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Investing for a world of change

Investors need to read the ‘ESG’ label carefully

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Bloomberg forecasts that ESG assets could reach US$40 trillion in 2022. Do you see that as a positive sign?

The terms ‘sustainable’ and ‘ESG’ investing conflate very different things, and they still cause confusion. Most of the US$40 trillion will be in ESG integration strategies – i.e., those that incorporate analysis of environmental, social and governance factors. This includes strategies that apply a ‘green screen’ and simply tilt towards emissions-light industries, which has minimal real-world impact. A much smaller share of the total is in funds that explicitly seek to make a positive impact, for example by investing in companies that are contributing to decarbonisation or that channel debt finance to support the net-zero transition. In short, ‘sustainable’ funds vary enormously. The fund industry has a responsibility to make sure investors know exactly what they are putting their money into.

Ninety One’s focus is on what you call ‘sustainability with substance’. What does that mean?

It means that where we label an investment or a fund sustainable, we set a high bar. If it is a strategy with an explicit impact objective, we can measure the positive impact. For our current impact strategies, we track impact primarily in terms of carbon avoided, which is a measure of the emissions saved relative to the typical way of producing a good or delivering a service. But we are growing our set of sustainability metrics to include factors like financial inclusion and other areas.

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The content of this communication is intended for readers with existing knowledge of financial markets.

Is enough capital being allocated to addressing climate change?

Ninety One's Planetary Pulse survey this year focused on transition finance, canvassing the views of 300 asset owners worldwide. The vast majority of asset owners think that allocating to climate matters. Interestingly, most of them also believe that investing in support of the net-zero transition in emerging markets is important; however, only 16% of respondents said they were currently making investments that could qualify as doing so. So there is a big disconnect between what people want to do and what they are doing. One reason for this, I think, is that there are not yet many investment vehicles that enable institutions or individuals to invest in the emerging market climate transition. There is also work to do to get people comfortable enough with the opportunity to pull the trigger and invest.

How do you think concern over the economic outlook will affect sustainable investing?

A recession would pose difficult questions about what to prioritise, and there are obviously issues that need to be dealt with right now, such as how do we cope with high energy prices. So it could slow the shift to investing sustainably in the short term. But in the medium term, the sustainable investing movement remains very much intact. At COP26 last year, we saw a general acceptance that developed markets need to help fund the emerging market transition. Initially, many investors seemed to think that most of that funding would be concessional (i.e., finance provided below the market rate). Encouragingly, there is a dawning realisation that a good chunk of the emerging market transition can be commercially funded, by backing private sector companies in the developing world. I am hopeful that this realisation will continue to grow, because it will accelerate the flow of money into the transition.

General risks. All investments carry the risk of capital loss. The value of investments, and any income generated from them, can fall as well as rise and will be affected by changes in interest rates, currency fluctuations, general market conditions and other political, social and economic developments, as well as by specific matters relating to the assets in which the investment strategy invests. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Past performance is not a reliable indicator of future results. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks. Emerging market: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. Sustainable Strategies: Sustainable, impact or other sustainability-focused portfolios consider specific factors related to their strategies in assessing and selecting investments. As a result, they will exclude certain industries and companies that do not meet their criteria. This may result in their portfolios being substantially different from broader benchmarks or investment universes, which could in turn result in relative investment performance deviating significantly from the performance of the broader market.

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