Issue three hundred and seventy-seven

Sustainable Indices

Many column inches have been written over the last couple of years relating to sustainability and investments. Many arguments – on both sides of the fence - have been put forward with regards to how it should be measured and the taxonomy surrounding this incredibly important topic and yet here we are, years later and still no agreement. In reality, it isn't as if this approach to investing is new – there have been unit trusts specialising in this space going back many decades.

We have long argued that there is not, and will not be, a one-size-fits-all approach to sustainability. The fact that there isn't a simple adopted measure really provides lots of scope for wiggling out and for greenwashing to occur. Even the broad "ESG" moniker doesn't really work as a catch all as stocks can be (and are) included in portfolios and index because they pass one measure of ESG and fail miserably on the other two for instance.

Huge strides are being made in this arena, and the recent introduction of the Sustainable Finance Disclosure Regulation (SFDR) which is a part of the EU's Sustainable Finance Action Plan really has made fund managers raise their game as they now have to show increased transparency relating to sustainability and the associated impacts and risks thereof. I look forward to the UK adopting a similar measure too in the none too distant future.

I recently read an article suggesting the FTSE4Good indices have undergone some major changes to their screening criteria which could see more than one tenth of the index constituents potentially being expelled from it. Considering the FSTE4Good All World Index contains more than 1,500 stocks, and just over 200 companies are at risk really shows the far, and wide-reaching changes. FTSE4Good indices were launched in 2001. They are celebrating their 20th Anniversary. ESG investing is not new, but it is becoming more engrained into the investment psyche. Is it time to drop the traditional index and start comparing to more environmentally friendly indices instead?

But, with all this change, are the indices themselves "sustainable"? As an investor, do you know what you are getting into should you want to invest along the lines of the FTSE4Good Indices? With the potential of so much change occurring, could this create more risk and greater volatility for the end investor as well as the exiting company that might see a run on its share price which could cause problems further down the line? When will the next major shake-up be? As this is still a burgeoning approach to portfolio management maybe the risk is too high to create a portfolio that closely tracks an index that could potentially undergo massive change?

For a company to meet the acceptability criteria for inclusion in the FTSE4Good All World Index, they first must be a component of the FTSE All World Index (of which there are over 4,000 companies that meet this requirement) but then they have to pass a number of environmental, social and governance requirements to be included in the more specialist index. Comparing the two indices for performance and volatility has them delivering similar numbers, but comparing their characteristics is not the point of this piece.

I don't know how much money is invested in strategies that mimic (either directly or indirectly) the FTSE4Good indices, or how important it is for management of these businesses to want to be in the FTSE4Good indices either, but for more than 200 companies to be potentially excluded is definitely a warning shot. With more money being invested in this space and the spotlight shining very brightly at the moment on all things ESG, it makes sense that corporate management pay attention. It is fairly safe to say there is more money tracking ESG indices than last year, which was more than the year before, which was more than the year before, but less than there will be "tomorrow".

The 200+ stocks that are under fear of expulsion are due to the introduction of minimum scores for climate performance standards which look at all stocks and cover 14 themes and over 300 indicators.

Ultimately, I'm very pleased that the Index provider is making these changes and raising the bar when it comes to inclusion of this index. I expect there to be more changes as time progresses and I expect further slicing and dicing and specialist sub-indices to be created over time. I'm really glad that the data is being collected and used as a measure to force corporations to want to create a cleaner planet, to reduce carbon emissions, to be accountable to the earth as well as the finance professionals. It will drive improvements for all to see. I expect to see the index morph as well over time, not just the constituents. It takes a brave stance to make such a significant change, but I can guarantee this decision hasn't been taken lightly and at the end of the day until we have the agreed taxonomy and clarity of approach surrounding this subject, I believe the index will continue to change over time.

There is a saying associated with doing things for the common good of the planet: The best time to do something was 20 years ago; the next best time is now. As ESG investing gathers momentum, assets under management, an increased regulatory scrutiny and greater recognition this is a great time for the index providers to turn the screw as well. Arne Staal, CEO of FTSE Russell, the company that has created the index said the following "Over the next 12 months, we will work closely with constituents at risk of deletion to ensure they understand what is required to retain index membership" and this should once again hit home the importance of the impact a corporation has on the planet, not just the economy.

Market Snapshot (02.07.21 – 09.07.21)

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FTSE 100	7121.88	↓0.02%	UK	0.64	↓11.11%	£/$	1.3900	↑0.58%	Brent Crude	$75.58	↓0.51%
S&P 500	4369.55	↑0.40%	US	1.33	↓6.99%	£/€	1.1700	↑0.43%	Gold	$1809.40	↑1.24%
NIKKEI 225	27940.42	↓2.93%	Germany	-0.29	↓21.41%	€/$	1.1870	↑0.08%			
DAX 30	15687.93	↑0.24%	Japan	0.03	↓25.00%	£/¥	153.1300	↓0.25%			
CAC 40	6529.42	↓0.36%									

Figures quoted are in local currency.
Source: FE Analytics & Financial Times

Week Ahead

Monday –
Tuesday – US: Core CPI (MoM) (Jun)
Wednesday – China: GDP (YoY) (Q2)
Thursday – UK: Average Earnings Index + Bonus (May)
Friday – Euro Area: CPI (YoY) (June)

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