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RESPONSIBLE INVESTING

Bridge to ESG Integration: Country Selection in Emerging Markets

By: Marshall L. Stocker, Ph.D., CFA | December 14, 2023

When investing in emerging markets (EM), top-down country selection can be a powerful way to generate excess returns and positive change on environmental, social and governance (ESG) issues. While it might feel satisfying to find the company with the best ESG characteristics within a specific country, our research shows the country allocation decision explains 80% of excess returns in EM equity. That's why, in the Calvert Emerging Markets Advancement Fund, we utilize a top-down investment process that evaluates the macroeconomic and governance environment at the country level.

EM countries often have weak governance institutions and poor economic freedom, which is reflected in EM valuations. But, as with many ESG issues, what matters most is the direction and rate of change. In the Calvert EM Advancement Fund, we look for countries with political and economic conditions that suggest an improving governance and investment climate.

For example, when Russia invaded Ukraine in 2022, our Calvert EM Advancement Fund owned no Russian equities, not even its highest ESG-ranked stocks, because the country-level institutions were deteriorating. That, in turn, protected us from the losses experienced by Russian equities following these events. In contrast, the Republic of Georgia appeared to attract productive Russians who wanted nothing to do with Putin's war, and thus represented a potentially interesting region for investment.

In fact, these top-down, country-specific assessments are what we view as the role of "Advancement" within the Calvert EM Advancement Fund. We apply our expertise to identify those countries where governance institutions are greatly improving such that ESG outcomes are advancing in a positive direction. "Advancement" also means that we are engaging with EM governments or policy thought leaders in an effort to advance the quality of institutions.

Within EM, a country-based analysis can offer significant insights and alpha.[1] We seek out the nations where governance institutions are improving because we know those improvements correlate to better socioeconomic outcomes. Once we forecast a positive trajectory for a country, we purchase a broad basket of stocks, all of which meet the Calvert Principles. Those stocks are almost entirely those in the Calvert EM Responsible Index—in other words, we take active country risk but passive stock risk.

As a result, we're not only capitalizing on the extensive sovereign analysis so critical to investing in EM markets, but we're actively participating in positive change, helping improve the rule of law and mitigating risks within our holdings.

Bottom line: By taking a unique approach in the Calvert Emerging Markets Advancement Fund, we're adding diversification to an EM exposure, given that most traditional EM managers employ a bottom-up approach.

Learn more about Calvert Emerging Markets Advancement Fund here.

1. Alpha is the excess return or value added (positive or negative) of a portfolio's return relative to the return of its benchmark.

Risk Considerations: *The value of investments held by the Fund may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility. Investments in foreign instruments or currencies can involve greater risk and volatility than U.S. investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions. In emerging countries, these risks may be more significant. The Fund generally intends to hold each company in the Calvert Emerging Markets Index located in countries selected for investment, regardless of market conditions or individual investment performance, which could cause the Fund to underperform funds that select individual securities without reference to an index. Because the Fund investments may be concentrated in a particular industry, the Fund share value may fluctuate more than that of a less concentrated fund. Investing primarily in responsible investments carries the risk that, under certain market conditions, the Fund may underperform funds that do not utilize a responsible investment strategy. The Fund is exposed to liquidity risk when trading volume, lack of a market maker or trading partner, large position size, market conditions, or legal restrictions impair its ability to sell particular investments or to sell them at advantageous market prices. No fund is a complete investment program and you may lose money investing in a fund. The Fund may engage in other investment practices that may involve additional risks and you should review the Fund prospectus for a complete description.*

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