

“Buying a green bond with zero ‘greenium’ could be termed an ‘ESG arbitrage’ with future expected outperformance as the ‘greenium’ returns.”



Where has the 'greenium' gone?



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25 March 2024

A few years back a new word was added to the long list of bond market jargon: 'greenium'. This comes from 'green-premium' but in fact represents a 'green discount' referring to the lower yield on bonds with positive ESG fundamentals compared to the equivalent bonds that do not. This might sound straightforward, but a number of complexities arise.

First is the verification that the proceeds of green bond sales are indeed allocated to worthy projects such as renewable energy or sustainable infrastructure.

Detailed frameworks exist to ensure compliance, such as the green bond principles from the International Capital Markets Association. Additionally, granular ESG scoring is available by entities such as ratings agency Moody's and additional reassurance for investors is available from external audits by the large accounting firms.

Many of the sizable issuers in debt capital markets, such as the World Bank, have invested heavily in comprehensive and robust green bond frameworks. In fact, ¹all World Bank issues since 2021 have been part of their 'sustainable development bonds and green bonds' programme.

In addition to the large multinational development agencies such as World Bank, EIB, Asian Development Bank and many others who are, by definition, funding projects with positive environmental or developmental impact, other corporate and government borrowers have also developed green bond programmes in recent years. This has been driven by investor demand and the opportunity for borrowers to fund at more competitive yield levels under green bond programmes.

A second consideration is to determine how much this positive ESG impact is worth from an investor standpoint. Here there could be a conflict when stated investment objectives of maximising fund return are combined with a target exposure to green bonds. When the UK Government issued their first green Gilt in September 2021 (UK Treasury 0.875% 2033), the auction was very heavily oversubscribed with £100bn of bids for a £10bn issue size. The 0.87% yield to maturity was estimated to be 0.025% lower than the expected level for a conventional gilt at that time, saving the UK Treasury £28m over the life of the bond. As well as benefiting the UK Treasury, ²investors also made additional profits (at least in the near term) as changes to the 'greenium' caused these Gilts to outperform on a market value basis.

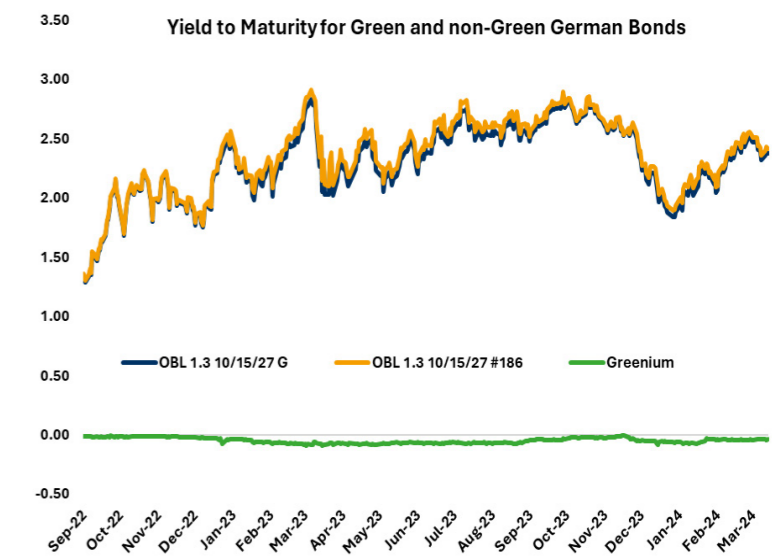
Measuring the 'greenium' for UK Gilts was complicated by the need for a yield curve model to adjust for the maturity difference between the green Gilt and neighbouring Gilts with similar maturities, a sort of 'join-the-dots' which can be quite complex. The German government has made things much simpler by issuing pairs of bonds, one green bond and one conventional, with precisely the same interest and principal payment dates and amounts. Comparing the yield difference between these bonds gives an exact measure of the 'greenium'. The following chart, using data from Bloomberg, shows the evolution of this 'greenium' for the German OBL 1.3% 2027.

Sources: ¹The World Bank Sustainable Finance and ESG Advisory Services ²The Financial Times.

Alarming, despite the additional ESG characteristics of the green OBL, not to mention the significant extra cost in managing and reporting within the green bond framework for the Federal Republic of Germany, their yield traded above the equivalent non-green issue. At that point the 'greenium' was negative, thus offering an ESG discount!

Fixed income investors often compare bonds with similar maturities to extract relative value. For example, by comparing the yield of a corporate bond to an equivalent maturity 'risk free' government bond, in the same currency, the so-called 'credit spread' can be determined. 'Greenium' is analogous to this credit spread but represents an altogether different measure. Buying a green bond with zero 'greenium' could be termed an 'ESG arbitrage' with future expected outperformance as the 'greenium' returns.

In conclusion, exposure to green bonds within a portfolio can contribute to benchmark outperformance as the relative valuations between green bonds and non-green bonds provide additional opportunities for active fixed income managers.

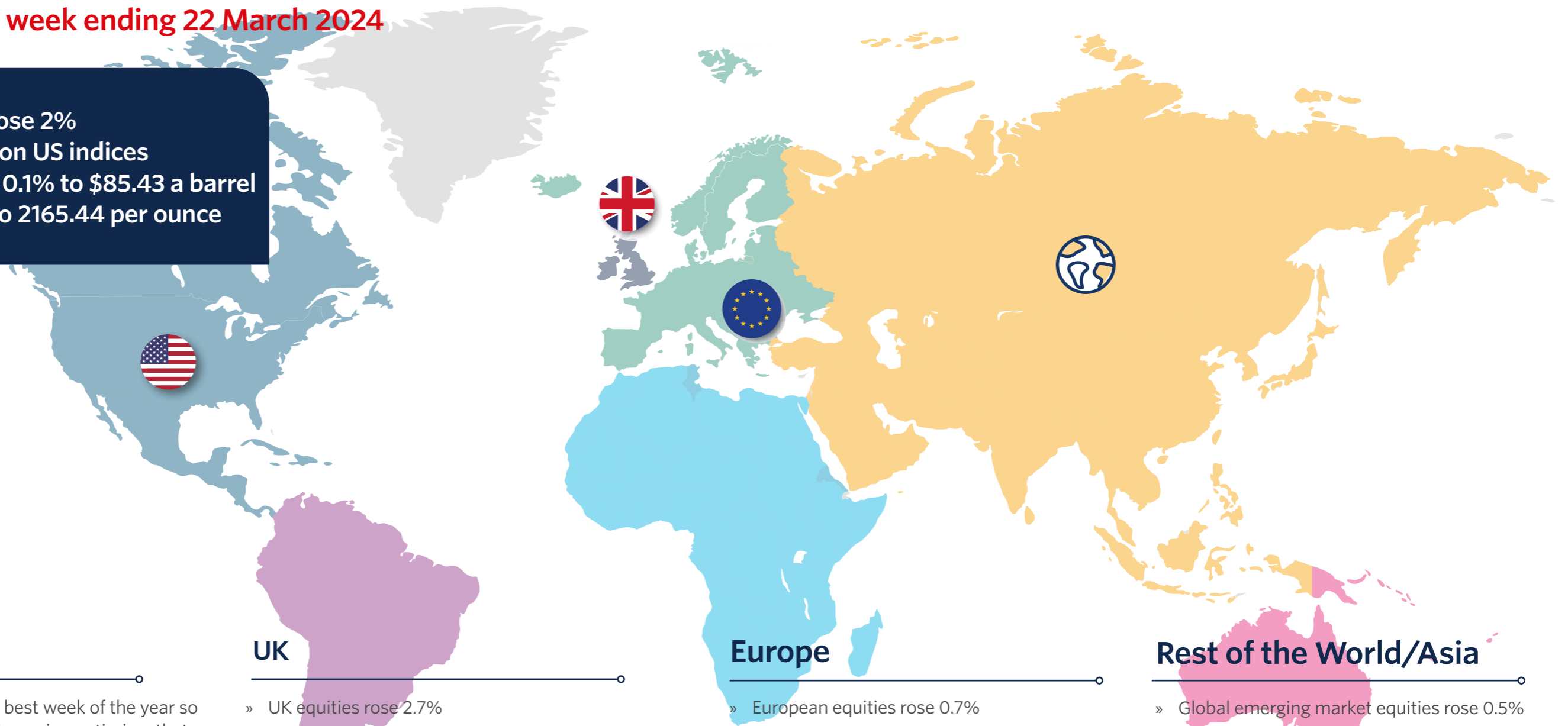


Source: Bloomberg Finance L.P.



Market Review - week ending 22 March 2024

- » Global equities rose 2%
- » New records set on US indices
- » Brent crude rose 0.1% to \$85.43 a barrel
- » Gold rose 0.4% to 2165.44 per ounce



US

- » US equities rose 2.3%, the best week of the year so far and a new record amid growing optimism that rate cuts by many major central banks are now on the way
- » Tech stocks led the gains, as the benchmark technology index rose +2.85% (and +0.16% on Friday) and the Magnificent 7 jumped +4.31% (+0.89% Friday)
- » US Investment grade and high-yield spreads fell -1bps and -6bps, seeing their lowest weekly close since November 2021 and January 2022, respectively

UK

- » UK equities rose 2.7%
- » The Bank of England (BoE) kept its key interest rate unchanged at 5.25% for a fifth consecutive time, although the 8-1 vote in favour appeared to send a more dovish signal
- » The BoE's monetary policy announcement came a day after data showed that annual consumer price growth decelerated to 3.4% in February from 4.0% in January

Europe

- » European equities rose 0.7%
- » The number of rate-cuts priced in for the European Central Bank rose by +4.7bps for the year end
- » European government bond yields declined on a weak Purchasing Managers' survey for Germany and a reduction in Swiss interest rates

Rest of the World/Asia

- » Global emerging market equities rose 0.5%
- » Japanese equities rose 5.3%. The Yen fell -1.55% during the week
- » Chinese equities fell 1.3%
- » Japanese consumer price inflation (CPI), rose to a higher-than-anticipated 2.8% annualised over the month of February. This was a sharp pickup from January's 2.0% and ahead of the Bank of Japan's inflation target

Market Performance - week ending 22 March 2024

Asset Class / Region	Currency	Cumulative returns			
		Week ending 22 March	Month to date	YTD 2024	12 months
Developed Markets Equities					
United States	USD	2.3%	2.8%	10.0%	34.4%
United Kingdom	GBP	2.7%	4.4%	3.8%	9.3%
Continental Europe	EUR	0.7%	3.1%	7.6%	18.4%
Japan	JPY	5.3%	5.1%	18.9%	46.9%
Asia Pacific (ex Japan)	USD	0.4%	2.1%	1.6%	7.7%
Australia	AUD	1.3%	1.6%	3.6%	15.2%
Global	USD	2.0%	2.9%	8.5%	29.7%
Emerging Markets Equities					
Emerging Europe	USD	1.4%	-1.1%	4.9%	35.5%
Emerging Asia	USD	0.5%	2.5%	2.9%	9.0%
Emerging Latin America	USD	0.2%	0.0%	-4.9%	27.6%
BRICs	USD	-0.6%	-0.2%	-0.8%	4.3%
China	USD	-1.3%	0.6%	-2.5%	-13.4%
MENA countries	USD	0.6%	-0.3%	4.0%	13.9%
South Africa	USD	-0.6%	2.1%	-9.2%	-2.3%
India	USD	-0.5%	-0.3%	1.5%	29.2%
Global emerging markets	USD	0.5%	2.0%	1.9%	11.0%
Bonds					
US Treasuries	USD	0.3%	0.1%	-1.5%	-0.5%
US Treasuries (inflation protected)	USD	0.9%	0.7%	-0.3%	0.4%
US Corporate (investment grade)	USD	0.8%	1.0%	-0.2%	4.9%
US High Yield	USD	0.6%	1.1%	1.4%	12.5%
UK Gilts	GBP	1.2%	1.5%	-1.9%	-0.2%
UK Corporate (investment grade)	GBP	0.9%	1.8%	0.1%	7.4%
Euro Government Bonds	EUR	0.7%	1.0%	-0.6%	4.1%
Euro Corporate (investment grade)	EUR	0.5%	1.0%	0.2%	6.9%
Euro High Yield	EUR	-0.4%	0.3%	1.5%	11.3%
Japanese Government	JPY	0.3%	-0.3%	-0.7%	-2.3%
Australian Government	AUD	0.3%	0.4%	0.2%	0.1%
Global Government Bonds	USD	-0.1%	0.1%	-3.1%	-1.9%
Global Bonds	USD	0.3%	0.6%	-2.0%	1.3%
Global Convertible Bonds	USD	0.7%	1.2%	-0.5%	7.8%
Emerging Market Bonds	USD	1.3%	1.9%	2.0%	11.6%

Asset Class / Region	Currency	Cumulative returns			
		Week ending 22 March	Month to date	YTD 2024	12 months
Property					
US Property Securities	USD	0.0%	-0.7%	-3.0%	14.8%
Australian Property Securities	AUD	2.0%	6.4%	12.7%	27.5%
Asia Property Securities	USD	1.6%	2.4%	-3.6%	-4.0%
Global Property Securities	USD	1.1%	1.4%	-2.3%	12.8%
Currencies					
Euro	USD	-0.7%	0.1%	-2.3%	0.1%
UK Pound Sterling	USD	-1.1%	-0.2%	-1.3%	2.8%
Japanese Yen	USD	-1.6%	-0.9%	-7.0%	-12.5%
Australian Dollar	USD	-0.6%	0.4%	-4.6%	-2.4%
South African Rand	USD	-1.2%	1.1%	-3.9%	-3.4%
Swiss Franc	USD	-1.6%	-1.7%	-6.6%	2.8%
Chinese Yuan	USD	-0.5%	-0.6%	-1.8%	-4.8%
Commodities & Alternatives					
Commodities	USD	-0.2%	3.0%	4.3%	8.3%
Agricultural Commodities	USD	0.6%	2.8%	4.1%	9.5%
Oil	USD	0.1%	2.2%	10.9%	11.4%
Gold	USD	0.4%	5.9%	5.0%	11.3%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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