COLUMBIA THREADNEEDLE INVESTMENTS

GLOBAL OUTLOOKS **2023**

Themes for thought: **responsible investment in 2023 and beyond**

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Many responsible investment funds struggled in 2022 due to low exposure to gas and oil and a quality bias, but says Claudia Wearmouth, the investment case remains intact and responsible investing is now mainstream investing

Covid-19 chaos may have eased in many parts of the world thanks to immense vaccine rollout programmes, but 2022 has certainly been a turbulent one. The war in Ukraine, energy prices, soaring inflation and the cost-of-living crisis all spring to mind, while the onslaught of extreme weather events demonstrated that climate change remains a major global challenge to address.

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And what of responsible investment (RI) during all this uncertainty? After strong returns in recent years, many RI funds suffered during 2022, in part due to typically low exposure to the oil and gas industry, which has benefited from surging energy prices. Additionally, RI-orientated strategies are typically weighted towards growth stocks and sectors such as technology and healthcare, which have endured a downward rating thanks to uncertainty around inflation and interest rates. Longer term we firmly believe that the investment case remains intact, especially as related opportunities broaden in their nature.

Responsible investing is mainstream investing

Despite these headwinds, RI remains very popular – which brings me on to my first thought for 2023. Environmental, social, governance (ESG); sustainable; socially responsible investment (SRI); impact … all these terms and types of investing that sit under the RI umbrella are everywhere now. Indeed, **Bloomberg** has suggested that ESG assets could exceed $50 trillion by 2025. It feels like every corner of the investment industry has woken up and wants to better understand the idea of investing for people and the planet alongside financial returns. For us the focus is on quality and ensuring we continue to evolve our approach to ESG integration – we continue to review ESG data sources and develop ESG analytical tools to help our investment teams extract high quality information to best inform investment decisions – this will be a key focus for us in 2023 and beyond.

Regulation is increasingly robust

My second observation for the year ahead is that as RI gains yet more momentum, regulation is ramping up to increase oversight and prevent greenwashing. SFDR (Sustainable Finance Disclosure Regulation) in Europe is being followed by SDR (Sustainability Disclosure Requirements) in the UK, while similar measures could soon come into force in the US under the Securities and Exchange Commission. Coupled with commitments such as the UK Stewardship Code and the Net Zero Asset Managers Initiative, these regulations are increasing reporting demands.

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It is a huge task to understand the crossover of different regulations and commitments while staying close to your beliefs as a firm. While this step-up in regulatory reporting can feel quite onerous, I do believe it will drive our industry in the correct direction and encourage better transparency, ultimately ensuring that clients are matched with the strategies most suited to their needs. Increased regulatory oversight and common standards can drive not only improvements in reporting but enhancements in products and services too, as asset managers look to innovate to stay on top, or even better ahead, of the regulatory environment. Linked to all this, there is an increasing reliance on ESG data to fulfil regulatory requirements and update clients on the impact of the strategies in which they are invested. While coverage and quality of data is improving, there is still some way to go before it can be accurately relied on. There is no substitute for in-depth real expertise and capabilities.

Engagement matters – but it must be done properly

Finally, my third thought for RI in the year ahead centres around engagement. Investors globally are realising the power to be gained from thoughtful and thorough ESG engagement. Many of the well-known "sustainable companies" are widely held, and we believe that engagement is an important tool in identifying which companies are well positioned to be the next leaders. Engagement is also going to be a key tool if we want companies and industries to transition to more sustainable practices, which is the focus of many ESG funds.

Regulatory reporting will drive our industry in the correct direction and encourage better transparency

By investing in companies able to credibly evidence their path towards a sustainable future, and using engagement to further drive this, investors can create real-world positive impact. Contrast this with a blanket approach meaning you divest from a company solely because it is too early on its path. We have over 20 years' experience engaging on ESG issues and we focus on highly targeted, thoughtful engagement with companies. This ultimately makes our work more impactful as it is considered and focused on how well positioned investments are to transition towards a sustainable future.

Coming soon … engagement priorities for 2023

In January we will be publishing our ESG engagement priorities for the year ahead and detailing how we are thinking about the global challenges we all face and the related ESG issues we plan to address through our engagement programme.

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