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Weekly

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The many dimensions of sustainability

One can achieve substantial results and benefit through better long-term risk-adjusted returns.

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I am writing this piece from a wet and cold Italian countryside in early June, quite unusual for what should instead be "the good season" already. Last year on this very day, I was on holidays with a friend in Puglia, it was really hot and we were cooling down in the Adriatic sea. There's climate change for you! But that is only one of the many things that worries me. There's climate change, social inequalities, human rights, justice, environmental preservation, poverty and (unfortunately) a lot more.

From an investor's perspective, I'm twice as worried though. What's the impact that all these dynamics are having on my investments? What's the impact my investments are having on these dynamics? How do I devise a win-win plan for my portfolios?

When it comes to incorporating sustainability considerations into investment decisions, there is a growing consensus on the importance of doing so, both from a responsibility perspective (position your investments to have an impact) and from a financial return perspective (position your investments to benefit from sustainable characteristics). However, there is still ongoing debate and little agreement on the best approaches to do so and several different methodologies are being used, each with its own pros and cons.

The first method is sector exclusions, that involves excluding specific industries or sectors from investment portfolios based on their negative environmental or social impacts. For example, investors may choose to avoid companies involved in tobacco, weapons, or fossil fuels. The advantage of sector exclusions is that it provides a straightforward way to align investments with sustainability values, but it can limit diversification and potentially restrict opportunities for engagement and positive change within those industries.

Controversy exclusions represent another approach. This methodology involves excluding companies that are involved in controversies related to environmental or social issues, such as child labour or human rights violations. By avoiding those, investors aim to promote responsible practices. However, determining the extent and severity of controversies can be subjective, and there may be challenges in obtaining accurate and timely information.

Environmental, Social, and Governance (ESG) risk mitigation revolves around considering and quantifying how ESG factors can materially impact a company's financial performance. This approach provides a comprehensive assessment of a company's sustainability performance and its potential impact on investment returns. However, there may be challenges in accurately measuring and quantifying these factors, as well as variations in methodologies used by different investors and data providers.

Another methodology is centred around reducing the environmental footprint of the investment companies, seeking to minimize carbon emissions, waste generation, and water usage, for example. By investing in companies that actively work towards environmental sustainability, investors can contribute to positive change but setting reduction targets and accurately measuring environmental impacts can be complex and require ongoing monitoring and verification.

Measuring and increasing impact towards the United Nations' Sustainable Development Goals (SDGs) is gaining traction as a methodology for sustainable investing. This approach aligns investments with specific SDGs, such as poverty alleviation, gender equality, and climate action. By directing capital towards companies that contribute to these goals, investors aim to generate positive social and environmental outcomes. However, defining measurable impacts and assessing the alignment of investments with the SDGs can be challenging, even more than with ESG risks.

Lastly, voting and engagement play a crucial role in sustainable investing. This methodology involves actively using shareholder rights to influence companies' practices and policies through voting on resolutions and engaging in dialogues with management. It allows investors to drive change from within and hold companies accountable for their environmental and social performance. However, it requires dedicated resources and expertise to effectively engage with companies and promote sustainable practices.

Incorporating sustainability considerations into equity investment decisions can be approached through various methodologies, each with its own advantages and challenges. I firmly believe that by integrating them all, in a measured, holistic and risk-managed way, one can achieve substantial results and benefit through better long-term risk-adjusted returns. After all, sustainability is just another dimension of quality. Sustainable companies should face lower costs of running their business (less carbon taxes, fines, renovation costs etc…), improved market sentiment, lower cost of capital and ultimately better returns.

Market Focus - 5 June 2023

- **Global equities returned +1.7% last week**
- **US debt ceiling raised to prevent default**
- **Brent crude fell 1.1% last week to $76.13 per barrel**
- **Gold returned 0.1% last week to $1947.97 per ounce**

US

- US equities rose 1.9% last week despite being closed on Monday 29 May for US federal holiday, Memorial Day
- The Senate approved legislation to suspend the US debt ceiling and impose restraints on government spending through the 2024 election, averting a potentially catastrophic default
- US payrolls eclipsed expectations in May, surging by 339k (vs estimate of 195k) and a revised 294K in the prior month, with the jobless rate also topping estimates rising to 3.7%
- Artificial Intelligence has investors pouring a record amount of money into tech stocks, with the US tech Index now at an all-time high relative to the US 2000 small-cap index

UK

- UK equities returned -0.3% last week after being closed on Monday 29 May
- UK Manufacturing Purchasing Manager Index (PMI) for May beat expectations coming in at 47.1 (vs 46.9 estimates)
- UK Business confidence in May retreated to its long-term average of 28%, after three months of rising optimism, according to a monthly sentiment index compiled by Lloyds Bank

Europe

- European equities were flat last week
- Euro-area inflation slowed in May to 6.1% (vs 6.3% estimated)
- Spain's Prime Minister, Pedro Sánchez, called a snap election after the far-right opposition triumphed in local polls
- German Consumer Price Index for May fell 0.1% (vs 0.6% estimated), Manufacturing PMI 3.1 (vs 46.9 estimates)

Rest of the World/Asia

- Global emerging market equities rose 1.3% last week
- Japanese equities rose 1.8%
- Last week Chinese equities rose 1.5%. China is said to be working on a new package to support the property sector. Regulators are considering reducing the down payment in some neighbourhoods of major cities, lowering agent commissions, and further relaxing curbs for residential purchases
- China's Caixin Manufacturing PMI unexpectedly gained to 50.9 in May, signalling expansion (vs 49.5 estimates)
- Global food costs fell to the lowest level in two years in May, reviving hopes that sticky inflation on supermarket shelves will start to ease. A UN index of food-commodity prices fell 2.6% as declines in grains, vegetable oil, and dairy offset higher sugar and meat costs

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

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Market Summary

Asset Class / Region	Currency	Cumulative returns: Week ending 2 June	Month to date	YTD 2023	12 months
Developed Markets Equities					
United States	USD	1.9%	2.5%	12.1%	3.8%
United Kingdom	GBP	-0.3%	2.2%	3.6%	4.4%
Continental Europe	EUR	0.0%	2.2%	12.2%	9.3%
Japan	JPY	1.8%	2.4%	16.9%	16.4%
Asia Pacific (ex Japan)	USD	1.3%	2.6%	2.5%	-4.5%
Australia	AUD	-0.1%	0.8%	3.5%	4.2%
Global	USD	1.7%	2.6%	11.4%	3.9%
Emerging Markets Equities					
Emerging Europe	USD	2.8%	5.0%	10.9%	23.2%
Emerging Asia	USD	1.4%	2.5%	3.8%	-4.4%
Emerging Latin America	USD	1.5%	5.7%	11.9%	1.8%
BRICs	USD	1.4%	3.7%	-2.0%	-6.0%
China	USD	1.5%	4.5%	-5.0%	-9.9%
MENA countries	USD	-1.0%	0.1%	0.0%	-14.2%
South Africa	USD	2.5%	4.6%	-9.7%	-16.6%
India	USD	0.6%	0.5%	3.3%	5.9%
Global emerging markets	USD	1.3%	2.7%	3.8%	-4.6%
Bonds					
US Treasuries	USD	0.7%	-0.3%	2.2%	-2.2%
US Treasuries (inflation protected)	USD	0.3%	-0.3%	1.9%	-4.6%
US Corporate (investment grade)	USD	1.0%	-0.1%	2.8%	-1.2%
US High Yield	USD	1.2%	0.8%	4.6%	0.7%
UK Gilts	GBP	1.9%	0.4%	-2.9%	-15.9%
UK Corporate (investment grade)	GBP	1.3%	0.2%	0.4%	-8.7%
Euro Government Bonds	EUR	1.9%	0.0%	2.9%	-5.4%
Euro Corporate (investment grade)	EUR	1.0%	-0.1%	2.3%	-2.7%
Euro High Yield	EUR	0.5%	0.2%	4.0%	1.0%
Japanese Government	JPY	0.0%	0.0%	2.6%	-1.0%
Australian Government	AUD	0.4%	-0.2%	3.4%	2.3%
Global Government Bonds	USD	1.2%	0.1%	1.3%	-4.9%
Global Bonds	USD	1.1%	0.1%	2.1%	-3.9%
Global Convertible Bonds	USD	1.2%	1.5%	2.9%	-1.6%
Emerging Market Bonds	USD	1.5%	0.6%	1.6%	-2.7%

Asset Class / Region	Currency	Cumulative returns: Week ending 2 June	Month to date	YTD 2023	12 months
Property					
US Property Securities	USD	3.3%	2.3%	2.3%	-11.5%
Australian Property Securities	AUD	0.6%	1.0%	4.4%	-4.9%
Asia Property Securities	USD	1.7%	2.7%	-6.2%	-11.8%
Global Property Securities	USD	2.8%	2.5%	0.1%	-12.5%
Currencies					
Euro	USD	-0.1%	0.7%	0.0%	-0.3%
UK Pound Sterling	USD	0.9%	0.5%	2.9%	-1.0%
Japanese Yen	USD	0.5%	-0.1%	-6.4%	-7.2%
Australian Dollar	USD	1.5%	2.3%	-3.0%	-8.9%
South African Rand	USD	0.7%	1.2%	-12.8%	-20.8%
Swiss Franc	USD	-0.3%	0.6%	1.5%	5.5%
Chinese Yuan	USD	-0.3%	0.3%	-2.7%	-6.0%
Commodities & Alternatives					
Commodities	USD	-0.5%	2.6%	-8.8%	-20.6%
Agricultural Commodities	USD	1.0%	2.6%	-2.5%	-12.4%
Oil	USD	-1.1%	4.8%	-11.4%	-35.3%
Gold	USD	0.1%	-0.9%	6.8%	4.3%
Hedge funds	USD	0.2%	0.2%	0.0%	-1.3%

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

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