

ESG; New Investment Normal post covid-19

"Sustainable investing is the future of investing; 85% CFA members take ESG factors into consideration in their investing". CFA Institute Survey 2020.

Dr. Adnan Akhter, CFA



The rise of Environmental, Social and Governance (ESG) factor aka sustainable/responsible investing since last five years after UN Sustainable goals (SDG) has evolved business model to some extent. Effective management of environmental, social and governance issue in unison is new business model for major corporate giants in developed world. COVID-19 crisis made this realization even more serious for developing and emerging economies. This crisis was a wakeup call that to shape bright future, interests of businesses, investors and society must be in close alignment.

Pre-pandemic scenario was very different as COVID-19 crisis was new for the whole world in modern time of technological advancements. The effect of crisis on businesses and economy at large is unprecedented. ESG is on table since decade but its importance was overlooked, and corporates business model remained 'shareholder primacy'. Because their interest was linked with short term gains i.e., quarterly earnings rather taking long term perspective which not benefits shareholder but society at large.

ESG will be 'competitive differentiator' post-COVID-19 crisis because corporations have

adapted to new business models and improved their social practices. Therefore, this crisis provided room for improvement in diversifying the ideology, inclusive recruiting, talent development, fair compensation etc. This crisis gives an opportunity to corporations to learn and adapt to new environment so to combat the challenges of future related to climate change especially.

Though ESG got significant interest in investment arena in last couple of years after global discussion on climate change. Covid-19 made this more plausible factor of investing, and investors/advisors talk about ESG philosophies and business's adoption of ESG principles. This crisis accelerated the need for alternate approach to investing in comparison of traditional approach which is eminent in developed markets. Morningstar reported that in first half of 2020 ESG funds AUM totaled \$21billion which was twofold as compared to 2019.

This pandemic gives new impetus of ESG investing, though it does not come at cost but can boost future returns; facts proved the resilience of sustainable investing.

ESG In ASIA

ESG growth in Asia lags North America and Europe. According to Bloomberg intelligence, ESG related ETF's in Asia will grow 20% in 2021 and China will be at advantage to get fair share due to her policies.

Transparency leads to accountability; accountability drives innovation and innovation reshapes economies.

Though Europe is leading in ESG focused products across the globe but flows of funds heavily injected in ESG related products in Asia by investors post-pandemic market crash.

Investors' willingness to engage on ESG issues is set to continue into 2021, as Covid-19 shed light on the need for sustainability and resilience of sustainable investing. According to Asia Pacific Wealth Hong Kong, ESG is real game changer in investment arena which is adding strong performance in growth of ESG related products in market. Post-pandemic China's origin ESG corporations performed significantly well in market as compared to other regional counterparts. Krane Shares MSCI China ETF (trades in NYSE) posted 135% return in past year, and 107% return in second half 2020. While Global X China clean energy ETF (trades in

Global Sustainable Funds 4Q 2020 Statistics

Region	Q4 2020 Flows		Assets		Funds	
	USD billion	% Total	USD billion	% Total	#	% Total
Europe	120.8	79.3	1,342.8	81.3	3,196	77.0
United States	20.5	13.4	236.4	14.3	392	9.4
Asia ex-Japan	5.0	3.3	25.4	1.5	208	5.0
Australia/New Zealand	1.2	0.8	19.8	1.2	126	3.0
Japan	3.7	2.4	17.7	1.1	138	3.3
Canada	1.2	0.8	10.2	0.6	93	2.2
Total	152.3		1,652.3		4,153	

Source: Morningstar Direct, Morningstar Research. Data as of December 2020.

Hong Kong) posted 67% return in second half of 2020. The rise of sustainable funds in Asia in 2020 is clear indication of attraction of ESG factor in investments.

Given China's transformation to high quality development and internationalization, industry

lasting—impact on the global economy and financial markets, there were concerns that interest

Market Summary of Sustainable Funds in Asia

	No. of locally domiciled ESG funds	No. of new launches	Net Flows (USD million)		Fund size (USD million)	
	Q3 2020	Q3 2020	Q3 2020	Q3 2020	Q2 2020	QoQ Growth
Japan	128	13	7,003,218,675	12,386,686,249	4,762,302,456	160%
China	47	2	715,799,339	8,159,988,715	6,101,216,429	34%
Taiwan	15	4	801,288,645	2,386,104,172	1,579,813,411	51%
South Korea	53	1	177,829,888	757,576,433	515,037,552	47%
India	4	0	-16,567,074	641,331,011	597,110,672	7%
Malaysia	10	1	23,892,411	323,679,546	318,817,829	2%
Hong Kong	2	0	3,254,679	306,837,616	282,782,899	9%
Thailand	8	1	-10,543,682	63,756,797	75,773,954	-16%
Indonesia	9	0	3,572,524	62,765,968	82,127,154	-24%
Singapore	2	0	-474,404	15,296,113	14,527,080	5%
Asia Total	278	22	8,701,271,000	25,104,022,620	14,329,509,435	75%

Source: Morningstar Direct

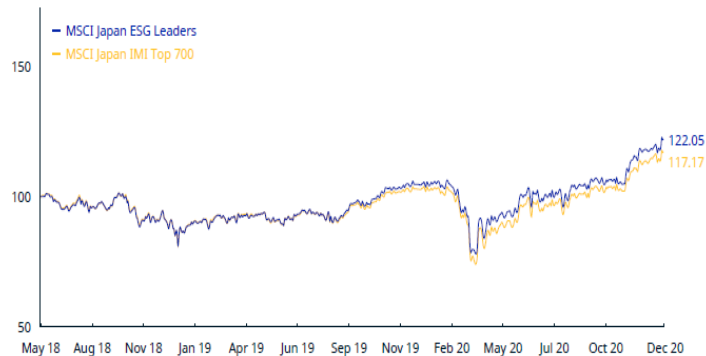
experts believe that ESG has much room of growth in such environment, though ESG got traction in China after market stability in late second quarter 2020. ESG compliant corporations are increasing in China due to government led policies. Japan and China leads Asia in terms of ESG products for investment.

At the end of Q1 2020, when it became clear that the outbreak would have a much bigger—and

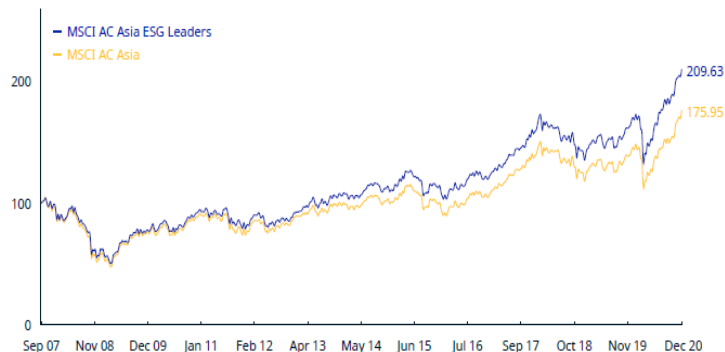
in ESG investing would wane as attention and resources were diverted toward saving lives and preventing an economic depression from materializing. But once global markets stabilized, investors worldwide injected more than US\$70 billion into ESG funds in the second quarter of the year as per Financial times report.

Within global sustainability investing, China has the potential to get traction more in 2021 because of her significant role in Asia as green market is encouraging corporations to invest in ESG-related projects. Given the potential scale of ESG-driven changes at the enterprise level, investors in China will likely see ESG practices emerge as a valuable source of alpha potential over the long term. Following performance depicts that China is major Asian economy where ESG got traction and ESG performance is outstanding as compared to broad market.

CUMULATIVE INDEX PERFORMANCE – NET RETURNS (USD)
(MAY 2018 – DEC 2020)

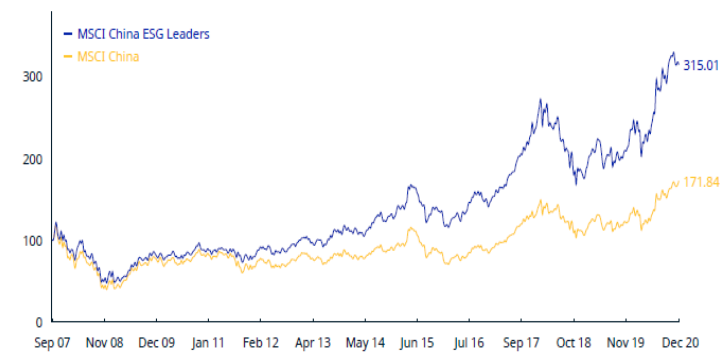


CUMULATIVE INDEX PERFORMANCE – GROSS RETURNS (USD)
(SEP 2007 – DEC 2020)



On same lines as China at large and other Asian economies generally have transformed business models post-pandemic and with rise of ESG focus in corporate sector due to green policies, it is expected that ESG investing will not be an alternate investment model but part and parcel of the traditional investment model. Going forward, traditional investment factor will wane and ESG will be new investment normal for advisors/investors to remain resilient in turbulent times and reap long term benefits.

CUMULATIVE INDEX PERFORMANCE – GROSS RETURNS (USD)
(SEP 2007 – DEC 2020)



Here's the thing about luck... you don't know if it's good or bad until you have some perspective." — Alice Hoffman