

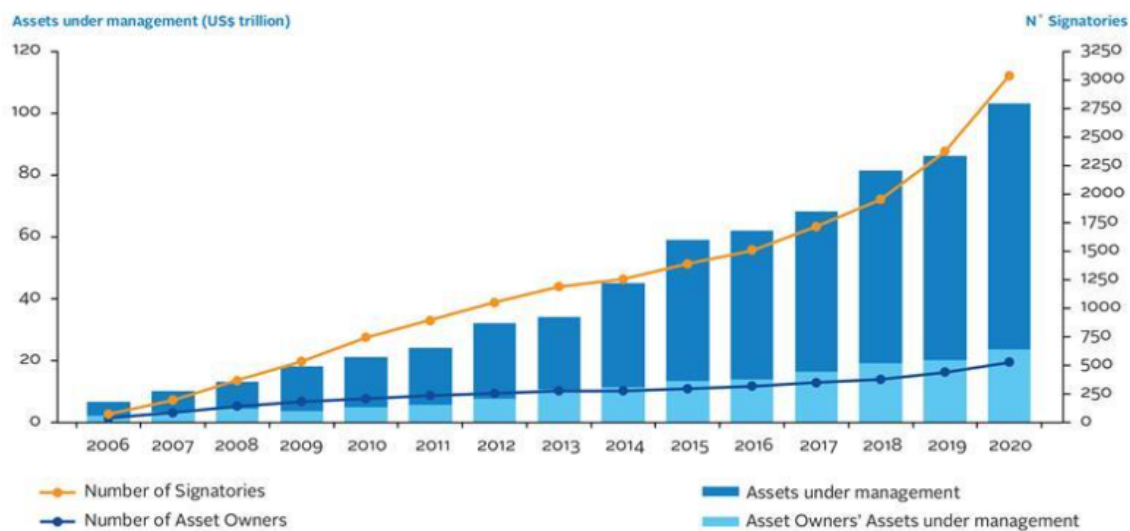
A multi asset approach to ESG integration

Maria Municchi and Marie-Benedict Senou

Significant growth of ESG integrated strategies

Over the course of only a few years, economic, social and governance (ESG) integration has become a mainstream feature of investment funds. Together with regulatory requirements, the availability of ESG-relevant data and clients' demands have driven a shift towards the inclusion of financially material ESG parameters across many investment strategies.

UNPRI signatories by AUM, 2006-2020



Source: UNPRI

At the same time, broad standards of ESG integration approaches have been identified, especially for equity and corporate bond investing. However, when it comes to combining top-down and bottom-up investment decisions, as well as assessing a variety of asset classes within the same strategy, such as in multi asset strategies, ESG integration can become more complex.

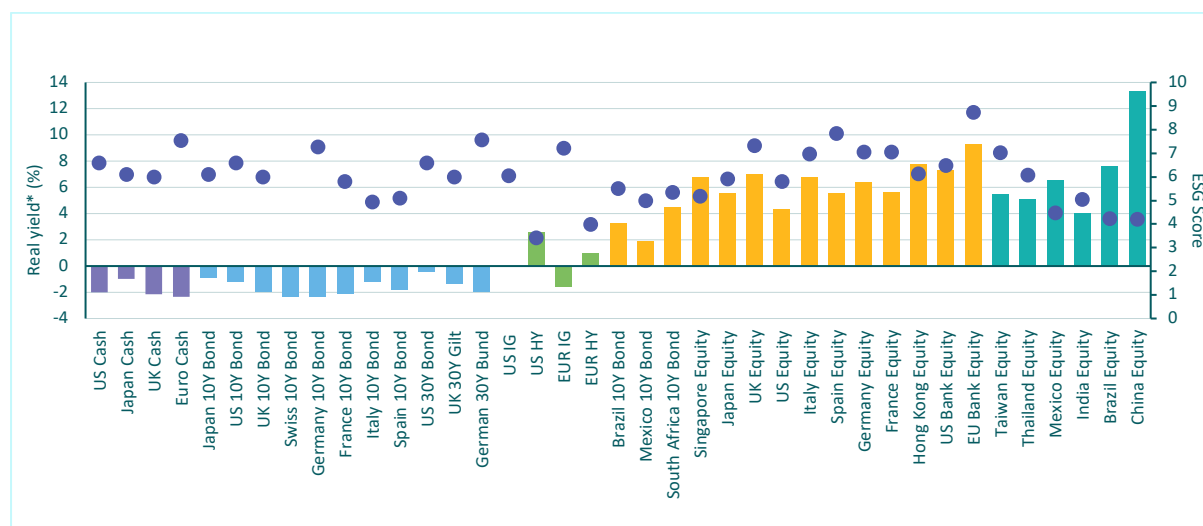
The broad set of investment decisions found in multi asset strategies have a variety of ESG integration implications:

- **Strategic and tactical asset allocation decisions:** ESG factors can be financially material to asset allocation decisions, but the time horizon over which they are relevant may vary.
- **Top-down and bottom-up investment decisions:** ESG factors can be financially material across asset classes both at the aggregate and the single stock level, but the way this is assessed may vary.

A view from the top on ESG factors

As multi asset investors, our aim is to allocate capital across asset classes according to their risk and return characteristics, while considering the current macroeconomic trends. Economic activity, demographics, monetary and fiscal policies are some of the key determinants of the macroeconomic background we operate in. However, ESG factors also have an important role to play; these can alter economic beliefs and shape the risk and return characteristics of the investments we make. Therefore, when assessing the asset classes we invest in, we believe it is important to incorporate the different levels of ESG risks and opportunities that characterise them.

Real yield vs ESG score of asset classes



Source: M&G Multi Asset, ESG score is the MSCI ESG adjusted ESG score. Real yield is defined as an inverted p/e ratio, using forward consensus data. The above data is a hypothetical representation for illustrative purposes only and is not representative of any M&G product or strategy.

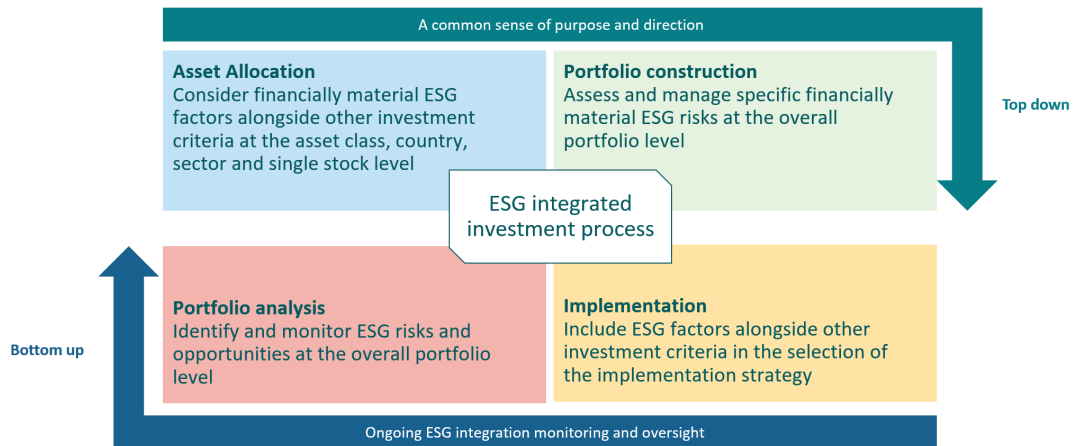
Today, we observe how the current economic and social environment is being increasingly impacted by sustainability trends (climate change risk and mitigation being one aspect of it), making ESG factors ever more relevant.

ESG Integration within the investment process

ESG integration needs to be 'explicit and systematic' and therefore embedded within the investment process. ESG factors remain relevant throughout the four-step investment process – from the asset allocation, to the portfolio construction, the implementation phase and overall portfolio analysis.

Multi asset ESG integration

ESG integrated investment process and outcome



Source: M&G

Asset Allocation: We consider financially material ESG factors alongside other investment criteria at the asset class level. For example, when investing in emerging market sovereigns we take into account the fact that ESG risk might be higher than developed market sovereigns. This, together with other investment criteria, might lead to higher volatility but also higher expected return.

Portfolio construction: When constructing our portfolios we aim to assess and manage specific financially material ESG risks. For example we would observe the overall ESG score of the portfolios as well as identify areas of the portfolio with particularly high ESG risks.

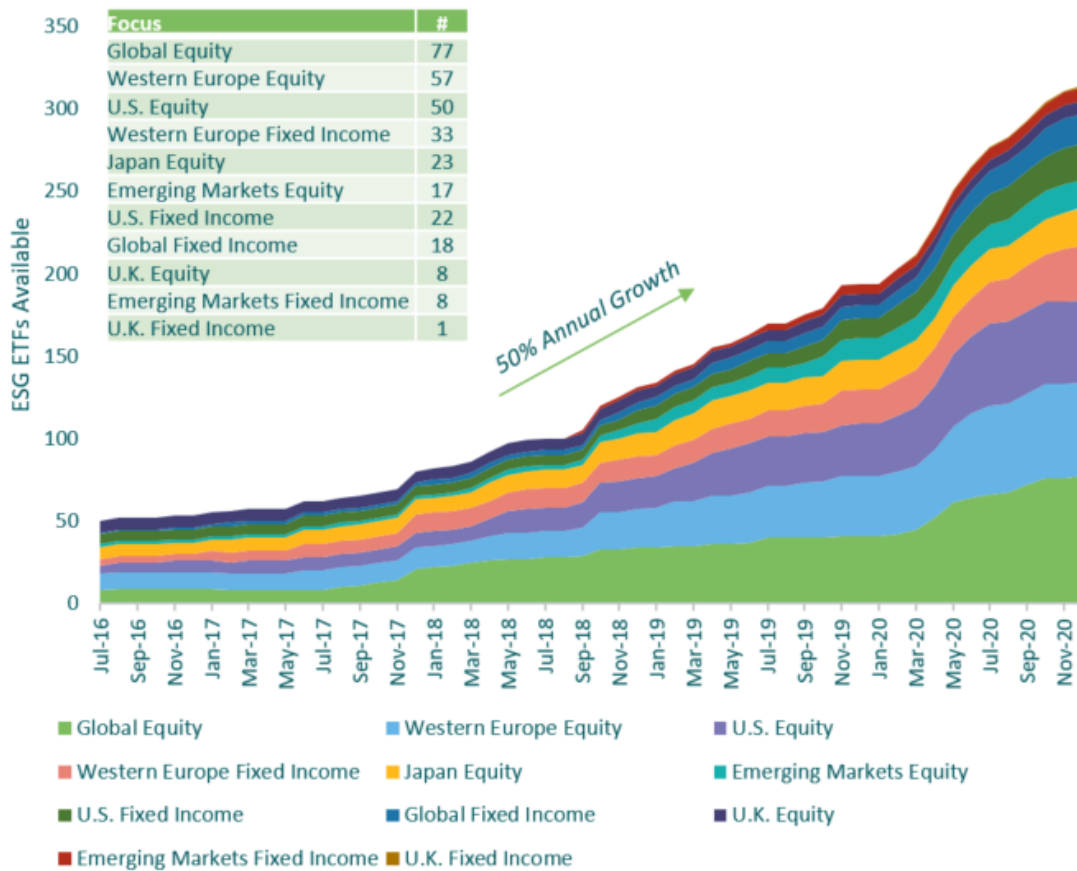
Multi asset portfolio breakdown by asset classes and ESG score

	Fund 1	Fund 2	Fund 3	Fund 4	Fund 5	Fund 6	Fund 7	Fund 8
Total	4.54	4.88	5.40	5.54	5.62	5.83	6.01	6.49
Equity	6.44	5.69	5.83	6.23	6.00	6.77	6.14	7.13
Government	4.49	4.65	5.07	4.71	4.83	5.47	5.83	5.58
Europe						5.50	4.95	5.50
US	6.10	4.65	5.00	4.64	6.10	6.10	6.10	6.10
Emerging Markets	3.81	4.65	4.06	4.05	3.73	4.49	3.48	4.39
Corporate Bonds	5.24	6.04	5.73	5.82	6.09	4.55		8.18

Source: M&G Multi Asset, MSCI ESG adjusted score (0 to 10)

Implementation: When implementing our asset allocation views we include ESG factors alongside other investment criteria. Interestingly, as the availability of ESG integrated indexes and relative instruments (ETFs) is growing this should enable us to implement our views via ESG integrated collective or derivative instruments in the future.

Total Number of ESG ETFs Available



Source: M&G

Portfolio analysis: We aim to identify and monitor ESG risks and opportunities at the overall portfolio level. For example, a number of our funds invest in renewable energy infrastructure, which can be a reliable source of income. We also aim to identify opportunities for active ownership and engagement on climate and diversity related issues.

ESG characteristics of sample US equities

ESG characteristics of sample US equities

Security Description	Environmental	Social	Governance	Adjusted Score	Weighted Average Score	Controversy Score
BANK OF NEW YORK MELLON CORP	10	5	4.9	7.6	5.2	3
CIGNA CORP	10	4.6	6.2	7.4	5.4	1
AMERIPRISE FINANCE INC	8.7	5.5	3.9	6.1	5	8
CENTENE CORP	8.3	4.2	5.6	4.5	4.9	3
LABORATORY CORPORATION OF AMERICA	10	5.1	5.7	5.5	5.5	5
ALEXION PHARMACEUTICALS INC	3.4	3.8	6.3	3.6	4.6	5
WHIRLPOOL CORP	4.7	3.8	5.2	3.3	4.5	3
CITIZENS FINANCIAL GROUP INC	1.5	3.7	6.5	5	4.4	8
MERCK & CO INC	6.8	5	3.4	5.6	4.6	1
GENERAL MOTORS	5.2	0.8	4.9	2	3.5	1
BORGWARNER INC	5	4	5	6.4	4.6	6
PPL CORP	5.8	3.7	4.7	5.6	5.2	5
QUEST DIAGNOSTICS INC	9.2	6.2	5.4	8.1	6.1	4
VERIZON COMMUNICATIONS INC	10	4.6	5.4	5.3	5.2	3
ALTRIA GROUP INC	3	3.2	3.9	3.6	3.4	1
ARROW ELECTRONICS INC	3.7	5	3.3	3.1	4	8
WALGREEN BOOTS ALLIANCE INC	8.4	3.3	4.6	5.5	4.2	4
REGIONS FINANCIAL CORP	6.5	4.4	6.4	8.4	5.4	5
PFIZER INC	4.7	2.6	2.8	2.4	2.8	1
KEYCORP	2.6	3.6	5.6	6.2	4.1	8

Source: MSCI

Source: MSCI

An evolutionary approach

Integrating ESG within our investment approach enables us to capture risks and opportunities that are linked to environmental, social and governance factors. However, we do not see this as a 'revolution' for our established investment strategy but rather an 'evolution'. As the macroeconomic background continue to change, the availability of ESG data and our ability to analyse and integrate it across the investment process should enable us to make better investment decisions.

[Please can [Sustainability trends: from economics to financial markets \(mandg.com\)](https://www.mandg.com/insights/sustainability-trends-from-economics-to-financial-markets) go as a related insight, if it's not automated?]

For financial advisers only. Not for onward distribution. No other persons should rely on any information contained within. This financial promotion is issued by M&G Securities Limited which is authorised and regulated by the Financial Conduct Authority in the UK and provides ISAs and other investment products. The company's registered office is 10 Fenchurch Avenue, London EC3M 5AG. Registered in England and Wales. Registered Number 90776.