

Unlocking sustainable investing opportunities in Asian fixed income

► **Endre Pedersen, Murray Collis and Eric Nietsch of Manulife Investment Management consider how to unlock sustainable investing opportunities in Asian fixed income**

2020 was full of surprises – not all of them positive; however, the final few months of the year brought about developments that few could have anticipated: China announced its intention to achieve carbon neutrality by 2060,¹ while South Korea, Japan, and Hong Kong pledged to do the same by 2050.²

The seemingly independent announcements are highly significant. These four economies have effectively committed to removing approximately 35 per cent³ of global carbon emissions by 2060, thereby establishing a concrete goal against which they will be measured. In our view, these announcements reflect the continent's commitment to address sustainability issues, which has important implications for Asian fixed-income investors.

Investment opportunities

Covid-19 has shifted consensus thinking around fiscal spending, enabling policymakers to introduce stimulus packages in a way that would have been unthinkable previously. This has created an opportunity for the region's leaders to incorporate sustainability goals into their spending plans. South Korea, for instance, launched its Green New Deal in July, pledging to invest more than US\$60 billion to shift its economy onto a more sustainable path.⁴

Undeniably, there's a fair amount of

scepticism surrounding these headline-grabbing pledges, however, in our view, the gap between where we are today and the pledged goals is where the investment opportunities lie.

Renewables

As Asia continues to grow, its need for energy rises – the region is forecast to account for nearly two-thirds of the world's new power demands in the next 20 years, with China and India leading the charge.⁵

China supplies more than 70 per cent of the world's solar panels and has recently pledged to invest as much as US\$6 trillion into the development of new energy technology by the end of the decade.⁶ The country's recent carbon neutrality pledge means its existing targets and policies will need to be revised higher in order to achieve its goal. India, on the other hand, plans to install 100 gigawatts of solar power capacity by 2022 (up from about 35 gigawatts in 2020⁷), having managed to generate solar energy in a manner that's cheaper than coal.⁸ We believe this segment will create many entry points for fixed-income investors.

Sustainable bonds

China has always been an active green-bond issuer. In the first three quarters of 2020, the country issued US\$9 billion in green bonds, and remained the top

issuer in the Asia Pacific region last year. Singapore, Japan, and South Korea also made the list of the most active issuers globally during the nine-month period – evidence of the instrument's growing popularity in the region.⁹

Crucially, we noticed that the green bond structure has drawn the attention of Asian credit issuers from other sectors in recent years beyond the traditional realm of energy and infrastructure. Real estate developers and real estate investment trusts in China, Singapore, and the Philippines, for instance, are beginning to tap into this market for funding. This is an encouraging development since it reflects the growth in both the breadth and depth of the region's green-bond market, which should, by extension, usher in new opportunities.

Governance

Forty-three per cent of the world's top 5,000 companies, according to total revenue, are headquartered in Asia¹⁰. The inherent contradiction here is that Asian companies typically feature in the lower tier of most global corporate governance rankings. The positive correlation between profitability and good corporate governance practices is well known, and there can be no doubt that the region's companies have much work to do here. The less obvious takeaway, we would argue, is that when viewed through the lens of sustainable investing, independent and diverse governance structures can be an important investment theme that can be a meaningful source of alpha.

Capturing ESG opportunities in Asia fixed income – essential tools

It's easy to understand the appeal of sustainable investing however, it would be disingenuous to pretend that challenges don't exist.

The absence of a common taxonomy means that data vendors, environmental, social, and governance (ESG) research providers, and issuers can have varying definitions of key metrics, making analysis a highly challenging task.

Similarly, ESG rating companies aren't regulated in the same way as credit rating agencies, calling into question the reliability and accuracy of their work (a popular charge relates to greenwashing and, increasingly, social washing).

For these reasons, many have noted that sustainable investing is best suited to active management. What follows are some of the steps that we've taken at Manulife Investment Management that we believe are important when it comes to sustainable investing in this asset class.

Access to a dedicated team of ESG specialists

Fixed-income investing and ESG research are two separate disciplines, and it's important that both teams are able to work together to create an integrated investment process that takes into consideration all relevant ESG factors.

Local presence is critical

It's an inescapable fact: Most sustainability issues are geographically and culturally specific. In a sense, this is reflected in the diverse nature of the various economies that make up what we call the Asian economy. Having a strong local presence is essential – it enables the investment team and the ESG specialists to keep tabs on local developments and translate idiosyncratic nuances that are often lost within a global context.

Independent, proprietary research

The shortage of external analyst coverage is a persistent issue within the Asia fixed-income universe; unsurprisingly, the issue is exacerbated in the area of sustainable investing. For this reason, the critical role that independent and proprietary research plays in the



investment process couldn't be clearer. In our case, we rely on our team of dedicated ESG specialists not only for original insight, but also for their ability to bridge and verify ESG data from external sources. Similarly, we depend on our Asian credit research team for proprietary in-depth credit analysis that isn't readily available from global third-party researchers.

A robust corporate engagement program

In our opinion, all investment firms that are serious about sustainable investing will have a comprehensive corporate engagement program in place. At Manulife Investment Management, we make it a point to share relevant ideas on best ESG practices with investee firms – leveraging our research in different sectors and regions – with the aim of helping them create value in their business and enhancing returns.

Opportunities in sustainable investing in Asia are growing, particularly in the fixed-income space. Recent

announcements from China, Japan, South Korea, and Hong Kong have strengthened our belief that the region has indeed moved beyond the inflection point on the sustainability front. However, in order to unlock the investment potential that Asian fixed income has to offer on this front, we believe the right tools must be in place.

For more information, please visit manulifeim.com/institutional/uk/en



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¹ "The secret origins of China's 40-year plan to end carbon emissions," The Japan Times, November 23, 2020. ² "Hong Kong Pledges Carbon Neutrality by 2050, a Decade Before the Mainland," Caxin Global, November 26, 2020. ³ "Fossil CO2 emissions of all world countries—2020 Report," European Commission, September 10, 2020. ⁴ "South Korea's Green New Deal shows the world what a smart economic recovery looks like," The Conversation, September 9, 2020. ⁵ "Can Solar Power Compete With Coal? In India, It's Gaining Ground," Wall Street Journal, February 17, 2020. ⁶ "Promoting China's Energy Transformation through Deepened Supply-side Structural Reform," Development Research Centre of the State Council of the People's Republic of China, August 21, 2020. ⁷ "India aims for half of state-run fuel stations to be solar-powered in five years," Reuters, September 15, 2020. ⁸ "India leads with lowest renewable cost in Asia Pacific," Wood Mackenzie, July 27, 2019. ⁹ "Green bond market: Summary Q3 2020," Climate Bonds Initiative, November 13, 2020. ¹⁰ "Corporate Asia: A Capital Paradox," McKinsey & Company, January 2020.

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