Cheat sheet: Asset-class benefits of sustainable investing

A guide to some of the benefits to investors of LGIM's approach to sustainable investing in equities, fixed income and real assets.

Equities

- Long-term thematic analysis of material ESG factors helps us to identify the companies that will be the winners of the future
  - For example, stocks that stand to benefit from the shift to the low-carbon economy, such as electric vehicle manufacturers
  - This analysis can also help reduce the risk associated with negative ESG incidents[1]
- Integrating material ESG factors into company analysis provides an enhanced toolset, in addition to financial metrics, with which to focus engagement efforts
- This can help us invest in well-positioned, sustainable industries and businesses that are mispriced by the market – there is money to be made in the transition!

Fixed income – credit

- Companies that mismanage ESG factors present a higher risk to investors, due to the danger of default or credit-rating downgrades
  - Credit markets may misprice the risk of material ESG incidents, creating trading opportunities for those who analyse these scenarios
- The impact of such events on creditworthiness can be modelled through scenario analysis
  - Long-term thematic analysis enables the identification of sectors facing disruption in the future – creating investment opportunities and insulating portfolios against these threats[3]

Real assets

- ESG scores inform part of our investment analysis, helping us to select more resilient assets as well as identify and manage risks
  - Improving the environmental efficiency of assets can lower costs and optimise operational performance
  - Owners of more energy-efficient properties are less likely to default on mortgages, research suggests[2]
- Urban regeneration projects can rejuvenate communities and stimulate economic growth, boosting asset values and rental yields
- Infrastructure investments play a key part in the transition to a low-carbon economy
  - In order to meet climate targets, governments are increasingly focusing on clean energy as part of their industrial strategy, potentially benefiting private sector initiatives

Fixed income – sovereign debt

- ESG factors are one input into the sovereign investment process; however, in our view, they are less relevant to developed market debt due to the typically lower likelihood of default
- Within emerging markets, scores can be used to rank sovereign issuers on ESG metrics, giving an indication of relative value between countries[4]
  - Metrics range from climate policies; to waste and natural hazards; to fiscal management, government stability and human rights
  - Governance factors, such as institutional strength, are likely to have an impact on a sovereign issuer's willingness and ability to repay on time

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1. Research by Morgan Stanley finds the average share price loss one year after an ESG scandal was -64.4%. Source: https://www.morganstanley.com/im/publication/insights/investment-insights/ii_esgandthesustainabilityofcompetitiveadvantage_us.pdf

2. Source: Barclays, https://home.barclays/news/2018/06/green-shoots/

3. Eleven sectors with $2.2 trillion in debt face elevated credit exposure to environmental risk, according to Moody's. Source: https://www.moodys.com/research/Moodys-Eleven-sectors-with-22-trillion-of-debt-have-elevated--PR_389299

4. Countries with good ESG scores tend to have lower default risk and bond spreads, according to the World Bank and GPIF, citing Capelle-Blancard et al (2017). Source: https://www.worldbank.org/en/news/press-release/2018/04/19/environmental-social-and-governance-factors-can-be-material-risks-for-fixed-income-investors-finds-world-bank-group-and-gpif-report

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