

ADVANCEMENTSⁱⁿ Fixed-Income ESG Investing



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The first thing many investors think about when considering environmental, social and governance investing is screening out specific stocks from a portfolio. Indeed, as ESG investing becomes more popular, it's most often discussed in context of equities. That, however, is only half the story.

"The industry is at the stage where equity is more evolved because there's increasingly more quantitative data around ESG factors," explained Vishal Khanduja, portfolio manager for diversified fixed income at Calvert Research and Management.

"But fixed income is right behind it."

Pointing out that Calvert began as a fixed-income money manager, Khanduja said the firm's analysts do not differentiate their ESG analysis for equities or corporate fixed-income investments. For Khanduja, the key is taking the ESG rating and determining what that means from a fundamental perspective.

"We have created ESG models for every sector across capital markets – 200 models – and determined what is really material for companies in terms of environmental, social and governance risks," he said. "The end goal is how we rate and rank compa-

nies within a sector based on ESG scores.

"Through all this rating and ranking, we're trying to find information on nonfinancial factors like ESG to tell us something about the long-term sustainability of balance sheets or income statements."

While ESG risks are the same for equity and fixed-income investors, Khanduja said that in Calvert's experience, companies that better manage higher levels of environmental risk, for example, have stronger balance sheets over the long term, a key factor in his investment analysis. Here is where deeper analysis comes into play.

"Duration, which is a big determinant of total return, is a factor," he said. "As you try to move toward highly rated ESG companies, yes, the balance sheet will be stronger and more stable, but what kind of duration risk are you capturing if you focus on double-A, single-A and highly rated ESG companies? You can't just go with the most highly rated companies."

One key component of Calvert's investment process is to customize the analysis for each client.

"Investors have different goals and opinions with ESG," he said. "We created a customizable process because we want to cater to the goals of our investors," who have become much more involved and engaged over the last six months.

"Education and information have increased exponentially," he said, "but there's still a lot of work to be done to get the right information to the right clients."

Part of that development involves impact reporting, which Calvert has been working on. "More clients are saying, 'Show me impact reporting,'" he said. "Performance attribution is key but impact is important too. How do we align value and performance?"

For Khanduja, the way to do that is to make sure ESG analysts and fundamental analysts work together. "On a day-to-day basis, we have our fundamental analysts talking with our ESG analysts to be sure that the bottom-up securities we select recognize the ESG score," he said.

"As a fixed-income portfolio manager, I'm trying to provide stable income back to our investors from their fixed-income allocation," Khanduja explained. "So it becomes more important to look at those ESG factors because if there are certain longer-term risks in a company – even if it scores adequately on ESG and comes into my investible universe – I want to talk to the ESG analyst. I am investing in a 30-year maturity bond in that company, and I want to be cognizant of those risks that I'm taking on within the portfolio." ■

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At Calvert, integrating financially material ESG factors into our rigorous credit analysis – at the sector and security level – strengthens our ability to identify investment risks and opportunities that may be missed by those who ignore ESG.

Calvert offers a broad range of ESG-integrated fixed income capabilities including:

Calvert Ultra-Short/Short Duration Income

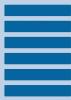
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