

ESG: sustainable investing and bond returns

Sustainable investing represents a growing belief that financial criteria alone are not sufficient to evaluate the investment viability of a company. A firm's impact on the environment, relations with employees and management quality, for example, are important considerations too. The key to ongoing growth in ESG investing is the performance question. Evidence of a positive impact on financial performance may encourage investors to adopt sustainable investment models.

What is an ESG rating?

The three dimensions covered by ESG provide a set of tangible and objective metrics that corporations can be evaluated against. Those who seek to invest more responsibly rely on ESG scores and ratings in their investment decisions.



E

is for Environment

Is a company a polluter and does it make any efforts to remedy its impact on the environment?

S

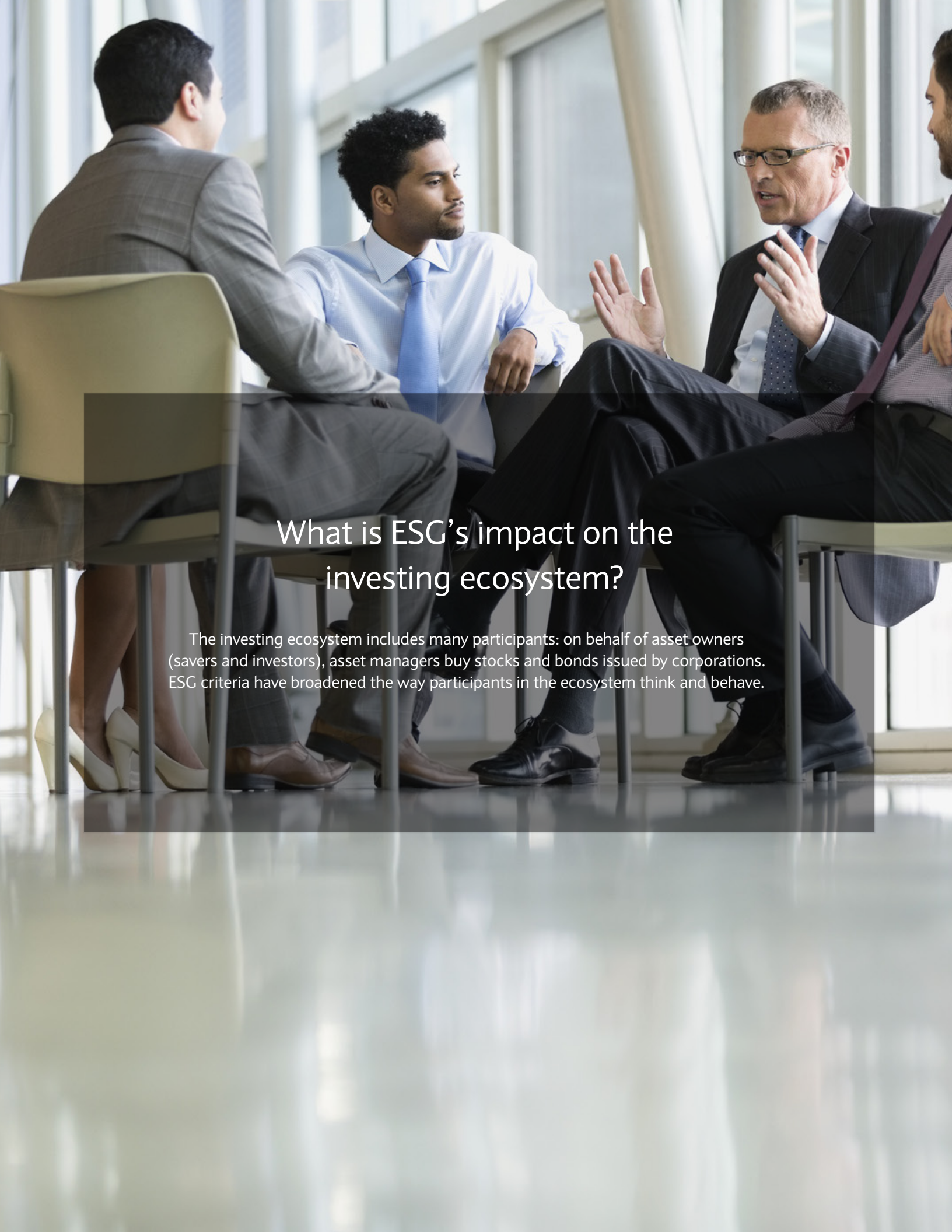
is for Society

Does a company treat its workers well and play a positive role in its community, for example?

G

is for Governance

How well managed is a company? Does it have appropriate management incentives and sound processes in place?



What is ESG's impact on the investing ecosystem?

The investing ecosystem includes many participants: on behalf of asset owners (savers and investors), asset managers buy stocks and bonds issued by corporations. ESG criteria have broadened the way participants in the ecosystem think and behave.

Sustainability of the investment

Investors seek companies that do business “the right way,” with enduring business models and practices.

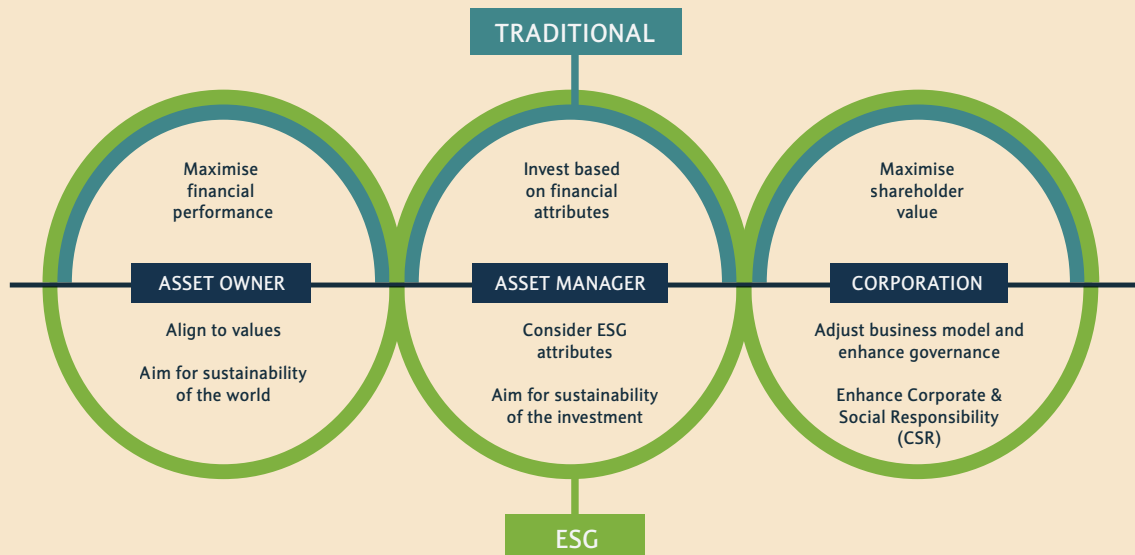


Sustainability of the planet

Investors also expect companies to consider the effect of their activities on the environment and on society.

ESG encourages a broader view

Asset owners, asset managers and corporations all have to look beyond their traditional remit.

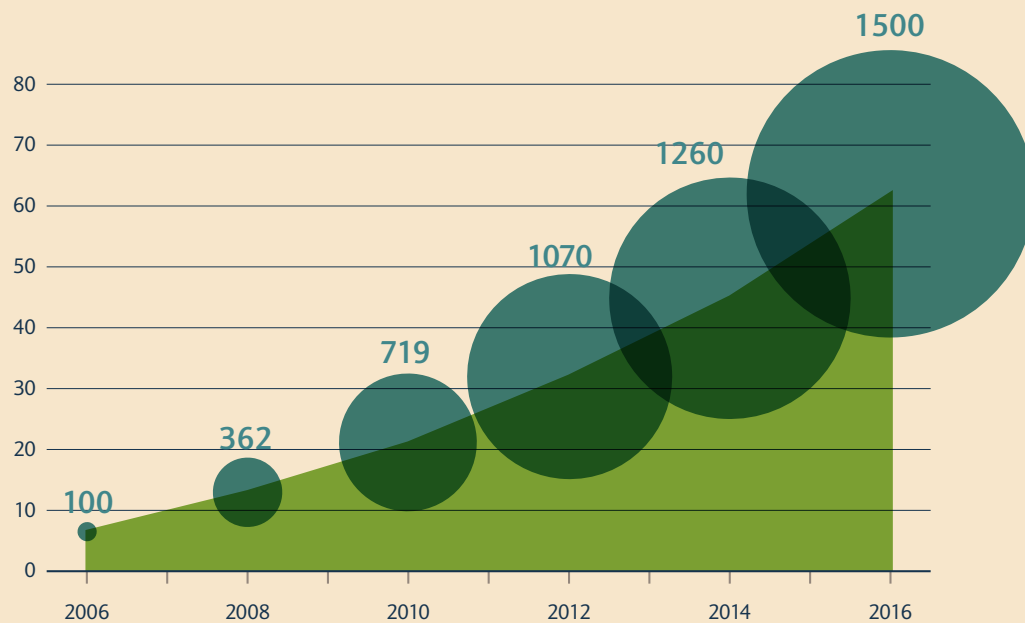


Responsible investing has gathered momentum

The number of banks and asset managers to sign the UN's Principles for Responsible Investing (PRI) has increased nearly tenfold in the past decade.

Growth in signatories to the United Nations Principles for Responsible Investing, and assets under management

- Assets under management (US \$ trillion)
- Number of signatories



Source: UN PRI

ESG scores measure sustainability

Companies are evaluated on non-financial criteria.



High E score

can indicate that a company is less exposed to significant risk due to environmental issues.



High S score

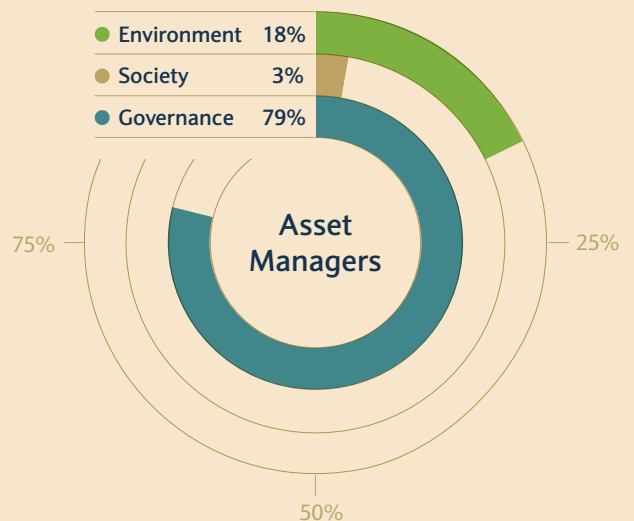
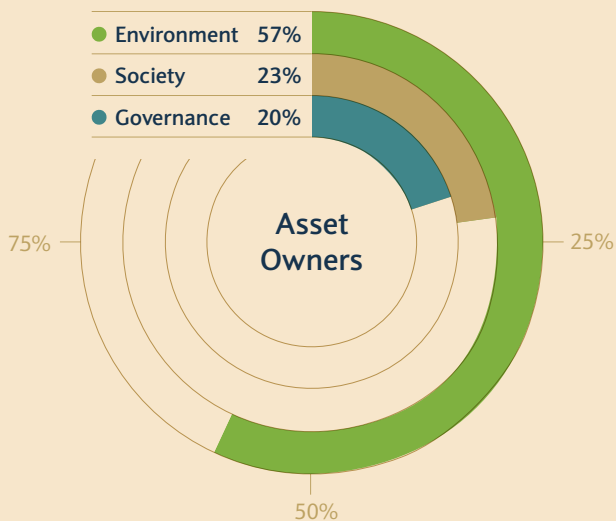
can reflect a better ability to attract and retain skilled workers, to maintain consumer loyalty and avoid product liability issues.



High G score

indicates a well run company with strong governance and high-level risk controls.

Which one of E, S or G is most important to asset owners and to asset managers?



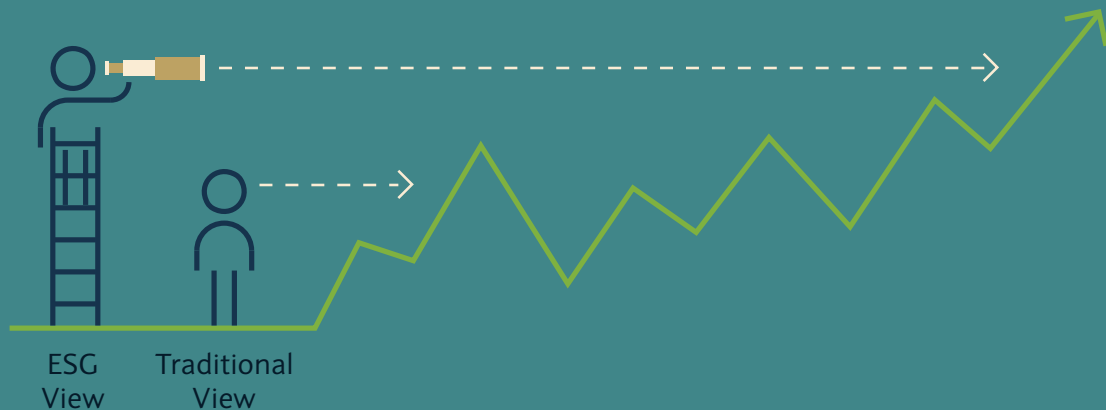
How does ESG align with returns?

Does the incorporation of ESG criteria improve the financial performance of an investment portfolio or hurt it? Much evidence has been produced showing ESG investing can have a positive impact on equity investments, but there has been a lack of research into its effect on bond portfolios.

A study by the Barclays Research team fills this gap.

ESG encourages a long-term view, which works well for bonds

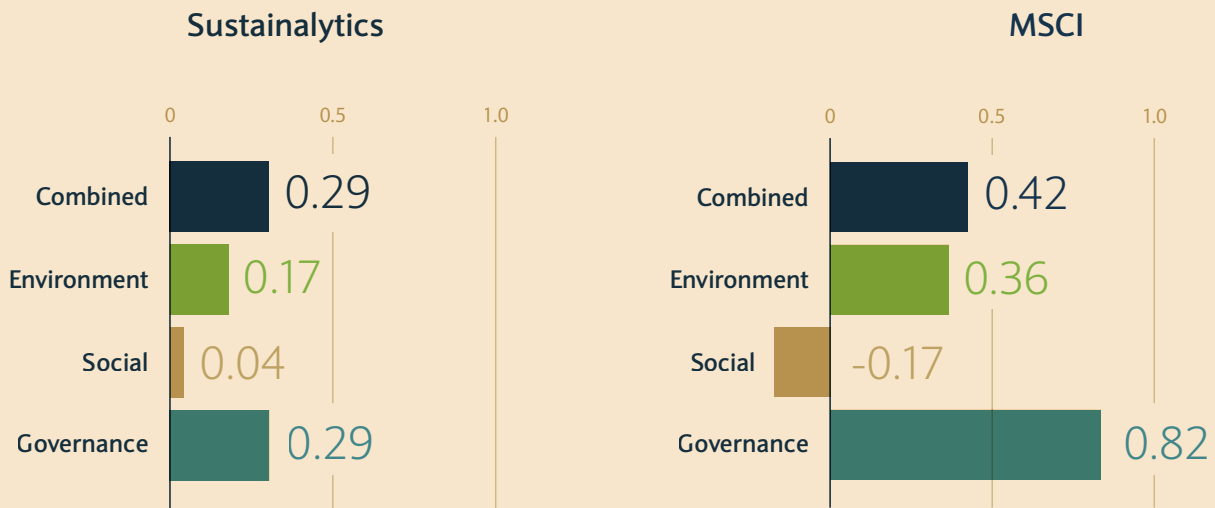
Greater emphasis on ESG factors, which play out over a long horizon, may provide a counterweight to the constant pressure on companies to maximise near-term earnings. This longer-term approach to value creation is well suited to the investment horizon of many bond investors.



Effect of ESG on bond performance

Barclays found that ESG factors produced a small but positive return in corporate bond portfolios, with a high G score especially correlating with better performance. Bond portfolios with strong ESG attributes (measured by either MSCI or Sustainalytics) have outperformed low-ESG portfolios in the past seven years. Irrespective of the ESG data source, Governance has the strongest positive effect on performance while the effect of the Social factor was marginal.

High-ESG bond portfolios perform better than low-ESG ones (return difference in % per year)



Source: Sustainalytics; Barclays Research
*Sustainalytics' Governance pillar measures governance of sustainability issues. The firm has a separate Corporate Governance rating that is not represented in this study

Source: MSCI ESG research, Barclays Research

A high G score has been correlated with better performance



Relationship between ESG and credit ratings

The Barclays research also shows that companies with higher ESG scores often have higher credit ratings (measuring financial health) and lower spreads (yield difference over government bonds). The data shows that investing in top-tier ESG bonds comes with a roughly one-notch uptick in credit quality.

Higher ESG can mean better credit ratings

	Bonds with low ESG scores	Bonds with high ESG scores
Average ESG score (from 0-10)	2.6	7.7
Average spread (bp)	172	134
Average credit quality	A3	A2

Source: MSCI ESG Research, Barclays Research

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