The long-term Turtle and the short-term Hare

Having it all

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Financial markets are facing their greatest crisis since the Great Recession of 2008-2009. At that time, Environmental, Social, and Governance (ESG) was a specialty investment; today it is a mainstream approach, with ESG worldwide assets under management of least three[1] times what they were ten years ago. The first serious, global test for ESG strategies is arguably the double whammy of Covid-19 and the oil price war.

If April 2020 is 'only the end of the beginning', what can we observe so far from this crisis?

First and foremost, on an aggregate basis, ESG-focused strategies have outperformed non-ESG strategies[2]. Research by Bank of America as of 25 March showed that since the peak of the S&P© 500 in February, stocks in the top quintile by ESG ranks outperformed the market by over 5%. Even adjusting for size and sector performance, highly-ranked ESG stocks outperformed the S&P 500 by 3-4%"[3],[4].

Before anyone says it – twelve weeks is not the long term. However we believe that what we have seen with our own ESG investment strategies, both prior to and during this crisis so far, is no coincidence.

At Candriam we have advocated for more than two decades that integrating ESG considerations within securities analysis and portfolio construction represents an essential dimension of risk assessment, in particular for so-called fat tail risks.

Along this journey, we have developed a range of investment strategies, all sharing the same ESG analytical framework that helps us spot the companies best-positioned from an operational and business model standpoint. Since the onset of the crisis, our ESG strategies have delivered consistent risk-adjusted outperformance compared to their respective reference indices[5] and their respective peer groups.

1. http://www.gsia-alliance.org
2. https://www.morningstar.fr/fr/news/200524/les-fonds-esg-prot%c3%a8gent-mieux-dans-les-phases-de-krach.aspx
3. Bank of America Global Research, ESG matters – Global. Bull market phenomenon? Quite the contrary, March 25th 2020.
4. It is important to note here that this ESG group includes strategies that widely differ from one another, ranging from pure exclusion ones (controversial weapons, tobacco, etc) to highly active integration of ESG factors based on their materiality. Therefore it is likely that a lot of variation can be found between ESG blends in terms of performance.

Figure 1:

ESG strategy performance in Bull and Bear markets

For this illustration, we consider the three years ended March 2020 as a bull market, and the three months ended March 2020 as a bear market.

Gross performances. Data as of 31 March, 2020. Indeces shown as reference only; strategies do not replicate[5].

Candriam ESG Strategies	1 Month	YTD	6 Months	1 Year	3 Years	5 Years	AUM (millions)	Base Currency
ESG Equity								
Emerging Markets	-14.80	-18.01	-11.43	-7.90	3.97	9.82		
MSCI© Emerging Markets NR	-15.31	-21.84	-15.10	-15.77	-7.19	-3.90	522.1	EUR
Excess Return	***0.51***	***3.83***	***3.68***	***7.86***	***11.16***	***13.72***		
Europe	-12.19	-19.59	-13.30	-6.33	4.05			
MSCI© Europe NR	-14.35	-22.59	-18.17	-13.53	-9.21		590.1	EUR
Excess Return	***2.16***	***3.00***	***4.87***	***7.20***	***13.26***			
ESG Fixed Income								
Emerging Markets	-10.79	-9.59	-7.35	-1.22	7.17			
JPM© EMBI Global Diversified	-13.85	-13.38	-11.81	-6.84	1.27		1.042.9	USD
Excess Return	**3.06**	**3.79**	**4.46**	**5.62**	**5.90**			
Global Agregate	-0.60	4.27	1.36	8.99	12.47	13.37		
Citi© WBIG Ex-MBS &-JPY	-2.27	2.11	-0.27	7.19	9.88	10.71	10.3	EUR
Excess Return	***1.66***	***2.16***	***1.63***	***1.80***	***2.59***	***2.65***		
Global High Yield	-5.01	-5.65	-4.28	-0.28	NA**			
ML© Global HY BB-B 2% Constr Non-Fin Hedged EUR	-12.06	-13.34	-11.57	-9.33	-1.99		461	EUR
Excess Return	***7.05***	***7.69***	***7.29***	***9.05***	***NA*****			
ESG Asset allocation								
Global Balanced	-7.46	-9.90	-6.82	-2.56	2.81	4.89		
Balanced Index*	-8.01	-11.18	-8.98	-4.85	1.12	3.91	628.3	EUR
Excess Return	***0.55***	***1.28***	***2.16***	***2.29***	***1.69***	***0.98***		

* 20% MSCI© Europe (NR), 20% MSCI© US (NR), 2.5% MSCI© Japan (NR), 7.5% MSCI© Emerging Markets (NR), 50% BC© Euro Aggregate 1-10Y
** Less than three years. Strategy launched 29 Sep 2017.

Warning: Past performances of a given financial instrument or index or investment strategy or an investment service, or simulations of past performances, or forecasts of future performances are not reliable indicators of future performances. Gross performances may be impacted by commissions, fees and other expenses. Performances expressed in a currency other than that of the investor's country of residence are subject to exchange rate fluctuations, with a negative or positive impact on gains. If the present document refers to a specific tax treatment, such information depends on the individual situation of each investor and may change.

So why do we believe ESG is causal for performance, not just correlated? We offer five reasons.

5. Candriam ESG strategies do not replicate or aim to outperform any reference index. The reference indices are used for informational/ comparison purposes only.

N ° 1

Global warming is the economic issue of our time

Climate change is the key megatrend in our ESG analytical framework, and indeed in our overall investment framework. This has led us to underweight oil and gas and focus on the most resilient power generation companies, namely those with the most advanced strategies to achieve the Paris Agreement 2 degrees target. It is not as simple as "oil or no oil". For example, we have not stopped investing in natural gas, a lower-emitting fossil energy that is only partly correlated with oil prices, and where delivery contracts are usually negotiated for several years with fixed prices. Hence the spot price is not very meaningful over the short to medium term for natural gas producers Climate change is the key megatrend in our ESG analytical framework, and indeed in our overall investment framework. This has led us to underweight oil and gas and focus on the most resilient power generation companies, namely those with the most advanced strategies to achieve the Paris Agreement 2 degrees target. It is not as simple as "oil or no oil". For example, we have not stopped investing in natural gas, a lower-emitting fossil energy that is only partly correlated with oil prices, and where delivery contracts are usually negotiated for several years with fixed prices. Hence the spot price is not very meaningful over the short to medium term for natural gas producers

Candriam's response:
All Candriam ESG funds incorporate our climate strategy, aligning their investment positions with a fair energy transition. Some funds simply exclude the worst fossil energy sources, whilst others foster the most efficient fossil energy sources whilst actively supporting renewables. We prefer optimization to exclusion.

N ° 2

Alignment with big sustainability challenges helps

Besides climate change, our framework includes four other sustainability trends. This has led us to seek out those companies that deliver solutions in health, in digital technologies, or in the development of a more circular economy. These companies have shown themselves to be more resilient in the recent sharp downturn, with investors apparently concluding that they are better-positioned to gain market share and emerge stronger from this crisis.

Candriam's response:
Our investment strategies are positioned in health care, to invest in companies at the forefront of the fight against viral diseases; in digital technology, towards microchips, video conferencing, and smart power grids; and in in infrastructure, which we believe stands to benefit from economic recovery programs, such as the one mooted by Chinese authorities.

N ° 3

Treat your people and suppliers with dignity

Beyond the trends, we also analyse issuers on a much more granular level. The 2020 crisis is a litmus test for human capital and supply chain management. Some will fail. Two of the six stakeholder categories that we systematically analyse are precisely those designed to determine which will prosper, and which will not. Through human capital management, companies have the ability to develop long-term bonds with the staff, and put in place business continuity processes so that when disaster strikes, like today, their operations can continue. Human capital management is proving a key differentiator in some sectors, such as food retailing, healthcare and consumer goods. Supply chains have also been severely tested by the widespread disruptions. Here the ability to maintain supplies, and to support suppliers if required, will prove essential if companies operating in highly integrated industries are to resume production promptly as we recover. The more stretched the supply chains, the higher the risk for suppliers to go out of business, disrupting operations further.

Candriam's response:
Through our use of stakeholder management analysis, our investments are tilted towards companies with more holistic long-term human capital strategies. Also in the short term, these companies have been better-positioned coming into this unexpected crisis. With investors favouring less aggressive company management from a human capital and supplier management perspective, this has helped our strategies cushion the recent market shock.

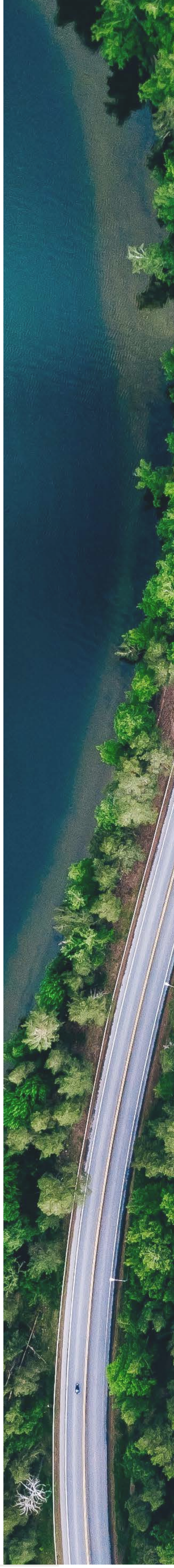
N ° 4

The two sides of alpha

ESG investing is all about assessing all parts of a company to reduce risks and discover opportunities, leading to better risk-adjusted investment profiles, and in doing so, delivering long-term alpha[6]. The current crisis highlights both the significant dispersion among companies in terms of ESG quality, and impact of ESG quality on their operational resilience and financial performance. In particular, ESG-related analysis is providing early indicators of drawdown risk in this crisis, as evidenced in the three elements above. Avoiding the most pronounced drawdowns brought by this crisis, or any other volatile market, can deliver relative outperformance. Hence the two sides of alpha: as a driver to overall performance, but also, as a risk assessment tool that is enabling our clients deal better with the volatile market conditions.

Candriam's response:

Our sustainable assets under management have grown to over €40 billion as of the end of 2019. One key to our growth has been our dedication to integrating ESG in previously little-covered asset classes, such as high yield bonds or emerging market debt. In these typically volatile asset classes, the focus on sustainability has been one of our drivers of alpha generation.



6. In a review of more than 200 academic studies, more than 90% of the academic work showed that sound sustainability standards lower the cost of capital, while 88% of the research showed that solid ESG practices resulted in better operational performance. 'From the Stockholder to the Stakeholder', University of Oxford and Arabesque Partners, March 2015..

N ° 5

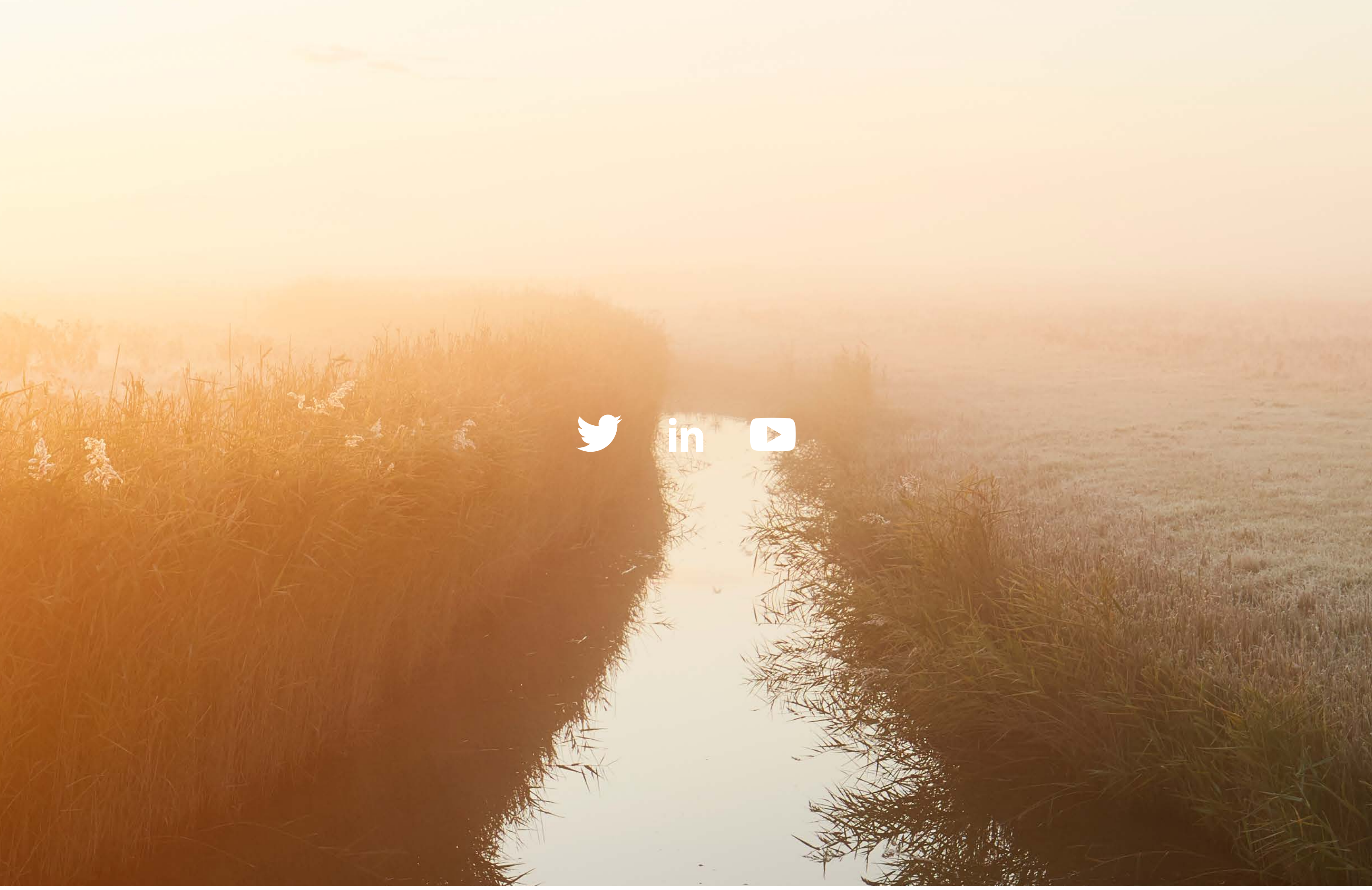
Likely rebalancing towards S & G

Beyond the crisis, we expect investors to take a closer look at the Social and Governance dimensions. This crisis has made clear the positive correlation between working conditions and corporate performance. It has also provided the opportunity for great corporate leadership to stand out, through resilient employment policies or sensitive top management remuneration through the crisis. For many investors who looked at ESG mainly through the lens of climate change, the realization that ESG can deliver value across all three dimensions could have significant consequences for the way ESG factors are integrated in the future. Regulators, also prone to focus on the environmental aspects (e.g. through green activities taxonomy or climate risk disclosure requirements), might also reconsider this focus and adopt a more balanced view of the respective merits of E, S, and G

Candriam's response:

The ESG materiality framework long in place at Candriam treats E, S, and G factors based on the extent to which they relate to corporate value generation within each sector. Employee health risks for a manufacturing company differ, for example, from those at a services company. Which factors we emphasize when assessing ESG quality depends very much on company-activity-specific sustainability challenges and opportunities. In doing so our active stakeholder management, engaging with companies and fostering better practices, complements our ESG research and provides some valuable inputs into corporate best practices.

Our ESG strategies had already shown their ability to deliver alpha thanks to their outperformance in the strong markets of recent years (figure 1). We are now in an environment to track their ability to mitigate drawdown, on a relative basis. Looking ahead, we expect this systematic integration of ESG as an alpha generator to become more significant. The current human and financial crisis demonstrates that systemic risks arising from environmental or social dimensions are not put on pause during a market crash. They continue to matter, even more.



€130 B

AUM
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550+

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25 years

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