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ESG investing in Asian fixed income Q&A

ESG investing in Asia–an invisible evolution

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Sustainable and responsible investing is fast becoming one of the most important investment criteria globally, and in Asia, while the uptake has been slower, this trend is growing. Moreover, sustainability is now also seen as an important economic driver for investment performance. Murray Collis, Deputy CIO Fixed Income Asia ex-Japan, and lead portfolio manager of the Sustainable Asia Bond strategy discusses the drivers behind this movement and how the COVID-19 outbreak may have influenced developments. Murray also explains the role of active management when investing in, and engaging with, companies in Asia's growing sustainable investments market.

How is the Asian bond market evolving towards increased sustainability awareness and integration? Also, what are the main drivers behind this growth?

Asia has developed a lot in terms of sustainability over the past decade. In fact, they've actively been embracing the concept of ESG. We've seen a few different drivers behind the growth of sustainability in Asia, and we've slowly been incorporating these drivers into our portfolios over time. Asian governments are continuing to affirm their commitments to ESG issues in the region; for instance, within the final months of last year, China announced that it wants to become carbon neutral by 2060, while South Korea, Japan and Hong Kong pledged to do the same by 2050.

What we've seen over the last decade is that governments in the region are recognising ESG issues and starting to put frameworks in place to deal with them. This has led to the initial growth that we've seen in the Asian sustainability market. Once an issue becomes part of the government's agenda, regulators then start to take notice. Asian countries and territories are now starting to build and develop best practice principles for ESG investing, and the corporations within these countries and territories are also starting to adopt stewardship codes. Governance regulations such as the separation of duties between CEO and chairman have now become mandatory requirements for listed companies in a growing number of countries and territories in the region.

Central banks in the region are also putting measures in place to support the growth of the ESG market within Asia. A good example of this is the Monetary Authority of Singapore setting aside around US$2 billion to support the development of sustainable finance in Singapore, while the People's Bank of China has introduced a series of significant measures in recent years, which include accepting green bonds as collateral for its medium-term lending facility programme. There are a number of different ways in which governments and regulators can help to support the growth of the sustainability market, and it's positive to see Asian nations starting to embrace them.

From an investor's perspective, there's a growing recognition within Asia of the benefits to be gained from investing in sustainable fixed-income products. It's evident historically that sustainable investments tend to outperform over the medium to longer term, and this is something that investors are starting to factor in when considering ESG investments.

On another positive note, the economic and corporate data originating from Asia has consistently improved over the last few years. Our belief is that having access to better-quality data enables investors to make more informed investment decisions. As a result, the increasing quality of the data has also resulted in market growth.

If you look at companies within Asia, the language around ESG and sustainability has improved over time. That's partly to do with engagement and partly to do with the regulatory environment and the government's approach to this topic. As previously mentioned, we're starting to see Asian corporations adopting best practices, which then creates opportunities for sustainable investment products. A good example of this is the green bond market in Asia. There were very few green bonds being issued four to five years ago, but since 2016, Bloomberg estimates that China represents around 17% of global green bond issuance.

When you put all of this together, it's evident that there are a number of factors that are helping to drive the market. Regulators and governments are supporting and incentivising the growth of sustainable investment, additionally you have investors demanding the adoption and implementation of ethical practices from corporations.

As with most themes in Asia, is China leading the way in the field of sustainable investment?

It's probably fair to say that the more developed countries and territories in Asia have been moving ahead. For example, we're starting to see a lot of green bond issuance from both Hong Kong and

Singapore. China is (and always has been) one of the biggest markets in the region, and if you look at China's weight within the Asian credit market it's increased dramatically in the last decade.

We're also seeing big developments within India, although they still have a lot more work to do in this space. Overall, there should be some great opportunities in the near-term pipeline, as we're seeing a lot more issuance from renewable energy companies in India, China, and in parts of South Asia.

As we move from 2020 into 2021, what are some key takeaways from managing through COVID-19?

In many ways it has strengthened our views. We've been integrating ESG into our investment processes for many years, and when investing in Asia, governance has always been a really important factor, particularly when looking at the high-yield universe.

If we look at COVID-19 and what's happened during the pandemic, it's helped to reinforce the broader social and environmental issues. Investors are really taking note and beginning to consider these concerns, and this is starting to be reflected by the market in terms of social bond issuance. In 2020 we saw social bond issuance globally surge to more than US$160.0 billion, up from US$13.3 billion a year ago[1] and this does create more opportunities in the market. ESG analysis globally tends to focus on environmental issues, and in Asia we are often asked about governance, but we think it's important to consider all material ESG issues together as part of the credit analysis and portfolio construction.

Has COVID-19 pushed ESG to the bottom of the list of investor priorities?

I'd argue that the opposite has occurred. We've seen investors worldwide inject more than US$152 billion into ESG funds in the fourth quarter of 2020[2]. We think that there are a few reasons for this, one being that investors have seen the effects of COVID-19 and it's highlighted some key sustainability issues that need addressing. Secondly, when you look at the wild fluctuations that we witnessed last March and April, investors have probably looked at the economic risks that are playing out and are wanting to invest in businesses that are robust and that have sustainable business models.

How do you engage with fixed-income issuers on ESG-related factors?

We take a multifaceted approach. When people think about engagement, they commonly think about the equity market; however, engagement is also really important in the fixed-income space, particularly in Asia.

We see engagement as an opportunity to build long-term relationships with issuers that we engage with. When we engage with issuers, we discuss a number of topics with them, which gives us greater insight into their business models and the strategies that the businesses adopt. We can also leverage the knowledge that we gain from dealing with regulators and governments to identify strong opportunities within the region. Ultimately, engagement can create better outcomes for us and our investors.

What we want to do is to share what we believe are the best sustainability practices. For us, it's not just about the number of engagements, but the positive outcomes resulting from those engagements.

Looking ahead, where do you see the key opportunities for this asset class?

Asian countries and territories are currently some of the largest emitters of carbon dioxide in the world and with the recent net zero announcements they are committing to highly important transitions to low-carbon economies. These transitions will create opportunities for sustainable investors. There's now a greater emphasis on climate change and the risks associated with climate change, so it's going to be a long-term investment trend.

For example, we're seeing a surge in green bond issuance from property developers in China, which we think is really interesting. To us, this signals recognition by the government of what's going on in the domestic market and encouragement of the adoption of best practices. A lot of this new issuance is going towards renovating and revamping existing properties up to a green standard, which we think is a great outcome. The positive side of this for investors is that they're being rewarded with a substantial yield.

Renewable energy is expected to be another area of growth within Asian economies, so we're continuing to watch this space. We've also identified some excellent opportunities within India and other Southeast Asian countries and territories.

Why take an active approach to sustainable investing in Asian fixed income?

The issue with adopting a passive approach within Asia or indexing is that it's reliant on data that isn't yet complete. We currently have over 70 Asia fixed income experts, including over 20 credit analysts, spread across 11 markets in the region. Having presence in every major country allows us to benefit from local knowledge that we gain from having people on the ground, and, in our view, this is better than pursuing a passive approach.

There are some methodological issues that investors should consider when they look at adopting an indexing versus an active approach. We think that having an active approach allows you to research and choose the best-quality or best-performing names and then make the appropriate allocations to those companies. For us, this is the best way to generate better returns over the long term.

[1] Refinitiv, as of December 17, 2020
[2] Morningstar Research 'Global Sustainable Fund Flows: Q4 2020 in Review' January 28, 2021

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