FIXED INCOME

# How the Search For Yield is Going Green

May 22, 2019

David Zahn, CFA, FRM
Head of European Fixed Income,
Senior Vice President,
Franklin Templeton Fixed Income Group

Investors are considering a growing range of methods to try to eke out yield in this resolutely low interest-rate environment. As David Zahn, our Head of European Fixed Income notes, fixed maturity (or so-called buy and hold) funds have proven a popular choice for some. And with environmental, social and governance (ESG) considerations high on the agenda, Zahn argues that investors should not have to sacrifice their green credentials in the search for yield.

Even in today's environment of stubbornly low interest-rates across most parts of the world, for many investors, achieving attractive yield is not the sole consideration. A growing number of investors are focusing on the environmental, social and governance (ESG) characteristics of the assets they hold.

We don't think fixed income investors should have to choose between their ESG convictions and their appetite for yield.

As investment managers, we think it's crucial that we look at how the companies in our portfolios address these topics within their own activities.

In our eyes, the two areas that people care about the most—and which are the easiest to measure—are carbon dioxide (CO2) emissions and water usage.

We want to give our clients the opportunity to support and invest in companies that are trying to progress on CO2 emissions and water usage.

For example, we look for evidence of what bond issuers in our portfolios are doing to manage and reduce CO2 emissions and what are they doing to reduce their use and waste of water.

We aim to build an engagement strategy to help drive additional improvements, as we believe that dialogue and partnership can help these businesses move further forward than they'd be able to on their own.

## Availability of Data

There is little consistency in the way companies report their ESG exposures, or in the data they use. This is one of the biggest challenges for investors.

We think companies need to be clearer about sharing their strategic planning on these topics with stakeholders, including shareholders and bondholders.

### INVESTORS TURN TO FIXED MATURITY IN THE SEARCH FOR YIELD

Interest rates remain stubbornly low across the world, presenting challenges for investors seeking yield.

In the eurozone, we don't now expect an interest-rate rise until at least 2022. And in the United States, some commentators believe interest rates could fall before they rise again.

We're hoping that by engaging with companies whose assets we own, we can drive this up the corporate agenda. In our view, the more that investors and asset managers ask for these disclosures, the more companies will need to focus on delivering data in a consistent and effective way.

As we noted back in February, this challenging environment has prompted a resurgence of interest in so-called "buy and hold," or fixed maturity investment strategies.

These strategies offer a pre-determined yield over a fixed period (for example, five years), effectively locking-in the most attractive returns.

In the current environment, a fixed maturity investment can reduce exposure to duration risk—in other words, exposure to changing interest rates.

An investor holding bonds that mature in line with his or her investment horizon likely will not care what happens to interest rates in the meantime, as long as they are being paid their coupon.

## The Role of Fixed Income Investing

Traditionally, shareholders have been at the forefront of engagement with companies, but increasingly, bondholders are playing a role in driving ESG engagement.

The advantage that fixed income investors have in this regard is that companies normally only issue equity once, whereas many have to issue debt on a regular basis. So bond issuers are becoming more familiar with investors asking these kinds of questions. Corporates realise bondholders are likely to be repeat investors and they have to address their concerns.

Through better engagement, we'd hope to see better disclosure which in turn should offer more transparency on the progress that's being made across the gamut of ESG themes.

*The comments, opinions and analyses expressed herein are for informational purposes only and should not be considered individual investment advice or recommendations to invest in any security or to adopt any investment strategy. Because market and economic conditions are subject to rapid change, comments, opinions and analyses are rendered as of the date of the posting and may change without notice. The material is not intended as a complete analysis of every material fact regarding any country, region, market, industry, investment or strategy.*

*Data from third-party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments, opinions and analyses in the material is at the sole discretion of the user. Products, services and information may not be available in all jurisdictions and are offered by FTI affiliates and/or their distributors as local laws and regulations permit. Please consult your own professional adviser for further information on availability of products and services in your jurisdiction.*

*CFA® and Chartered Financial Analyst® are trademarks owned by CFA Institute.*

To get insights from Franklin Templeton delivered to your inbox, subscribe to the Beyond Bulls & Bears blog.

For timely investing tidbits, follow us on Twitter @FTI_Global and on LinkedIn.

## What Are the Risks?

**All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested.** Bond prices generally move in the opposite direction of interest rates. Thus, as prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline. Investments in lower-rated bonds include higher risk of default and loss of principal. Investments in foreign securities involve special risks including currency fluctuations, economic instability and political developments.