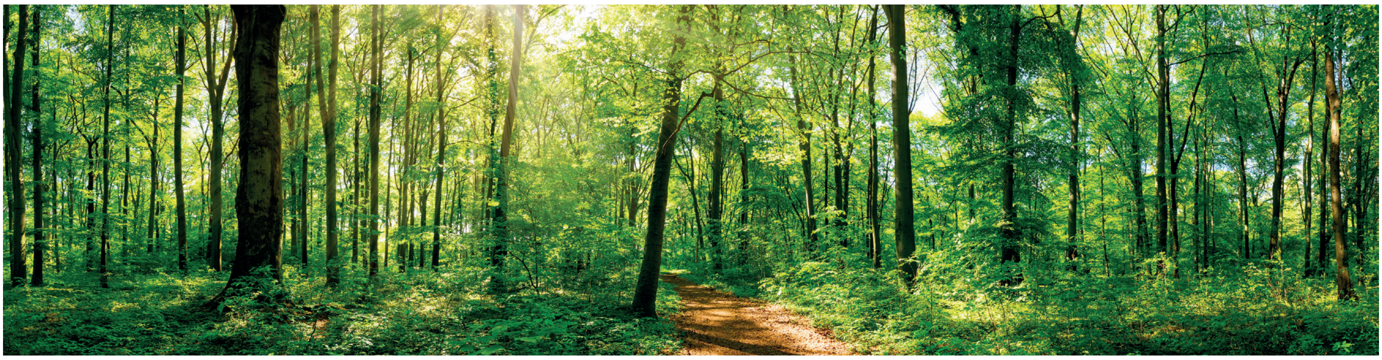
Instant Insights

Green bonds

Issue 11 | Second quarter 2021



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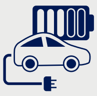
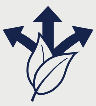
Idea in brief: green bonds

Growth in green bond issuance
Cumulative green bonds issuance reached $1trn in 2020, supported by a growing willingness to combat climate change among investors.[1]

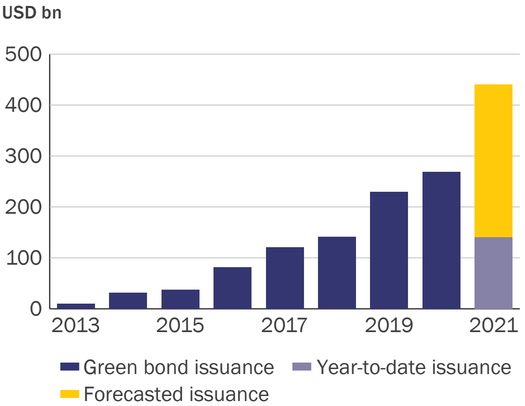


Many sectors turn to green bonds
Auto makers have recently joined the green bonds market as yet another element in the transition towards cleaner mobility and electric vehicles.



Considerations when investing
In order to implement green bonds in portfolios, a dedicated active manager can apply their expertise in a market that is quickly evolving to identify the most attractive opportunities.

Figure 1: Green bond issuance per year



Source: Bloomberg Intelligence, Rothschild & Co.

Bonds are greener on the other side?

Financial markets are forward looking. When, as investors, we put money to work in a company (investing, for instance, its stock), we do so by looking at the future, expecting profits of tomorrow to outsize those of today. Yet, we often have little (or no) influence as to how companies will achieve this. For investors seeking a more informed approach, green bonds allow investors to have a say on how firms work towards a more sustainable future, as green bonds seek to finance initiatives with environmental purposes.

The World Bank anecdotally explains on its webpage how, in 2007, the first green bond was issued when it helped a group of Swedish pension funds to find projects which benefit the environment. The Nordics had read how, that year, the Intergovernmental Panel for Climate Change, published one of the first reports that linked global warming to human activities and wanted to act on it. That event marked the birth of a new financial asset that would soon attract global attention and grow to a $1trn market by 2020.[1]

Uncovering green bonds

The International Capital Markets Association (ICMA) define green bonds as any type of bond where the proceeds will be exclusively applied to (re)finance eligible green projects – those with environmental benefits. Sometimes, green bonds are included in the category of sustainability bonds in which social bonds (seeking social impact) are also embedded. The impact of green bonds comes from the use of the proceeds of the issuance; those can include projects of renewable energies, pollution control, waste management or biodiversity conservation, among others. In order to foster transparency, disclosure and reporting

[1] Climate bonds initiative, 2020, $1 trillion mark reached in Global Cumulative Green Issuance: Climate Bonds Data Intelligence Reports: Latest Figures

in those projects, the ICMA developed in 2018 the Green Bond Principles, to which market participants can adhere.

Structural tailwinds set to help the market

Under the Paris Agreement, adopted at the 21st Conference of the Parties (COP21) in December 2015, signatory countries pledged to pursue efforts to limit temperature increases to 1.5°C above pre-industrial levels. The climate accord has recently attracted attention with US President Biden's announcement to re-join the Paris Agreement, setting out cooperation while working towards achieving net zero emissions by 2050 (an ambitious goal for the world's second largest polluter).[2] These developments look set to increase green bond issuances in the US.

Europe paving the way by issuance volume

Europe ranks first for green bond issuances. In 2020, the European Commission pledged a total of €1.8trn to help rebuild a post-COVID-19 Europe,[3] of which a third is expected to translate into the European Climate Law, made from climate-related targets and projects. Green bonds could constitute a valid financing solution to fund those projects. The US and China are ranked second and third by issuance (although a large part of China's issuance is in CNY with little accessibility to international investors).

The Climate Bond Initiative outlines how, out of the approximately $1trn cumulative notional issued to date, these three economies were responsible for around $770bn.[1] However, not only governments issue green bonds. Supranational entities such as the European Investment Bank and Spanish ICO are two such examples, as well as corporations.

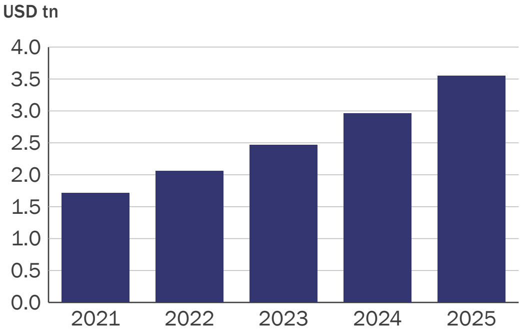
In terms of the latter, the automotive sector has recently been in the spotlight, as companies also turn to green bonds as means to transition towards a cleaner industry, with less reliance on gasoline engines and greater presence of electric vehicles. This new trend has a dual effect, as firms source financing with a sustainability element while environmentally aware clients diversify from green bonds which otherwise tend to be in utility, financial and real estate sectors.

The power of 'greenium'

Greener government policies and louder investor engagement have made it increasingly difficult for investors to fulfil their objectives in terms of allocations. In fact, the Climate Bond Initiative highlights how 70% of the euro-denominated green bonds in the second half of 2020 achieved a larger oversubscription than their regular (vanilla) equivalent. That can translate in what is known as the green premium or "greenium": greater investor interest allows the issuer to reward bondholders with a lower yield. In the second half of 2020, 26 out of 33 new bonds showed a greenium,[1] meaning investors expressed a willingness to receive slightly less yield in exchange for the opportunity to invest in a sustainable project.

In a market that is quickly evolving, active managers can apply their expertise to unlock value by reviewing the palette of issuers, perform in-depth company analysis, and identify the most attractive opportunities available to investors.

Figure 2: Forecasted total cumulative green debt issuance



Source: Bloomberg Intelligence, BI ESG Market Outlook: Assets Under Management, published on 15/12/2020

How to invest in green bonds

Being a fairly nascent subset of the fixed income market and as the number of strategies grow, utilising a rigorous selection process for investing in green bonds is of great importance.

With our **Investment & Portfolio Advisory** team at Rothschild & Co Wealth Management, we can advise on the most appropriate ways of gaining access to green bonds.

[1] Climate bonds initiative, 2020, $1 trillion mark reached in Global Cumulative Green Issuance: Climate Bonds Data Intelligence Reports: Latest Figures

[2] EDGAR, Fossil CO2 and GHG emissions of all world countries, 2019 report

[3] The European Commission, Recovery plan for Europe, December 2020