ | ✓ | ✓ |
| Observations | 22,693 | 22,693 | 22,693 | 22,693 | 22,693 | 22,693 |
| $R^2$ | 0.11727 | 0.11736 | 0.11737 | 0.11906 | 0.11939 | 0.11941 |

**Table D.6: Effect of lagged emissions on returns, full sample.** This table shows the estimation results of equation (16). The unit of observation is firm-year. The sample runs at an annual frequency from 2002 to 2022. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities lagged by one-year. Emissions intensities are defined in Section 3.1. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of monthly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

| | $R_{it}$ | | | |
|---|---|---|---|---|
| PANEL A | (1) | (2) | (3) | (4) |
| Scope-1+Scope-2 emission$_{it-1}$ | 0.0003 | 0.0005 | 0.0006 | 0.0027* |
| | (0.0004) | (0.0004) | (0.0005) | (0.0014) |
| Winsorization | 99.5 | 99 | 98 | 90 |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Observations | 22,693 | 22,693 | 22,693 | 22,693 |
| $R^2$ | 0.11730 | 0.11732 | 0.11734 | 0.11741 |

| | $R_{it}$ | | | |
|---|---|---|---|---|
| PANEL B | (1) | (2) | (3) | (4) |
| Scope-1+Scope-2 emission$_{it-1}$ | 0.0009** | 0.0013** | 0.0016*** | 0.0062*** |
| | (0.0005) | (0.0005) | (0.0006) | (0.0018) |
| Winsorization | 99.5 | 99 | 98 | 90 |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year FE | ✓ | ✓ | ✓ | ✓ |
| Industry FE | ✓ | ✓ | ✓ | ✓ |
| Observations | 22,693 | 22,693 | 22,693 | 22,693 |
| $R^2$ | 0.11921 | 0.11929 | 0.11935 | 0.11952 |

**Table D.7: Effect of lagged emissions on returns, sensitivity with respect to winsorization of emissions intensity, scope-1+scope-2 emissions intensity.** This table shows the estimation results of specification (16). The unit of observation is firm-year. The sample runs annually from 2002 to 2022. Panel A only includes year fixed effects. Panel B includes both year and industry fixed effects. Scope-1 emission$_{it-1}$ is the scope-1 emissions intensity lagged by one year. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities lagged by one-year. Emissions intensities are defined in Section 3.1 and are winsorized at the 99.5 percent level in Column (1), 99 percent level in Column (2), 98 percent level in Column (3), and 90 percent level in Column (4). The set of control variables included in our baseline specification are included in these two panels but omitted for brevity. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.

| | $R_{it}$ | | | | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Scope-1 emission$_{it}$ | | 0.0005 | | | 0.0003 | |
| | | (0.0008) | | | (0.0009) | |
| Scope-1+Scope-2 emission$_{it}$ | | | 0.0005 | | | 0.0004 |
| | | | (0.0008) | | | (0.0009) |
| MCAP$_{it-1}$ | -0.3297 | -0.3349 | -0.3357 | -0.3244 | -0.3261 | -0.3263 |
| | (0.2297) | (0.2298) | (0.2298) | (0.2356) | (0.2356) | (0.2356) |
| LEV$_{it-1}$ | -0.0033 | -0.0036 | -0.0036 | -0.0028 | -0.0028 | -0.0028 |
| | (0.0022) | (0.0022) | (0.0022) | (0.0025) | (0.0026) | (0.0026) |
| INVEST/A$_{it-1}$ | -0.3441*** | -0.3552*** | -0.3570*** | -0.3768*** | -0.3784*** | -0.3788*** |
| | (0.0854) | (0.0871) | (0.0873) | (0.1019) | (0.1020) | (0.1020) |
| ROE$_{it-1}$ | 0.0146** | 0.0145** | 0.0145** | 0.0150** | 0.0150** | 0.0150** |
| | (0.0070) | (0.0070) | (0.0070) | (0.0071) | (0.0071) | (0.0071) |
| VOL$_{it-1}$ | 3.266*** | 3.268*** | 3.265*** | 3.199*** | 3.191*** | 3.190*** |
| | (0.6462) | (0.6462) | (0.6462) | (0.6581) | (0.6584) | (0.6585) |
| BETA$_{it-1}$ | 0.5315* | 0.5313* | 0.5300* | 0.4604 | 0.4581 | 0.4573 |
| | (0.2985) | (0.2985) | (0.2985) | (0.3025) | (0.3025) | (0.3026) |
| B/M$_{it-1}$ | 2.090** | 1.990** | 1.978** | 2.282*** | 2.251*** | 2.246*** |
| | (0.8278) | (0.8418) | (0.8419) | (0.8618) | (0.8654) | (0.8657) |
| Year FE | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Industry FE | | | | ✓ | ✓ | ✓ |
| Observations | 10,897 | 10,897 | 10,897 | 10,897 | 10,897 | 10,897 |
| $R^2$ | 0.16133 | 0.16136 | 0.16137 | 0.16344 | 0.16346 | 0.16346 |

**Table D.8: Effect of contemporaneous emissions intensity on returns, subsample of firm-year observations with available price-dividend ratios.** This table shows the estimation results of equation (16) but with contemporaneous not lagged emissions intensity. The unit of observation is firm-year. The sample runs at at annual frequency from 2002 to 2022. The sample does not include observations of firms operating in "Electric Power Generation, Transmission and Distribution" (NAICS 2211) and firms with data available on price-dividend ratios. Scope-1 emission$_{it}$ is the contemporaneous scope-1 emissions intensity. Scope-1+scope-2 emission$_{it}$ is the sum of scope-1 and scope-2 emissions intensities. Emissions intensity is defined in Section 3.1 and are winsorized at the 95 percent level. The control variables are lagged by one year and are defined as follows: MCAP$_{it-1}$ is log of market capitalization; LEV$_{it-1}$ is total debt divided by total assets, winsorized at the 95 percent level (multiplied by 100); INVEST/A$_{it-1}$ is investment divided by total assets, winsorized at the 97.5 percent level (multiplied by 100); ROE$_{it-1}$ is net income divided by shareholders' equity (multiplied by 100); VOL$_{it-1}$ is the standard deviation of mothly returns over a 12-month period; BETA$_{it-1}$ is the CAPM beta over a 12-month period; B/M$_{it-1}$ is the book-to-market ratio, winsorized at the 97.5 percent level. *** p<0.01, ** p<0.05, * p<0.1.