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CALVERT INSIGHTS | RESPONSIBLE INVESTING

New Report Affirms Sustainable Fund Outperformance in First Half of 2023

By: John Farley | September 13, 2023

New York - The new "Sustainable Reality" report from the Morgan Stanley Institute for Sustainable Investing affirms the resurgence of performance and interest in environmental, social and governance (ESG) funds in the first half of 2023. The trends identified in the report support Calvert's long-held views on markets and investor interests:

1. Investment funds that consider financially material ESG issues may be better positioned to provide long-term investment performance.
2. Investor demand for responsible investment solutions continues to increase.
3. Investors have increasing concerns about how their investments impact the environment and society.

Sustainable funds outperform traditional funds

The latest "Sustainable Reality" report reveals that sustainable funds outperformed traditional funds on a relative basis over the first six months of 2023, with median returns of 6.9% compared with 3.8% for traditional funds. This held true across all asset classes and geographies, and represents a reversal from sustainable funds' performance in the first half of 2022, when they underperformed traditional funds for the first time in five years.

Global investor demand is strong

The first half of 2023 presented a host of challenges for investors in sustainable funds, ranging from the political environment in the United States to uncertainties over the Sustainable Finance Disclosure Regulation (SFDR) in Europe. Despite these challenges, sustainable funds attracted cumulative inflows of $57 billion, bringing assets under management as a proportion of total global AUM to 7.9%, up from 7.6% in December 2022.

Flows in Europe seem driven partially by the SFDR's classification system, which specifies that a fund will either be classified as Article 6 (funds without a sustainability scope), Article 8 (funds that promote environmental or social characteristics) or Article 9 (funds that have sustainable investment as their primary objective). Both Article 8 and Article 9 funds saw modest inflows in the first half of 2023, at $28 billion and $6 billion, respectively.

ESG concerns increasingly matter to investors

The report analyzes the growth in restricted screening based on sustainability issues, with more than 20% of global AUM considering issues such as controversial weapons, climate change and tobacco exposure. While Calvert does not use screening or exclusions to make investment decisions, we recognize that this information reflects the growing concerns of investors about the impacts of their investments on the environment and society.

Calvert's view

Calvert believes these trends are poised to continue. We believe that:

- Companies and issuers that successfully manage financially material ESG issues are better positioned for long-term outperformance. Correspondingly, investment portfolios that focus on these companies are more likely to provide opportunities for long-term value creation and positive global impact and change.
- Companies increasingly realize that successfully managing sustainability issues may provide advantages in managing operational risks and relationships with stakeholders (employees, clients, customers and investors).
- Investors continue to demand a sophisticated investment approach that aligns their investment portfolios with their concerns and priorities.

Bottom line: The report from the Morgan Stanley Institute for Sustainable Investing documents sustainable funds' return to relative outperformance in the first half of 2023 and investors' increasing appetite for investments that consider ESG issues. It supports our view that the long-term trend moving toward sustainable business and responsible investing continues, despite short-term headwinds.

Source: Morgan Stanley Institute for Sustainable Investing, "Sustainable Reality: Sustainable Funds Return to Outperformance in First Half of 2023."

This analysis builds on the 2019, 2020 and 2023 "Sustainable Reality" reports, now looking at global performance rather than just U.S.

Methodology: The fund universe for this analysis includes closed-end funds, exchange-traded funds and open-end funds, taking the oldest share class, and excludes feeder funds, funds of funds and money market funds. In total, this analysis covered approximately 96,000 funds globally.

Morningstar classifies a fund as sustainable if "...in the prospectus or other regulatory filings it is described as focusing on sustainability, impact investing, or environmental, social or governance (ESG) factors. Funds must claim to have a sustainability objective, and/or use binding ESG criteria for their investment selection. Funds that employ only limited exclusions or only consider ESG factors in a non-binding way are not considered to be a sustainable investment product."

This analysis takes each fund's classification as of June 30 (for H1 data) and December 31 (for full year data) in each year; Traditional funds are those classified as "Not Sustainable" by Morningstar. Morningstar's "Sustainable" classification can differ from the newer, and still broad, European Sustainable Finance Disclosure Regulation (SFDR) Article 8 and Article 9 definitions. Over 99% of Article 9 funds are also classified as Sustainable by Morningstar, while this only applies for around 30% of Article 8 funds.

Morningstar's calculation of total return is expressed in percentage terms and is determined each month by taking the change in monthly net asset value, reinvesting all income and capital gains distributions during that month, and dividing by the starting net asset value (NAV).

Risk Considerations: *There is no guarantee that any investment strategy, including those with an ESG focus, will work under all market conditions. Investors should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Past performance is no guarantee of future results.*

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