How investors are tackling sustainability in debt portfolios

Investors are grappling with the challenge of incorporating sustainability across entire fixed income portfolios although specific opportunities, particularly in the impact sector, continue to grow.

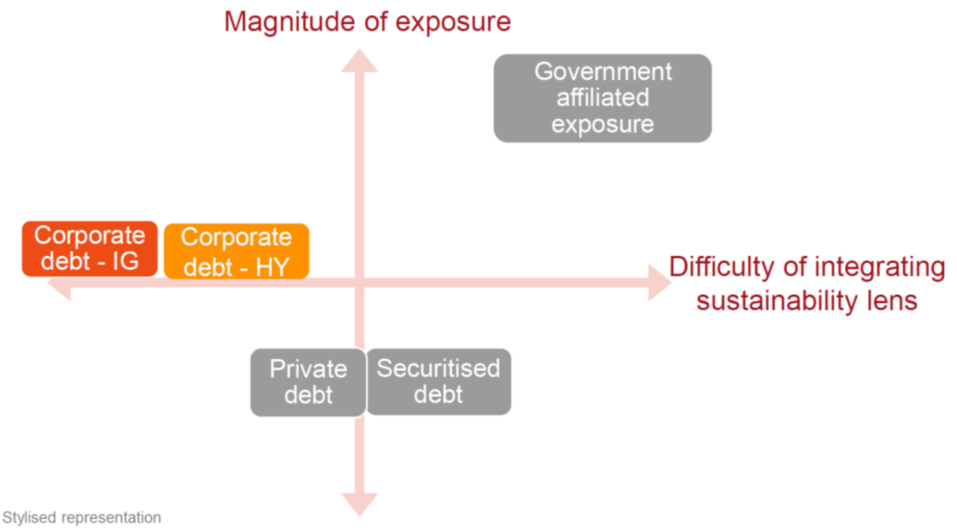
The task is made harder by data limitations, the ability to engage (especially with governments), different investment horizons, the size and complexity of the investible bond universe, and product availability.

Iain McMahon, Head of Defensives and Alternatives, Frontier Advisors, said the corporate sector offered the most tangible opportunity to implement sustainability.

“It’s where the rubber meets the road for a lot of this stuff,” he said.

“So, investment grade credit, it's reasonably doable to get a diversified sustainable portfolio with a similar return footprint. High yield is more tricky – you've got an energy concentration which makes it more challenging. Then the private, securitised and government sectors are increasingly complex and we’re seeing more limited things there from a client implementation standpoint.”

Ability to integrate without significant return/risk implications has led investors to focus on corporate debt



Source: Frontier Advisors. Stylised representation

Australia’s sustainable debt market has grown to around $150 billion including more than 115 issuers and 370 securities, according to Janus Henderson Investors. The Australian Office of Financial Management (AOFM) issued its first Green Treasury Bond in June. The green bond program enables investors to back public projects that drive Australia’s transition to net zero by 2050.

Henrietta Pacquement, Head of Global Fixed Income and Sustainability, Allspring Global Investments, said private financial institutions could finance about 55 percent of the required investment to achieve net zero by 2050.

“This is going to be a huge opportunity over the next few years,” she said. “We're talking about 7-8 per cent of global GDP every year between now and then. Fixed income is going to be a big contributor to that on the public side and on the private side.”

Investors should institute a robust climate transition approach that includes picking climate transition leaders, decarbonising the portfolio, and prioritising engagement over exclusions. An increased level of data through better disclosure and new regulation was making it easier to make assessments of companies.

One example of a company it has supported was a state-owned Finnish utility. While its carbon intensity score was ranked relatively highly, the company was “making strides in terms of their energy mix, tilting into hydro, tilting into nuclear, and moving away from coal, and they've got a plan around that, that we think is credible over years to come.”

Artee Khiatani, Credit and ESG Analyst, Janus Henderson, said it looks for companies with key sustainable components across ESG, the issuer’s core offering, people and planet impact, and engagement and stewardship.

While decarbonisation attracts much attention (97 per cent of companies have a 2050 net zero target), there are other areas to measure, such as social equality and poverty, as well as inclusion and social diversity.

For example, she said Woolworths’ profile improved when it demerged its gaming and alcohol business. Janus Henderson then engaged with the company over labour risks through its Big W subsidiary.

“A lot of the cotton gets sourced from China where there are modern slavery issues and labour issues, so we engaged with Woolworths to see whether that risk was real for them and what they were actually doing to prevent that,” she said.

Frontier can assist clients with assessing firm and fixed interest level ESG practices and identifying or evaluating managers with superior sustainability credentials. Contact Iain McMahon, Head of Defensives and Alternatives, Frontier Advisors, at imcmahon@frontieradvisors.com.au for more information.