

Sustainable investment fixed income: Bond markets can't intimidate everybody

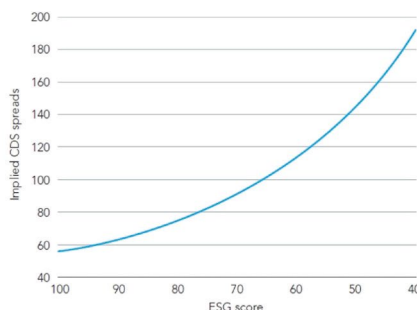
FTSE Russell's Lee Clements explores how sustainability risks are now a key consideration within fixed income investment

This year, rising bond yields have seen many market analysts reach for a famous fixed income quote. James Carville, a White House political adviser, on being told that his government would have to rein in spending, wished that he could be reincarnated as the bond market – “because you can intimidate everybody.”

But fixed income markets are facing one risk that they cannot face down. Not so long ago many investors saw sustainability or climate issues risks as down the road, but numerous data points show the future is already here. A material portion of both issuers and investors are now sustainability-focused, it is now firmly part of the list of risks to be considered, alongside rates, inflation, credit etc. and ESG performance can impact investment performance in some markets. If that is not enough regulators and stakeholders are forcing it to be a key issue for all investors.

Here are examples of the arrival of ESG fixed income risks:

- Studies show a direct inverse correlation between sovereign bond performance (evidenced by CDS spreads) and ESG scores¹. The better a security's ESG score, the lower its risk of default
- Issuance of sustainable finance bonds, such as green or sustainability linked bonds, are growing rapidly and are now 9-10 per cent of global debt capital markets proceeds²

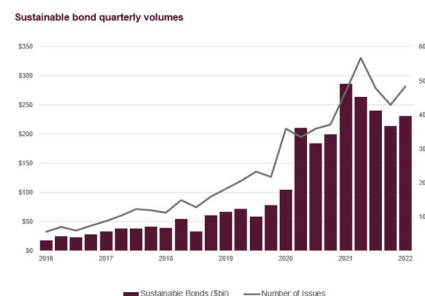


Source: Federated Hermes and Beyond Ratings, as at December 2019. Past performance is no guarantee to future results. Please see the end for important disclosures.

- Sustainability issues have a growing influence on credit ratings. A recent NLP study by ESMA found meaningful ESG considerations in ~50 per cent of the press releases relating to credit rating actions³

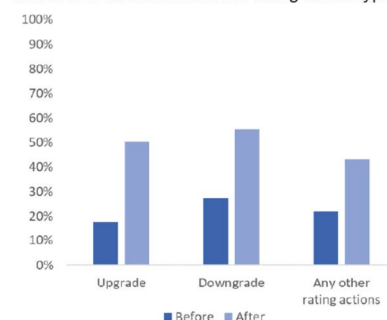
- Rising geo-political risk related to the war in Ukraine war has led investors to reconsider governance in issuers (both sovereign and corporate) relating to authoritarian regimes, human rights etc.⁴

- The European Central Bank has recently stated that it will apply climate



Source: Refinitiv Sustainable Finance review, Q1 2022. Past performance is no guarantee to future results. Please see the end for important disclosures.

Press releases with meaningful ESG considerations
More ESG discussion across rating action types



Source: ESMA. Past performance is no guarantee to future results. Please see the end for important disclosures.

risk measures to its €386 billion holding of corporate bonds^{5,6}

- Fixed income markets are not only unable to face down or ignore sustainable investment issues, but they are also assimilating sustainability risks into their frameworks more than ever. These risks are firmly on the agenda of regulators worldwide, with the number of sustainable investment policy interventions growing rapidly⁷.

In recent months there have been plenty of examples of bond markets intimidating central banks, economists, and investors. But it seems that sustainable risk is integral to fixed income markets, and that process can only deepen.

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¹ Pricing ESG risk in sovereign credit: an emerging divergence | Federated Hermes Limited (hermes-investment.com); Pricing ESG risk in sovereign credit | Federated Hermes Limited (hermes-investment.com)

² Sustainable finance weathers wider market storm | Refinitiv Perspectives

³ Text mining ESG disclosures in rating agency press releases, ESMA, Feb 2022

⁴ How Russia's war blindsided the world of ESG investing | Reuters

⁵ ECB takes further steps to incorporate climate change into its monetary policy operations (europa.eu)

⁶ ECB set for greener 'tilt' in €386bn corporate bond portfolio | Financial Times (ft.com)

⁷ UNPRI regulation database