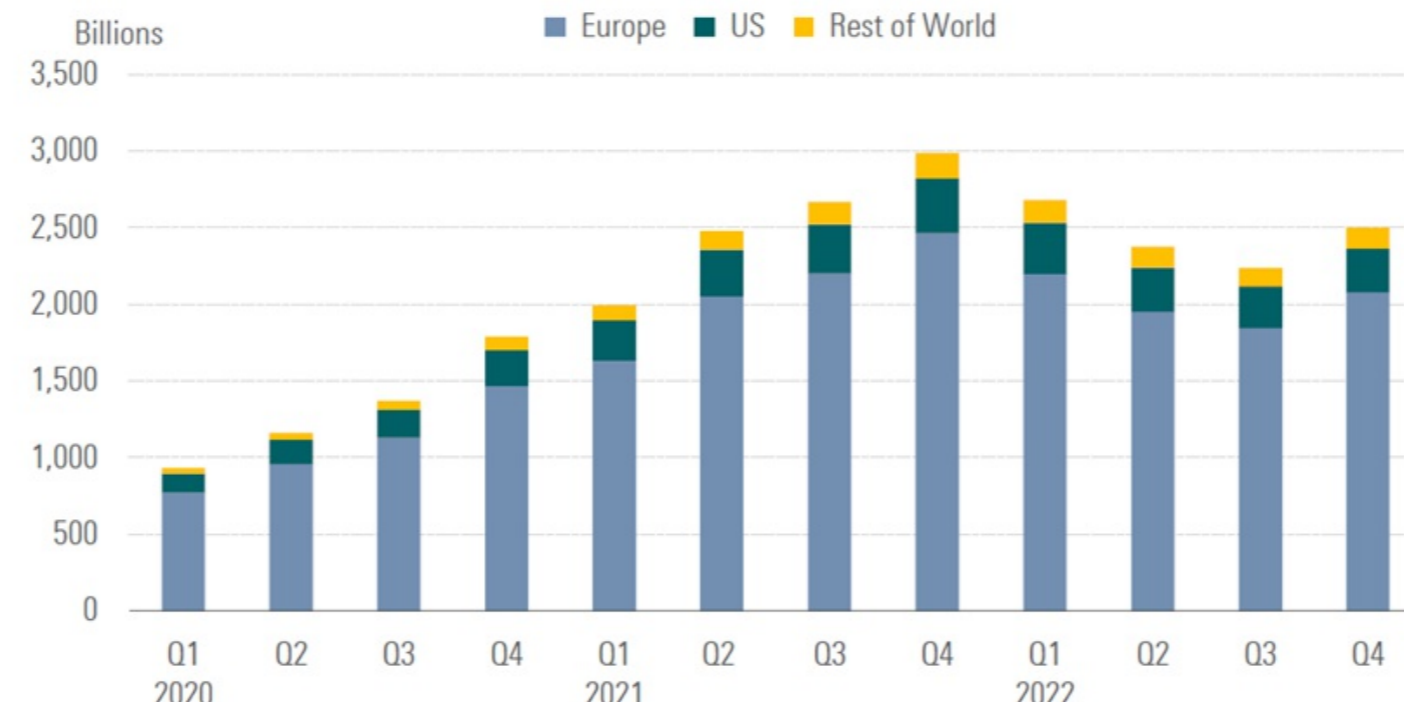




## Assessing Performance of Sustainable Investments

Assets in global sustainable funds stand at a significant USD 2.5 trillion according to Morningstar data, as at 31 December 2022. The sustainable universe encompasses funds focusing on sustainability, impact, or ESG (environmental, social, governance) factors. Growth is robust particularly in Europe which is the biggest market for sustainable funds. Chart 1 illustrates the growth in assets since 2020, a trend only disrupted by declining market values in 2022 amid macroeconomic headwinds.

**Chart 1: Quarterly Global Sustainable Fund Assets (USD Billion)**



Source: Morningstar Research (31 December 2022)

A question commonly asked about sustainable funds is whether investors sacrifice returns by investing in these funds. Although an important question, it is the wrong one in my view. We explore this below, first assessing some performance metrics and then discussing what should be prioritised when it comes to sustainable funds.

The ESG versions of the MSCI World and S&P 500 indices have delivered outperformance over their standard equivalents over the last 5- and 10-year periods. Looking at calendar year performance over the last 5 years reveals an interesting pattern. Outperformance has largely been in line with outperformance of the growth investment style. This is illustrated in Chart 2 below. The cells highlighted in green with a tick indicate outperformance periods.

**Chart 2: ESG Indices outperformance vs. Broad Index**  
(Outperformance highlighted in green with a tick)

	YTD	2022	2021	2020	2019	2018
<b>Outperformance vs MSCI World</b>						
MSCI World ESG Focus GR USD	✗	✗	✗	✓	✓	✓
MSCI World ESG Screened GR USD	✓	✗	✓	✓	✓	✓
MSCI World Growth GR USD	✓	✗	✗	✓	✓	✓
MSCI World Value GR USD	✗	✓	✓	✗	✗	✗
<b>Outperformance vs S&amp;P 500</b>						
S&P 500 ESG TR USD	✗	✓	✓	✓	✓	✓
S&P 500 ESG Exclusions II TR USD	✓	✗	✓	✓	✓	✓
S&P 500 Growth TR USD	✗	✗	✓	✓	✗	✓
S&P 500 Value TR USD	✓	✓	✗	✗	✓	✗

Source: Morningstar Direct (28 February 2023)

Long-term outperformance by sustainability funds is great but for a fair evaluation, an appropriate benchmark needs to be determined. Understanding what sustainable funds are trying to achieve gives a better picture of what success looks like and can then be used to shape appropriate benchmarks. Broadly, the following terminology applies:

Investment Type	Meaning	Aim
Sustainable	All-encompassing, balancing traditional investing with ESG related insights	Improve long-term outcomes
ESG	Consider <b>environmental, social and governance</b> factors alongside financial factors	Identify material risks and growth opportunities and encourage improvement
Impact	Focuses mostly on <b>social and environmental</b> factors alongside financial return	Positive impact / using finance for good with specific observable targets

Attaining sustainability objectives aligns with trying to make the world a better place. Thus, success is more than just returns but includes actual change and progress. It is just lip service or marketing gimmicks if actual real impact is ignored. With the need to include impact, it does not make sense to purely look at returns and compare that to non-sustainable fund performance.

The aim is to have the best possible chance for sustainable targets to be achieved. We have seen that without clear targets and focus, greenwashing by fund managers and companies becomes prevalent. Actual impact is more important than the appearance of. Without clear focus and targets, metrics can be gamed without real change, with portfolios looking good only on the surface, and the world, not any better.

One would assume that if in the long-term risk is reduced, then it is superior risk-adjusted returns that we should expect from sustainable investments. This while making the world a better place. Ultimately, success is measured by assessing financial returns and more importantly, the desired impact which necessitates making only the right comparisons.



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