FTfm **ESG investing**

Majority of ESG funds outperform wider market over 10 years

Study of sustainable funds counters claims that ESG investment comes at the expense of performance

Activists in Cornwall. Environmental emergencies have pushed people to invest according to their values © Gav Goulder/In Pictures/Getty

Siobhan Riding JUNE 13 2020

Close to six out of 10 sustainable funds delivered higher returns than equivalent conventional funds over the past decade, according to a study that undermines claims that investing based on environmental, social and governance principles hampers performance.

ESG funds have exploded in popularity in recent years as emergencies such as climate change have pushed individuals to invest according to their values. Despite this, debates have persisted over whether a link exists between investing responsibly and achieving outperformance.

But research from data provider Morningstar examining the long-term performance of a sample of 745 Europe-based sustainable funds shows that the majority of strategies have done better than non-ESG funds over one, three, five and 10 years.

The analysis carries weight as up until now there has been limited data on sustainable funds' long-term performance due to the relatively short track records of many strategies and huge variety in ESG approaches.

"The findings debunk the myth that there is a performance penalty associated with ESG investing," said Hortense Bioy, director of passive strategies and sustainability research at Morningstar.

"ESG factors are not just 'nice to have' but drivers of outperformance," said Jan Erik Saugestad, chief executive of Storebrand Asset Management. "It is both right and smart to exclude certain business practices in violation with well recognised conventions or with inherent high risk and negative impact."

Sustainable funds' rates of success varied depending on the asset class. Of the seven asset classes examined by Morningstar, US large-cap blend equity funds that invest sustainably were the best performers, with more than 80 per cent of funds in this category beating their traditional peers over 10 years.

However, only three in 10 euro corporate bond funds achieved better returns than their non-ESG funds over the same period.

The study showed that sustainable funds also outpaced traditional funds during the market sell-off sparked by coronavirus in the first quarter, notching up average excess returns of up to 1.83 per cent.

ESG funds' low exposure to oil and gas gave them an edge at a time when energy stocks suffered steep losses, said Ms Bioy. However, she noted that even excluding the unusual market conditions unleashed by the pandemic, the majority of sustainable funds in the study still beat traditional funds over the long term.

Morningstar found that sustainable funds have greater survivorship rates than non-ESG vehicles. On average, 77 per cent of ESG funds that were available 10 years ago still exist, compared with 46 per cent for traditional funds.

But Ms Bioy warned that as asset managers launched more funds to meet growing investor demand, survivorship rates were likely to go down. Up until now, ESG funds have been less vulnerable to the commercial pressures that lead managers to close funds, due to their niche status and loyal, institutional client base, but this will change as the strategies move into the mainstream.

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Active Funds Dominate ESG — But Their Market Share Is Slipping

While the pandemic hasn't damped investor demand for ESG, asset flows to U.S. active managers fell in the first half of 2020, according to Broadridge.

September 30, 2020

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Actively managed funds have dominated when it comes to investing based on environmental, social, and governance factors — but rising investor demand for ESG in the U.S. appears to favor passive investment strategies this year.

Global assets in ESG mutual funds and exchange-traded funds have more than doubled in the past five years to $1.3 trillion in June, according to a new report from Broadridge Financial Solutions. While Europe leads the world in ESG investing, the fastest growth is stemming from the U.S.

ESG funds in the U.S. are on pace to surpass $300 billion of assets by the end of next year, according to the report. While actively managed equity funds have historically led the investing strategy, low-cost passive funds are grabbing market share.

Active funds saw 52 percent of net ESG flows in the U.S. in 2019 — a share that dropped to 35 percent in the first half of 2020, according to the report. Still, the pandemic has not slowed investor demand for ESG, with active and passive funds together attracting a record volume of assets in the first quarter that was matched in the following three months.

“Much of the activity historically has been in Europe and cross-border funds,” Jag Alexeyev, director of global distribution insights at Broadridge, said in a phone interview. “The U.S. is now growing rapidly.”

BlackRock, UBS Group, Amundi, BNP Paribas, and Nordea are the top ESG fund managers based on net flows in the 18 months through June, according to Broadridge. BlackRock attracted by far the most assets over the period at $42 billion, with just 7 percent flowing into actively managed funds, the report shows.

Switzerland’s UBS ranked second based on net asset flows of $15 billion over the same period, while French asset manager Amundi was the third most successful with $12 billion collected. Actively managed funds represented 46 percent of UBS’s net flows and 61 percent of Amundi’s.

“Despite the rising popularity of index funds, ESG represents one of the most attractive segments for active fund managers,” Broadridge said in the report. Eighty-one percent of assets overseen by European ESG funds are actively managed, compared to 68 percent for the U.S.

[*II* Deep Dive: ‘Seven Years of Being Just Tortured’: Why This Longtime Active Management CEO Started an Index Firm]

ETFs and passive funds are creating more ways for investors to invest in ESG, Alexeyev said. To keep their edge, he said active managers may seek to combine shareholder engagement with companies with the integration of ESG factors — such as the risk of climate change — into their investment decisions.

The most popular ESG investment strategy involves “best-in-class,” positive screening, representing 39 percent of assets globally, according to Broadridge. The investment approach weights allocations toward companies with stronger scores relating to environment, social, and governance criteria.

Exclusion strategies that keep certain types of companies out of investment portfolios, such as tobacco or weapons firms, are the next largest category with 25 percent of ESG assets, the report shows. Investing strategies focused on ESG integration and proactive company engagement are the third most popular based on 20 percent of total assets.

Exclusion strategies had been the most sought after by investors in 2015, capturing 36 percent of net ESG flows globally that year, according to Broadridge. By contrast, the strategy attracted just seven percent of net asset flows during the first half of 2020.

Over the past five years, the ESG industry has evolved away from the “values-based, simple exclusion approach embedded in the early version of socially responsible investing,” said Alexeyev. Today’s efforts are more focused on assessing “ESG risk factors” across a much broader range of companies, he said, noting that many passive funds follow “best-in-class approaches.”

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ESG index funds hit $250 billion as pandemic accelerates impact investing boom

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KEY POINTS

- Index funds investing in companies that rate highly on environmental, social and governance (ESG) factors have received a boost during Covid-19, with increased interest in

 sm.

- Sustainability funds were experiencing big growth before coronavirus: assets doubled over the past three years, according to a new Morningstar report.

- Impact investing index funds have topped $250 billion, and the U.S. market is now 20% of the total.

VIDEO 07:17

BlackRock CEO Larry Fink on climate change and ESG investing

Socially conscious investing continues to gain momentum as Covid-19 and the destruction left in its wake spark interest in stakeholder capitalism — the idea that a public company's focus shouldn't only be generating profits to reward shareholders without taking the bigger picture into account.

With investors increasingly favoring ESG stock selection — when a company's environmental, social and governance policies are considered alongside more traditional financial metrics — more impact investing funds are launching to keep pace with demand.

Both the number of sustainability-focused index funds, and their assets, have doubled over the past three years, according to a report from Morningstar released Wednesday. The financial research firm said that as of the end of the second quarter 2020, there were 534 index funds

ity, overseeing a combined $250 billion. In the U.S., which has lagged Europe in ESG investing, assets in sustainable index funds have quadrupled in the last three years and now represent 20% of the total.

"There's a great realization today that ESG issues are investment issues," Alex Bryan, Morningstar's director of passive strategies research for North America, told CNBC. "They're issues that can affect the bottom line, and that may not always be something that comes to bear immediately. But it's something that I think more people are starting to understand is aligned with shareholder value maximization," he said.

Actively managed ESG funds continue to attract the lion's share of dollars and represent a much larger portion of the sustainable investing landscape. Combined inflows into both active and passive ESG-focused funds reached $71.1 billion during the second quarter, pushing global assets under management above the [$1 trillion mark for the first time.]

In the U.S., 'a lot of runway for growth'

Sustainable index funds are growing in size, number and complexity, and Bryan said that despite the record inflows, there's "still a lot of runway," especially in the U.S., where these funds

than 1% of the overall market.

"They're still just a drop in the bucket compared to the full landscape of all index funds," he said.

For example, the [Vanguard Total Stock Market Index Fund], a traditional U.S. stock market investment portfolio, is on pace to hit $1 trillion in assets itself this year.

Bryan pointed to the coming $30 trillion wealth transfer from baby boomers to their millennial

According to a recent survey conducted by Morgan Stanley's Institute for Sustainable Investing, nearly 95% of millennials are interested in sustainable investing, while 75% believe that their investment decisions could impact climate change policy.

Covid-19 has also acted as a turning points of sorts. Not only has the global pandemic underlined the importance of resilient business models, but it's shown that how companies treat all their stakeholders — including employees and customers — can impact the bottom line.

"The Covid-19 pandemic and movement for racial justice in the U.S. have kept attention on social issues, including workplace safety and diversity, and have likely added to interest in sustainable funds," Morningstar's report said.

Another reason sustainable funds are attracting record inflows is that they've dispelled the idea that there's a financial trade-off for investors who want to focus on ESG. During the second quarter, 56% of sustainable funds ranked in the top half of their Morningstar category. Year-to-date, that number jumps to 72%.

"The things that are happening this year have accelerated some of the longer-term trends, but we're still in early innings, at least in the U.S.," Bryan said.

"ESG" has become a buzzword on Wall Street — Morgan Stanley recently said it will be the defining acronym of the next decade — and the investing approach is not without its critics. Some argue that it's merely jargon and doesn't actually move the needle on the biggest issues facing the world.

There's also no uniform way to track a company's ESG metrics, especially in the U.S., where issues such as diversity and pay practices do not have to be publicly disclosed. Additionally, there are many approaches to ESG investing, which means that funds can have very different practices. Some might exclusively invest in clean energy or companies that have a woman on their board of directors, while others might essentially track the S&P 500 but adjust their component weightings based on a company's ESG score.

"There is currently no standard definition for sustainability, which increases investors' due diligence burden and the risk that a fund will not meet investors' expectations," Morningstar's report said. "It is imperative to research these funds before jumping into them."

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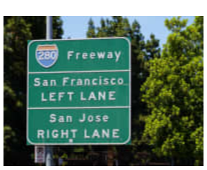

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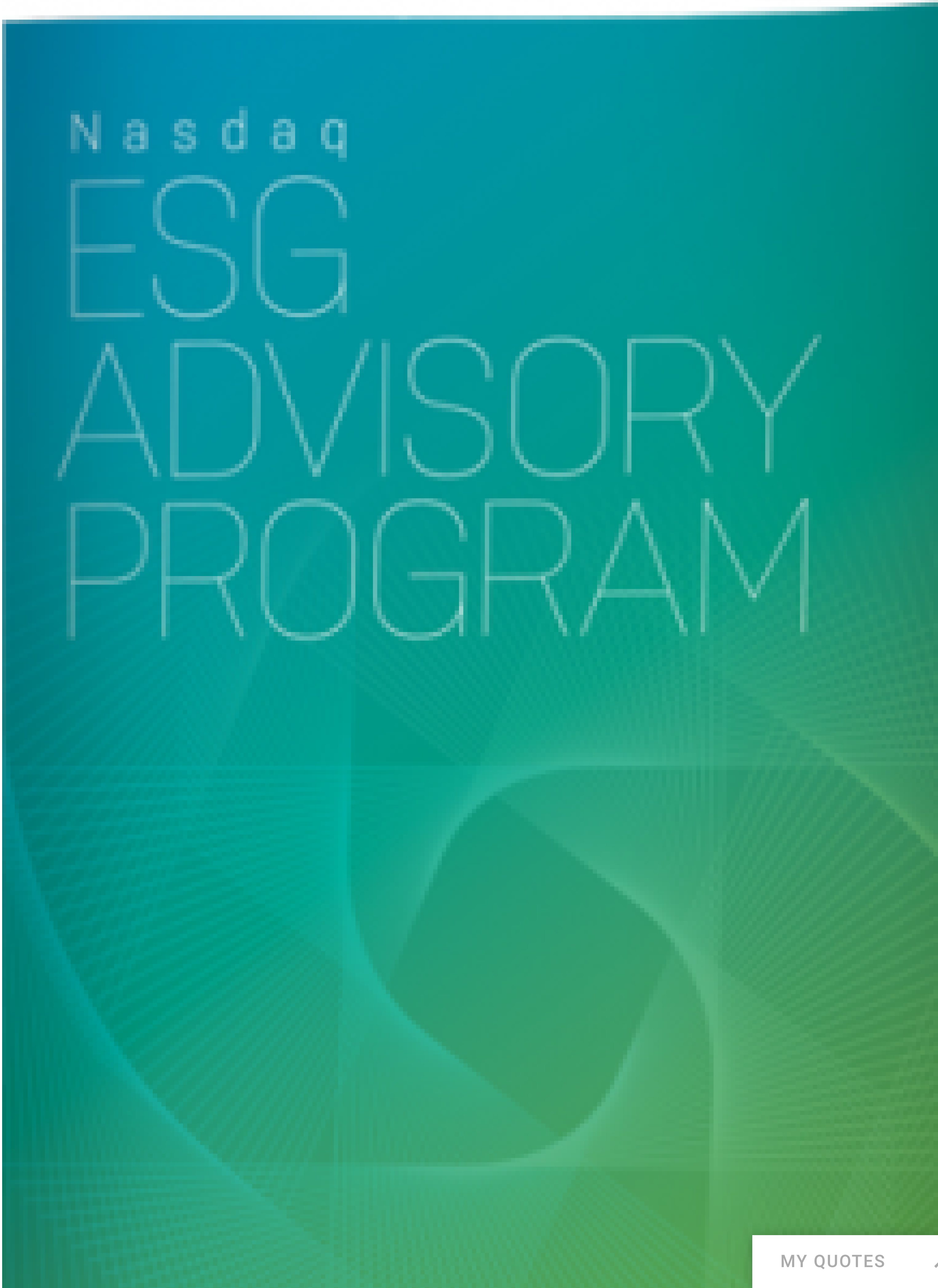
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Global ESG-data driven assets hit $40.5 trillion

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The value of global assets applying ESG data has almost doubled over four years, and more than tripled over eight years, to $40.5 trillion.

The value of global assets applying environmental, social and governance data to drive investment decisions has almost doubled over four years, and more than tripled over eight years, to $40.5 trillion in 2020.

Analysis of active and passive strategies by research firm Opimas showed that not all products that integrate ESG criteria into their investment strategies are labeled as "ESG" or "sustainable," with non-ESG products also using sustainability data as a source of insight on portfolio companies.

A report of the research said active strategies represent the majority of ESG-related assets under management, at 75% in the U.S. and 82% in Europe.

However, passive ESG strategies captured about 60% of new asset inflows in the U.S. in 2019.

The number of ESG-themed strategies has also skyrocketed over recent years. There were almost 400 ESG strategies launched in the Morningstar investment universe in 2019, compared with around 160 launches in 2016.

Strategy size was also analyzed by Opimas, finding that the overall average size of ESG funds is now around $250 million in AUM. By region, however, size varied, with an average $400 million U.S. strategy AUM, $270 million in Europe and $70 million in Asia.

Opimas also studied ESG indexes, which have fared better over the highly volatile **COVID-19-related period** than their reference indexes.

Between March 3 and April 16, the Dow Jones Sustainability index returned -8.4%, vs. a -12.4% performance by the S&P Global Broad Market index, the report said. The MSCI KLD 400 Social index returned -9.3% over the same period, vs. parent index MSCI USA Investible Market index performance of -11%.

The size of ESG teams at money managers has also grown across the top 30 money managers, by 229% compared with 2017. Figures were not available.

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