

ESG Fixed Income: Growing Steadily and Entering the ETF Space

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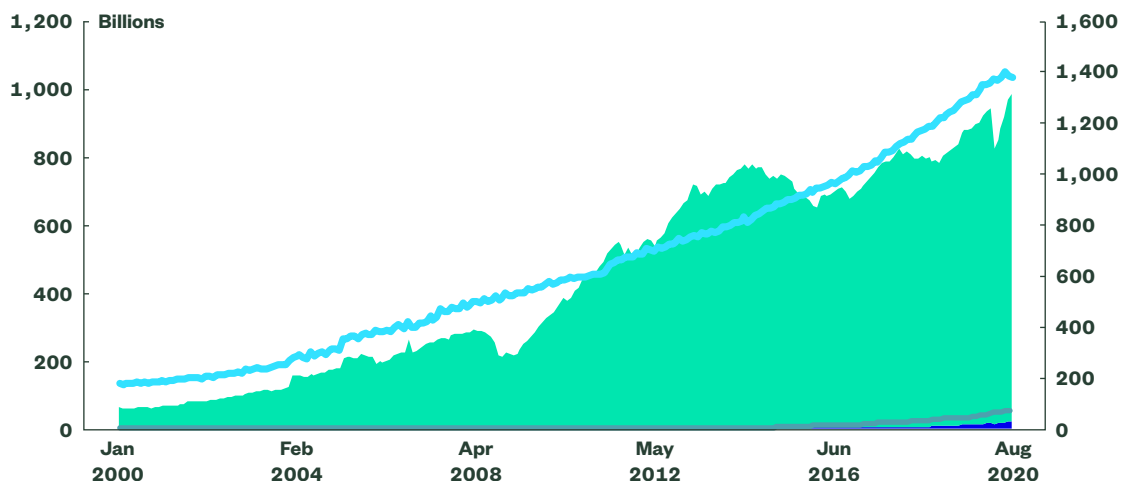
- For 20 years there has been a clear increase in demand for ESG fixed income, with the trend accelerating after the Global Financial Crisis.
- While investors have been slow to use ETFs as a vehicle for these strategies, preferring mutual funds, there has recently been clear uptick in adoption.

Many have associated the growth in ESG investing with equity strategies, while a less talked about area of the responsible investing landscape is within the fixed income space. Despite the lack of attention, fixed income ESG strategies have grown in popularity and there are now nearly 1,500 funds offered globally, with just shy of \$1 trillion of assets invested.

Although most of these assets have been invested within active mutual funds over the past three years, there has been a meaningful uptick in both the number of ESG fixed income ETFs and also the adoption of these investment vehicles by investors. In 2019 alone we saw \$5.6 billion flow into ESG fixed income ETFs, more than five times the previous record year, and 2020 has already surpassed that figure.

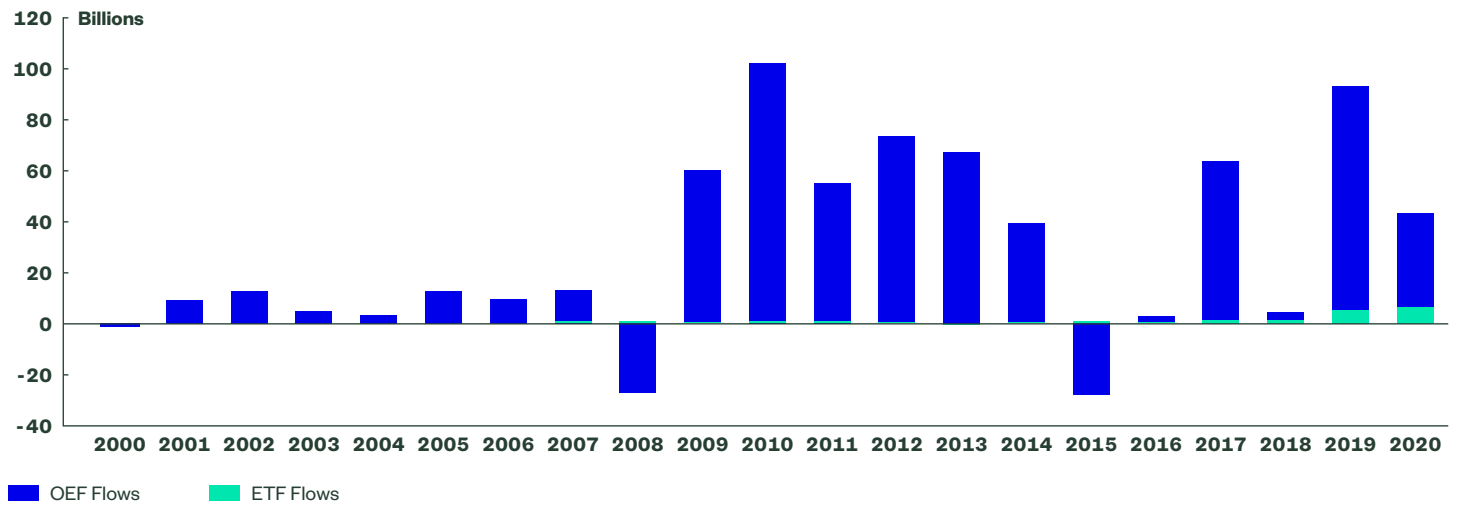
Figure 1
**ETF vs. Open-End
Fund Market Growth**

■ ETF AUM
■ OEF AUM
■ Number of ETFs
■ Number of OEFs



Source: Morningstar Direct, as of 31 August 2020. All figures expressed in USD billions. The above chart refers specifically to the ESG fixed income universe.

Figure 2
**ETF vs. Open-End
Fund Calendar
Year Flows**



Source: Morningstar Direct, as of 31 August 2020. All figures expressed in USD billions. The above chart refers specifically to the ESG fixed income universe.

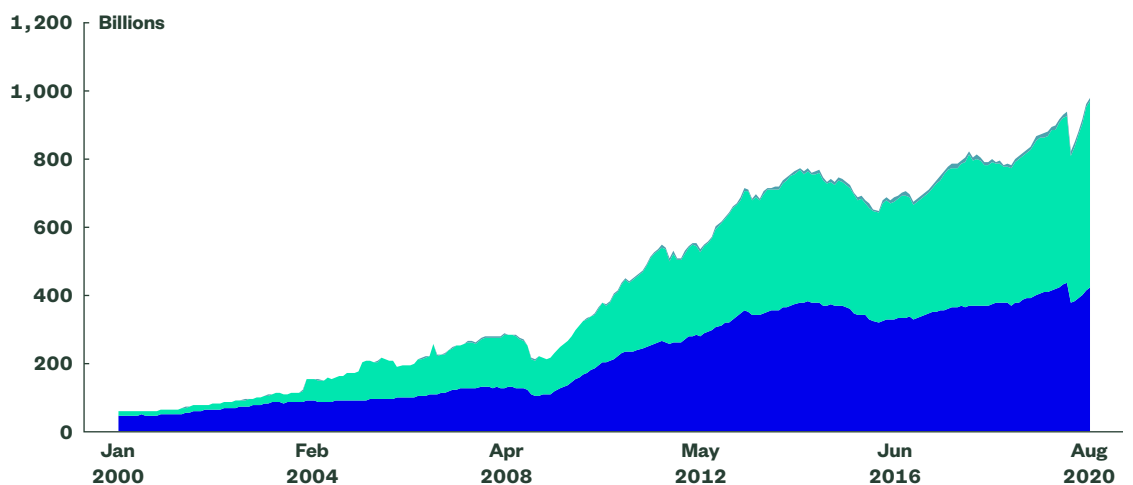
At the start of this century, US investors were clearly the front-runners in terms of ESG adoption within fixed income, with the vast majority of the assets accounted for by US-domiciled funds. However, after the Global Financial Crisis, European investors began to adopt ESG fixed income strategies at a far quicker rate.

In fact, since 2015, the European market has seen stronger growth than the US, and is now more than \$100 billion larger, with European assets accounting for \$545 billion versus \$424 billion in the US. APAC, on the other hand, has lagged behind, with assets invested in these strategies accounting for only \$12 billion there.

More recently, while European investors have continued to invest into ESG fixed income strategies, US investors have begun to see demand wane in the last few years. This trend has been particularly strong since 2019, when Europe set new records for largest net inflows while US-domiciled funds have seen much weaker flows compared to the early 2010s.

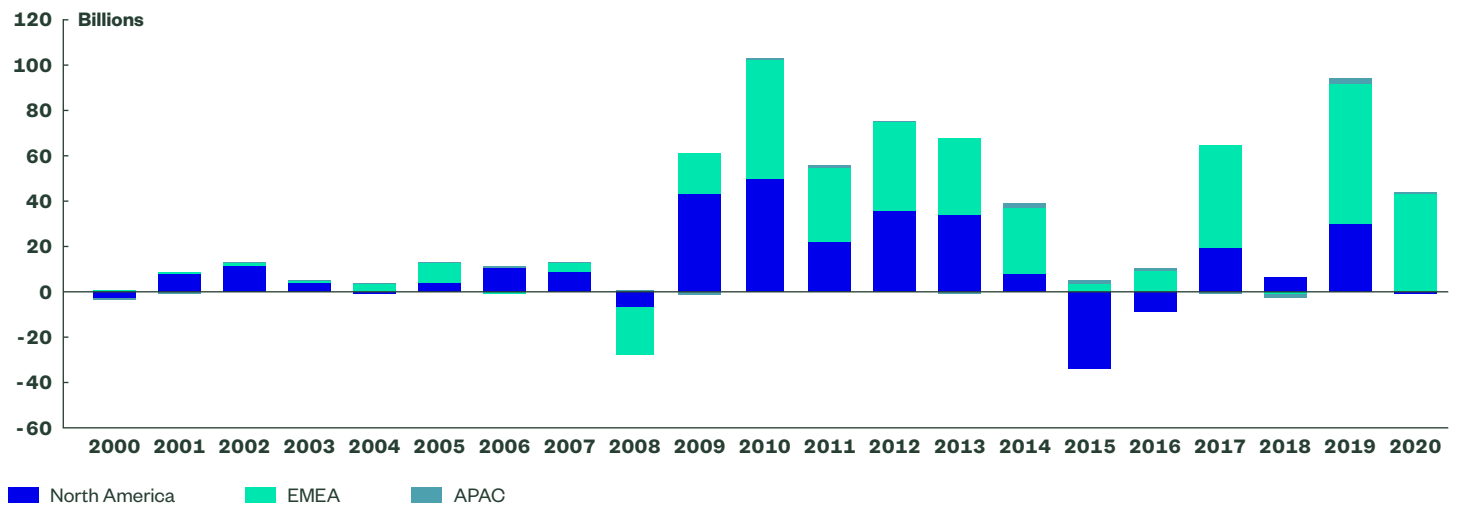
Figure 3
**Market Growth Split
by Domicile of Assets**

■ US
■ EMEA
■ APAC



Source: Morningstar Direct, as of 31 August 2020. All figures expressed in USD billions. The above chart refers specifically to the ESG fixed income universe.

Figure 4
Calendar Year Flows
by Domicile



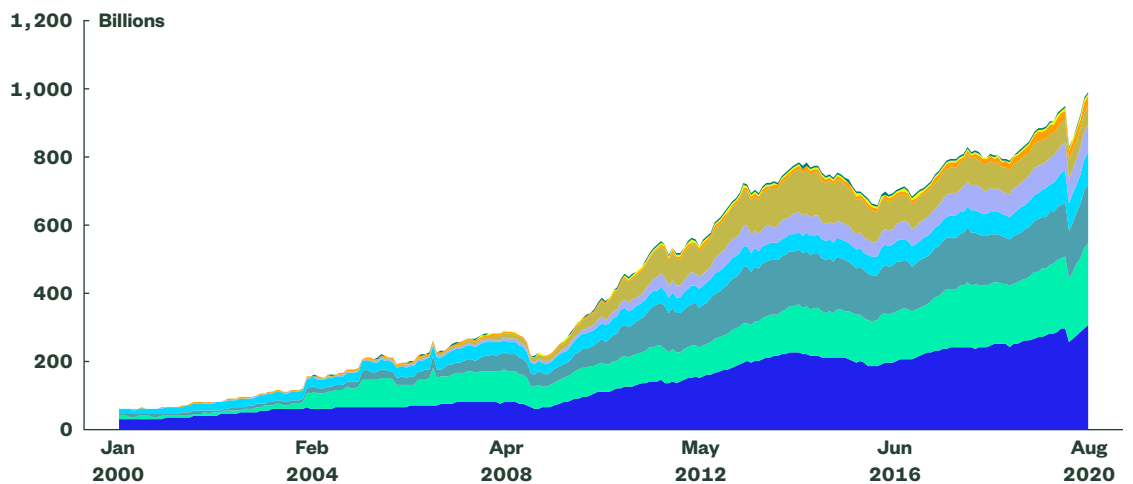
Source: Morningstar Direct, as of 31 August 2020. All figures expressed in USD billions. The above chart refers specifically to the ESG fixed income universe.

Although European-domiciled assets now make up the majority of the universe, most strategies still focus on the US fixed income market. European and globally focused strategies are beginning to catch up, but US strategies continue to see strong net inflows.

Since 2010, emerging market strategies have also seen explosive growth, going from less than \$10 billion at the start of the decade to well over \$80 billion now, far outpacing the growth rate of developed market strategies. Flows into Asia, Australia and New Zealand strategies, on the other hand, have remained fairly weak, as interest from investors in these regions has not helped to prop up growth there.

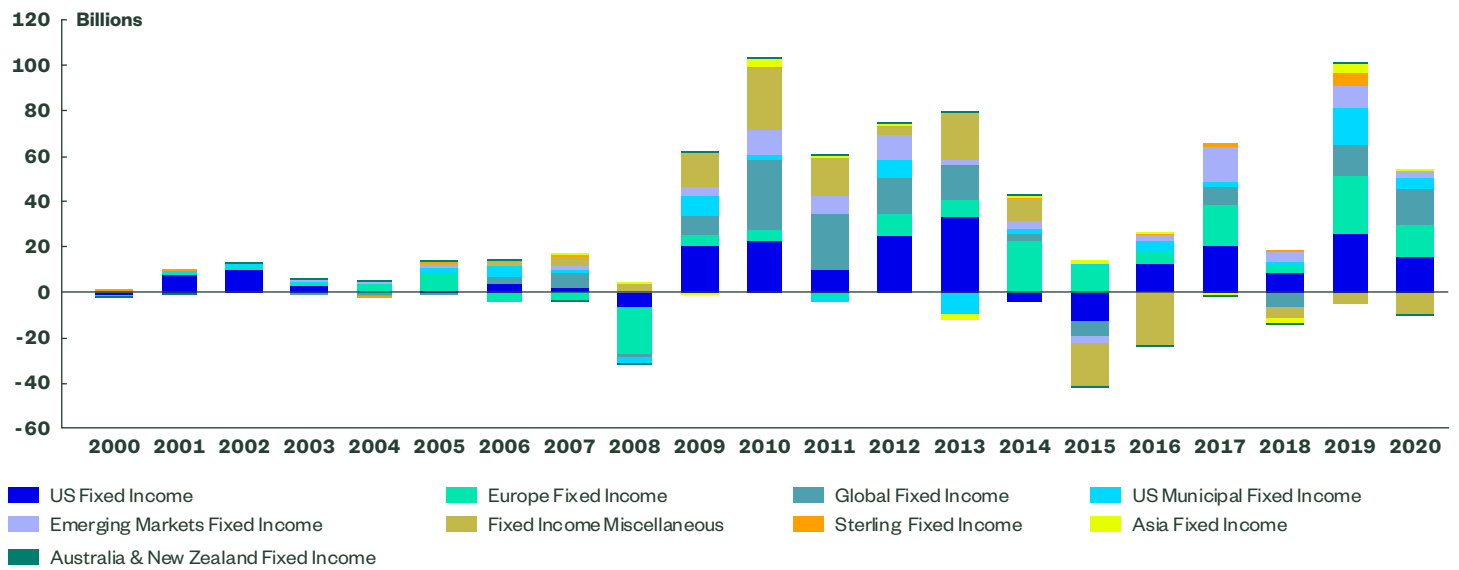
Figure 5
Market Growth Split
by Category

- US Fixed Income
- Europe Fixed Income
- Global Fixed Income
- US Municipal Fixed Income
- Emerging Markets Fixed Income
- Fixed Income Miscellaneous
- Sterling Fixed Income
- Asia Fixed Income
- Australia & New Zealand Fixed Income



Source: Morningstar Direct, as of 31 August 2020. All figures expressed in USD billions. The above chart refers specifically to the ESG fixed income universe.

Figure 6
Calendar Year Flows
Split by Category



Source: Morningstar Direct, as of 31 August 2020. All figures expressed in USD billions. The above chart refers specifically to the ESG fixed income universe.

Conclusion

For the last 20 years, there has been a clear increase in demand for ESG investment strategies within the fixed income asset class, which only accelerated after the Global Financial Crisis.

Although investors have been slow to take up ETFs as an investment vehicle for these strategies, preferring to use mutual funds, there has recently been a clear uptick in adoption as well as new products being launched to meet investor demand.

In just three years, ESG fixed income ETF assets have surged from only \$3 billion to more than \$21 billion today. There have been over \$6 billion of net inflows in 2020 alone, breaking previous yearly records in the first eight months of the year.

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