

Strategic: Go sustainable

Go sustainable

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Why? Sustainable investing can deliver competitive returns and alignment with sustainability goals. While the Trump administration's policies on climate, diversity, and multilateral organizations may weigh on parts of the SI market, opportunities still exist. We favor diversification across asset classes, exposure to less-policy-sensitive areas (like ESG leader equities), and exposure to private impact investments (subject to their unique risks).



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CIO identifies a number of transformational innovations that look set to shape global equity markets in the years to come. Each is closely linked to sustainability. *Artificial intelligence*, *Power and resources*, and *Longevity*, which represent CIO's three Transformational Innovation Opportunities (TRIOs), invest in companies addressing challenges and opportunities across varied fields like resource efficiency and food and water security to rising clean energy demand. These topics align with the priorities driving the global sustainability transition. We therefore believe the secular case for investing in a diversified sustainable portfolio approach across equities, bonds, hedge funds, and private markets remains firm.

Nevertheless, greater investor caution has arisen over questions about how the Trump administration's policies may affect sustainable investing. The first 100 days of the second Trump administration ended with the US president signing more executive orders over the period than any other president in the past 50 years. These executive orders and other policies have brought major layoffs, spending freezes, deregulation efforts, and a strong shift in priorities and status quo. In our Executive Order Tracker, we note that over 70% of executive orders signed as of 28 May have either an environmental or social impact.

While some sustainability-related policies may be rolled back in the years ahead—and we cannot rule out further trade-related volatility as negotiations evolve—we do not anticipate wholesale changes to the fundamental case for

sustainable investing and continue to see attractive growth opportunities.

All major asset classes, including equities, bonds, hedge funds, and private markets, offer sustainable options, which historically have shown similar return characteristics to traditional investments, though risk characteristics differ particularly for alternatives. While we expect volatility to persist as the Trump administration's agenda evolves, we believe that the longer-term performance of diversified sustainable investing strategies will be driven more by investment fundamentals and the economic environment than by politics.

In stocks, we believe investors can consider the equities of companies that are demonstrating improvements or leadership in environmental, social, and governance (ESG) principles, as well as ESG engagement strategies.

ESG leader strategies aim to be sector-neutral, meaning global performance isn't driven by sector or country tilts. This may help navigate a US political environment where the performance difference between perceived policy winners and losers widens. ESG leaders have shown resilience through less favorable policy periods in the past.

ESG leaders, as an investment screen, correlate with growth and quality equity factors. As such, they typically enjoy a valuation premium compared to benchmarks. This is also justified by consistent empirical research that shows a positive relationship between companies' management of

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sustainability issues and their financial performance (Friede, et al. 2015, Whelan, et al. 2021).

ESG improvers are companies that are demonstrating positive momentum in addressing ESG risks and opportunities. They are not yet "leaders" but their performance on various ESG criteria shows signs that they could become leaders in the future. Momentum is a well-known strategy in the investment industry. It consists of buying stocks that have an upward trending price and selling those that have had poor returns in recent months, based on the tendency of the price to move in the direction of the trend.

Within engagement strategies, we believe investors should diversify into sectors beyond climate that exhibit strong economic fundamentals and have a proven ability for engagement on sustainability to drive higher profits and real-world change. While we acknowledge that this approach has faced challenges from shifting regulations and a bias toward small- and mid-cap companies that have historically suffered in times of high interest rates or economic uncertainty, we reiterate that this remains the only public market strategy with impact investing potential. As the practice broadens in the industry, investors explicitly seeking impact investing goals should remain critical of manager selection, ensuring engagement is targeted and accountable.

In fixed income, we like bonds issued by multilateral development banks (MDBs) or those with stated green intentions, as well as credit strategies with an active approach.

MDBs are supranational financial institutions backed by multiple sovereign governments, with the purpose of supporting economic, social, and environmental development, mostly in emerging countries. Many, especially those issued by the World Bank, have the US as the largest guarantor or capital contributor. As such, the country has the largest voting power on new projects or developments.

However, even the withdrawal of the US from multilateral institutions to focus on domestic or bilateral relationships should not derail MDB bonds. They have strong fundamentals, appealing yields, and resilience to weakening in the credit quality of their member countries, so they do not trade at a credit risk premium over benchmark government bonds like US Treasuries in USD or German Bunds in EUR. They do, however, offer some extra yield over government debt given lower market liquidity for the largest institutional investors. This ranges from 5 to 30 basis points (bps) across the cycle depending on the bond tenor and

overall market volatility. Investors can continue to benefit from MDB bonds' stability and diversification effects in their portfolios, in our view.

In alternatives, risk-tolerant investors can consider sustainable hedge funds. Such funds incorporate ESG factors into their investment processes, aiming to exploit market inefficiencies related to ESG issues. They thus may offer differentiated investment opportunities.

And in private markets, we believe impact investments in climate technology that aim to help companies meet their decarbonization commitments, reduce overall greenhouse gas emissions, and drive the overall transition to a low-carbon economy represent a significant investment opportunity, with clean energy solutions alone representing a market of USD 650bn annually by 2030, according to our estimates. We see the most attractive commercial opportunities in technologies that serve sectors that are hardest to decarbonize: electricity and heat, industry, buildings, transportation, and agriculture. These sectors are critical to the economy and major contributors to emissions.

Nonetheless, private market investors need to consider risk factors like leverage, potential defaults, and concentration risks. Investing in private market vehicles also requires a tolerance for illiquidity and comes with limited disclosure and control over holdings.

For those looking to invest in climate tech, CIO sees opportunities in funds focusing on early-stage and growth-stage companies, providing the capital needed to scale their technologies and bring them to market. We believe such funds have the potential to deliver venture-like returns, while also generating measurable environmental impact.

Moreover, investors can explore co-investment opportunities, which allow them to invest alongside experienced fund managers in specific deals. This approach provides access to high-quality assets and the ability of seasoned investors, enhancing the potential for strong returns. Additionally, secondary markets offer liquidity options for investors looking to exit their positions or rebalance their portfolios.

More resources:

[Sustainable investing perspectives: Power shortages, UN Ocean Conference, and US bill impact on renewables](#)

[POTUS47: Executive Order Tracker - 7th Update](#)

Appendix

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