

Below are extracts from articles on sustainable investment, published by The Financial Time (ft.com 20th December & 9th November 2023) as referenced below.

LSEG INSIGHTS reveal how data is helping to usher in the green economy, influence sustainable investment decision-making and ease recent concerns in this maturing market.



Sustainable Investment: asset owner transition on course despite choppy waters.

FT.com (2023) reveals how, post Ukraine invasion, there has been a marked reversal of fortune for the sustainability investment markets during 2023. It also puts forward a case for cautious optimism in a market now showing signs of maturity and an ability to look beyond recent challenges pertaining to availability of data, reliability of corporate disclosures and a stringent regulatory environment:

Sustainable investment has been under the microscope. Political scrutiny, financial underperformance and accusations of greenwashing have all created headwinds. But, beneath the surface, there are signs of a maturing sustainable investment market which is moving beyond challenges of standards, data, and resource to become an increasingly robust part of the standard approach to investment.

Sustainable investment headwinds.

Arguably of primary concern for investors, many sustainable investment strategies posted poor performance in 2022. Again, enthusiasm for the theme in 2021 had helped to push up valuations of in-vogue environmental markets stocks, many of which fell sharply in the risk-off macroeconomic conditions of 2022. For example, the FTSE Environmental Opportunities All-Share index performed 23.1 per cent ahead of the market in calendar 2020 and 2 per cent ahead in 2021, before performing 6.2 per cent behind the market in 2022.

Some may argue that sustainable investment has been a victim of its own success. The flood of capital pouring into sustainable investments in 2020-21, alongside strong investment performance, lead to a diverse, and in many cases confusing, range of new sustainable investment products.

Regulators have taken action to rein in such greenwashing, encourage standards to help define what sustainable activities are and promote disclosure. Many investors – from sophisticated professionals to enthusiastic retail – continue to struggle to differentiate between sustainable investment strategies, interpret data, stay on top of evolving regulation, and avoid the risk of reputational damage.

The case for cautious optimism.

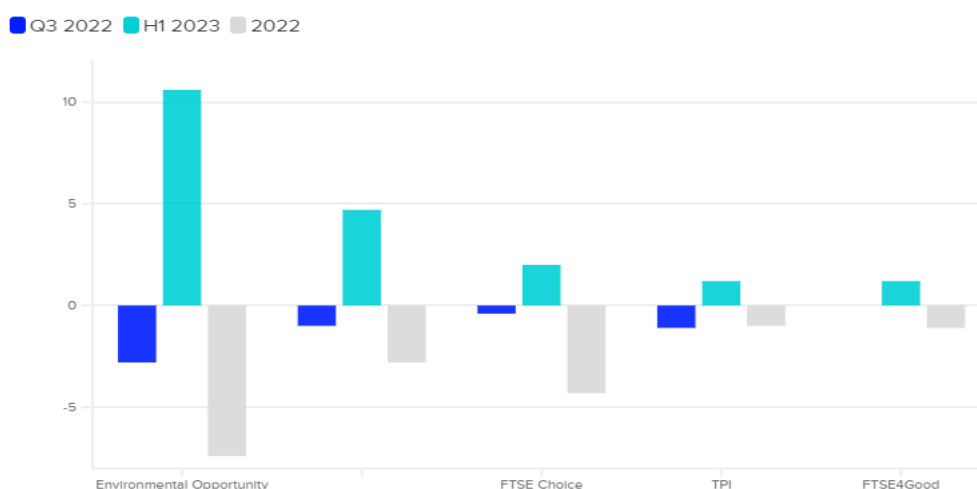
There are reasons to believe, however, that the worst effects of some of these factors might be behind us. In the US, President Biden’s Inflation Reduction Act is encouraging tens of billions of dollars of capital investment in clean technologies.

FT.com (2023)

According to FT.com (2023), FTSE Russell’s Sustainable Investment Asset Owner survey reports that any decline in sustainable investment in the US will have limited impact on the size of the global market and overall investor concerns appear to be easing. Plus, there is the introduction of the US Inflation Reduction Act by President Biden, which aims to promote investment in clean technologies. The same FTSE Russell survey also reveals an increase in sustainable investment considerations across portfolios, and an evident increase in capital committed to projects and companies relevant to sustainability challenges:

Furthermore, according to data from FTSE Russell’s Sustainable Investment Asset Owner survey, a dip in sustainable investment in the US will have a limited impact on the absolute size of the current global market; North American sustainable investment funds only account for 15 per cent of the global total. Meanwhile, the sector’s investment performance has reversed, with many of the worst underperformers in 2022 roaring back in 2023. Fund flows also support the view that the decline in interest in sustainable investment has been oversold. Fund data from Lipper show inflows into sustainable investment bond and equity funds in 2022 of \$151bn, down 67 per cent compared with 2021 – but that’s in the context of overall market bond and equity flows which saw \$435bn of outflows in 2022.

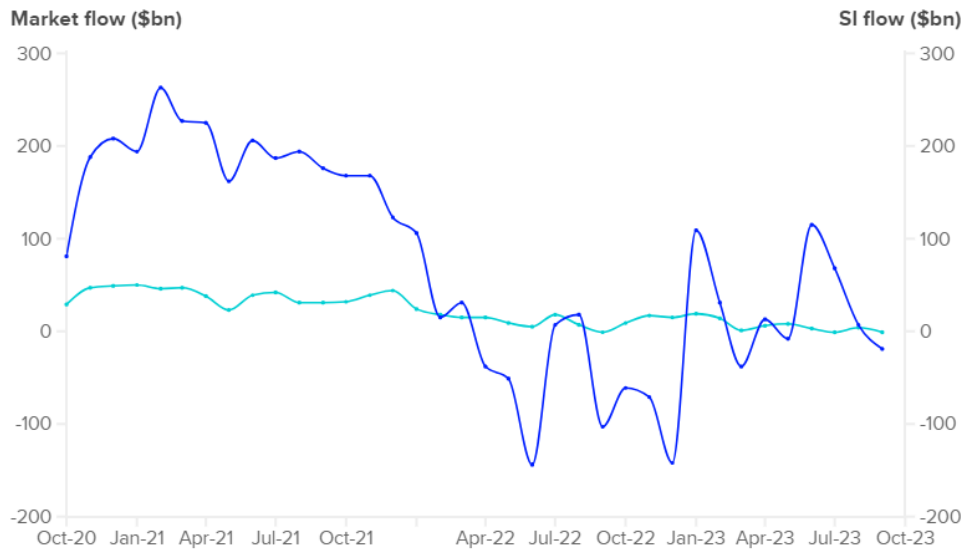
Performance of selected global sustainable investment equity indices



Source: FTSE Russell • Data as of September 30, 2023. Past Performance is no guarantee of future results.
 FTSE Choice = FTSE Global All Cap Choice; TPI = FTSE All-World TPI Climate Transition ex Fossil Fuels;
 FTSE4Good = FTSE4Good All-World; Paris-Aligned Benchmarks = FTSE All-World Paris-Aligned (PAB);
 Environmental Opportunity = FTSE Environmental Opportunities All-Share

Monthly global bond & equity fund flows, Sustainable investment vs. market

■ Total Market ■ Sustainable Investment



Source: FTSE Russell, LSEG Lipper • Data as of September 30, 2023.
Responsible investment vs. market bond & equity ETF & mutual funds

A maturing market for sustainable investment.

Behind the scenes, many of the challenges that investors faced regarding sustainable investing are beginning to ease. Concerns about the availability of ESG data persist – with half of respondents citing the issue as a barrier, the same figure as in 2022. But other worries are abating. For example, only 37% of survey respondents said that the lack of standardisation of ESG data, scores and ratings posed a barrier to greater adoption of sustainable investment, down from 59 per cent in 2021. Only a quarter of respondents expressed concerns about the quality of corporate disclosures, down from 45 per cent in 2021. And only 17 per cent cited limited historical data – down half from 2021.

Barriers to increased sustainable investment adoption across all asset classes

■ 2021 ■ 2022 ■ 2023



Source: FTSE Russell

Other barriers are continuing to decline in terms of their salience. Just 16 per cent of asset owners complain of a lack of resources when they are considering adopting sustainable investment, down from 29 per cent in 2021. Fewer than one in 10 asset owners consider questions about how to determine the best sustainable investment strategies for their portfolio to be a barrier, down from 26 per cent in 2021.

These responses reflect the ongoing maturation of the sustainable investment market. Make no mistake: investors continue to grapple with issues around data, disclosures, and sustainable investment methodologies. But discussions around how best to implement sustainable investment strategies are growing.

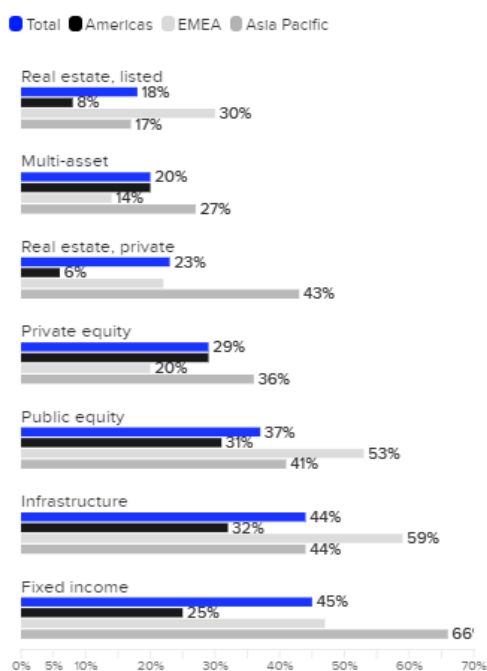
Passive is rising.

The survey also shows the growth of passive sustainable investment strategies which are, for the first time, as widely implemented as active ones. It finds that the same proportion of asset owners (73 per cent) have applied sustainable investment considerations to their passive as to their active strategies. Lower cost tends to be the main motivation for investors to favour passive strategies. However, their use of transparent, rules-based methodologies can help to allay concerns over greenwashing.

Financing the green transition.

Another noteworthy finding from the survey was the increase in the percentage of investors applying sustainable investment considerations to their infrastructure portfolios. For investors in EMEA, 59 per cent of them do so, up from 42 per cent in 2022 Globally, fixed income remains the top asset class for sustainable investment allocations. It is, arguably, by providing debt and investing in infrastructure that investors will have the biggest impact in terms of delivering the green transition.

Asset Classes for which sustainability considerations have been implemented (2023)



Source: FTSE Russell - Multi-pick question: for which asset classes have you implemented or are you considering implementing sustainability considerations?
 Total Asset Owners (Total n=350, Americas n=146, EMEA n=95, Asia Pacific n=109)

This echoes data seen elsewhere, such as in the green bond market – with the first two quarters of 2023 seeing record levels of issuance. Increasingly, investors are committing capital to projects and companies that are delivering the infrastructure and technologies relevant to sustainability challenges. Similarly, investors are putting their own investment infrastructure, processes and governance in place to invest in line with sustainability considerations.

FT.com (2023)



How data is helping to usher in the green economy.

Meanwhile in an associated article, FT.com (2023) expands on the concept of an emerging ‘green economy’, its rapid growth, what defines ‘green’ and how companies are innovating to adapt to the new order. Again, LSEG Insights reports on how the green economy could become the world’s largest industrial sector by 2050:

The global response to climate and sustainability challenges is bringing about new regulatory approaches and changing consumer demands, spurring technological and business model innovation. Companies offering solutions that support the transition to a sustainable global economy are emerging and thriving in what may be referred to as this century’s industrial revolution: the emergence of the green economy. This green economy is growing rapidly. In a report assessing its size, LSEG found it accounted for around 9.2 per cent of global listed equity markets in the first half of 2023. This has risen from around 5 per cent in 2015 and has grown at a compound annual growth rate of 13.3 per cent over the past 10 years – significantly outpacing the 6.9 per cent for global equity markets as whole.

And this is likely just the start. Trillions more dollars of investment is required to flow into the green economy to meet global climate and environmental objectives. If this happens, by some

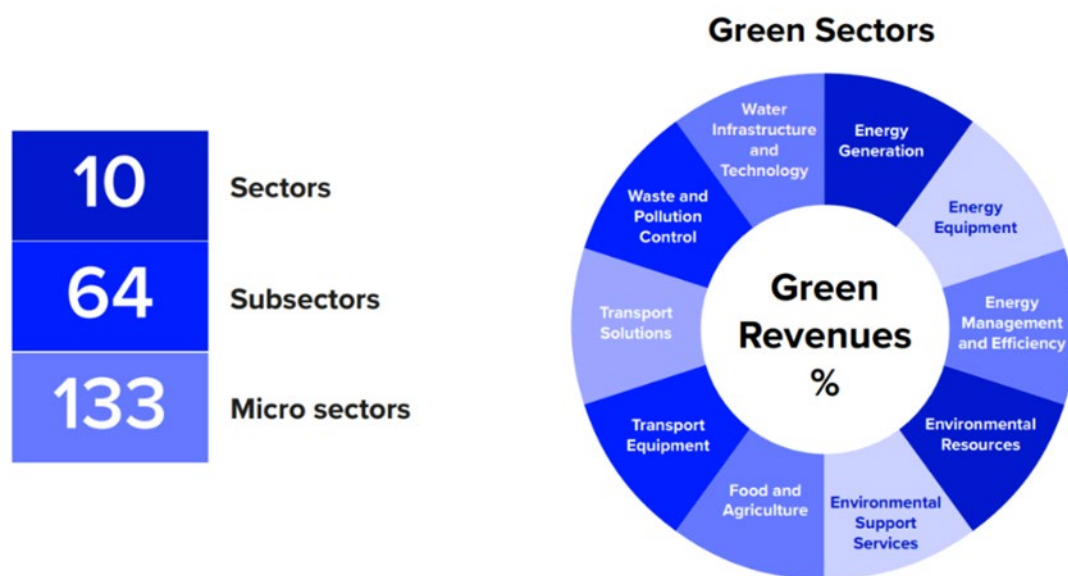
calculations, around 20 per cent of revenues earned by listed companies would be 'green' by 2050 – and the green economy would become the single largest industrial sector. Increasingly for investors, understanding and gaining exposure to the green economy is becoming central to their investment objectives. But doing so is far from straightforward.

Defining the green economy.

Classifying industry sectors is an important element of financial market infrastructure. It helps investors and companies alike to share information, identify opportunities, allocate capital, and measure growth. How can the green economy be defined? Unlike, say, the chemicals sector, the 'green economy' is not a universally recognised industry sector. While it might be obvious that a company manufacturing wind turbines or electric vehicles is a green economy stock, there are many economic activities that contribute less obviously to the green economy.

FTSE Russell has been tracking companies active in the green economy since 2008, when they launched the FTSE Environmental Technology index series. The series is based on their Green Revenue Classification System (GRCS), which identifies 10 sectors, 62 sub-sectors and 133 micro-sectors that address climate change mitigation and adaptation, efficient water consumption and resource use, pollution control and agricultural efficiency. It also tracks the revenues that 18,000 companies generate from these 133 micro-sectors, to map the growth of the global green economy.

Green revenues classification system



Source: FTSE Russell

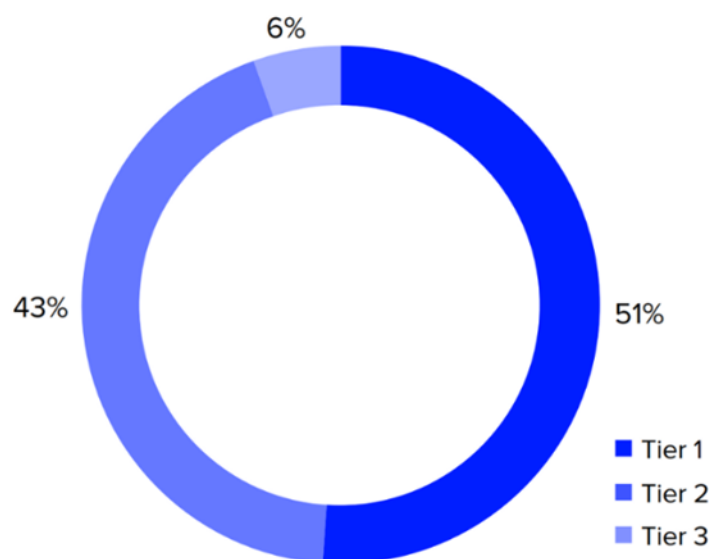
FT.com (2023)

The same FT.com (2023) article then demonstrates some data models which help with the definition of truly 'green' companies, and how data generated is being used to construct specific sustainable equity indices, assist investors to construct portfolios around the sustainability theme and identify companies that are best-positioned to transition to a net-zero economy:

Many of these sub-sectors may not be obviously environmentally oriented. For example, Cloud computing and efficient IT both qualify, as do companies producing advanced materials, those engaged in efficient logistics systems, and food safety and efficient food processing. These sectors and others, such as those generating key inputs such as cobalt, lithium and rare earths, all have a contribution to make to creating a green economy.

Because green products and services have both positive and negative impacts, the GRCS also differentiates the level of 'greenness' into tiers. Tier 1, which accounts for around 51 per cent of the green economy, includes activities with significant and clear environmental impacts, such as electric vehicles. Tier 2 covers those with more limited but net positive environmental impacts, such as large hydropower. This tier makes up around 43 per cent of the green economy. Finally, tier 3 covers products and services which have some environmental impacts but are overall net neutral or negative, such as nuclear power generation. This tier makes up 6 per cent of the green economy.

Composition of the green economy by tier



Note: Based on the latest Green Revenues data available (financial year 2022 or 2021) and the free-float market capitalisation at, June 2023. Source: FTSE Russell Green Revenues data as of July 2023. LSEG Free Float Market Capitalisation data as of June 2023.

Green economy data investment use cases.

There is a range of uses to which this green economy data is being put. Most directly, it is used to construct a range of indices to provide exposure to the theme. Green revenues data is helping investors build portfolios around the climate theme, while closely tracking mainstream equity benchmarks. The data can be used to identify companies that benefit from green revenues, allowing investors the optionality to customise their respective portfolios.

For example, the asset owner-led Transition Pathway Initiative (TPI) seeks to identify companies that are well-positioned for the transition to a net zero economy. Green revenues are one of the inputs into its forward-looking methodology, alongside carbon emissions performance and corporate governance of climate risk. The TPI's research has multiple use cases, including being used to construct the FTSE TPI Climate Transition Index. Indices like these, and the investment funds and products that track them, use a transparent, rules-based methodology, which if objectively applied, can provide reassurance to market participants and other stakeholders that investment managers are providing products that support the emerging green economy.

Oiling the wheels of the green economy.

Financial markets rely on data and information. The green economy data that the GRCS provides is designed to help investors make well-informed capital allocations decisions. This capital could help fund the research, development and deployment of the technologies needed to tackle the sustainability challenges of the decades to come.

FT.com (2023)

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EON- 03-04-24