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Video Transcript

HSBC Global Private Banking – April 2024

Zooming In: Episode 2 – Future-proofing portfolios with an ESG lens
Willem Sels and Peggy Smith

Willem:
Welcome to the second episode of our Zooming In series.

And as you all know, we have been focused on building resilience in portfolios and today I wanted to turn to the sustainability aspect of that search.

To do that, I've invited Peggy Smith, our Global Head of ESG Solutions – Peggy, welcome!

When I think of sustainability and how it can affect portfolios, there are of course, both the risks and the opportunities around the transition itself.

But using an ESG lens is also helpful because beyond that net zero transition, the move towards sustainable energy is driven by many other trends, which any good portfolio strategy should incorporate. For example, for many countries, achieving energy independence is a very important strategic goal It's also about strategic competition and gaining market share in an attractive growth sector, which of course helps accelerate the transition and technological innovation, but can also create competition issues and margin pressures.

So it's fair to say that the move to sustainable energy is well underpinned by many structural forces.

Peggy:
Absolutely Willem, and of course, this will require huge investments. The International Energy Agency estimated we need to spend $4.5 trillion per year on clean energy by 2030, and in 2023 we only spent $1.8 trillion. It clearly indicates much more needs to be done and there's a funding need from private sector. The hope is that rate cuts will accelerate investment in infrastructure and other areas related to the net zero transition.

Willem:
When we talk about portfolio resilience, we should look at this both from a short-term and longer-term perspective. In the short term, there can be significant style and sector biases which are important factors of course, to consider at different stages of the market cycle. So for example, excluding or limiting exposure to oil companies, can lead to quite a significant sector bias. And growth-style companies involved in the energy transition are often interest rate sensitive. Many sustainability-led strategies have a momentum and a quality bias. So as you can see, we need to be aware of these biases.

However, there are ESG leader indices which are agnostic to sector and style and they tend to perform in-line with the market – and in fact, actually they have shown a mild outperformance vs traditional peers in the medium to longer term.

Peggy:
Yes Willem, the logic here is, over the longer term, portfolio resilience can be improved by considering the underlying risks brought by the net zero transition; for example, carbon-intensive assets can become

stranded assets. It is not necessarily looking for companies that are already very clean, but also for those that have credible plans and strong ESG credentials to deliver the plans in the transition.

Willem:

So, Peggy, let's be practical. How can investors start their sustainability journey?

Peggy:

Many investors might hesitate to invest in sustainable investment products because they do not have the required information about this. By improving clarity on ESG risk management performance, which traditional financial metrics fails to capture, the ESG metrics can provide investors with meaningful insights to enable them to make informed investment decisions. For example, 'ESG Rating' measures a company's resilience to material long-term industry ESG risks and opportunities. Another metric 'Carbon Intensity' measures a company's carbon emissions per million dollar of revenue.

Willem:

What I notice when I bring up sustainability in client discussions is that every client is different. So to help clients reflect both their sustainability objectives and their financial goals, what we've done is we've started sustainability preference questionnaires in a few booking centres already, and we will gradually roll it out to more locations over time.

Peggy:

Yes, Willem, we see three main ways to embed sustainability in portfolio construction. This can be followed by individual product analysis and selection. To build a core portfolio, we suggest investing in products that have better ESG performance compared to peers. This is sector agnostic and can provide clients with diversified exposures. For satellite and tactical allocations, we consider thematic exposures by referring to 17 United Nations Sustainable Development Goals – such as health, education and tackling climate change. The third strategy is impact investing, which aims to deliver intentional, direct and positive environmental and/or social impact. We also call these strategies as Purpose in the UK. Green bonds are an example of impact investing.

Willem:

And of course, Peggy, whatever the approach, we look at all investments also through a traditional risk and return model because, to ensure that we fill both the financials and sustainability preferences is very important.

Thank you, Peggy. It's been a pleasure to discuss the importance of sustainability in constructing resilient portfolios.

Peggy:

Thank you Willem for having me today.