



Key Findings | Responsible investing & performance

The Recent Performance of ESG Investing, the Covid-19 Catalyst and the Biden Effect

Confidence
must be earned

Amundi
ASSET MANAGEMENT

Responsible Investing & Performance: Continuing earlier studies

Acting as a responsible financial institution is a founding pillar of Amundi's corporate strategy. This is demonstrated not only through our pledge to make ESG investing standard throughout our whole product range, but also through our commitment to ESG research in order to fully understand the responsible investment landscape.

This paper marks the latest update in our series exploring the impact of ESG investment on asset pricing in stock markets. The previous papers*, covering the periods 2010-2019, found that:

- 1) ESG investing tended to penalize both passive and active ESG investors between 2010 and 2013.
- 2) In contrast, ESG investing was a source of outperformance from 2014 to 2017 in Europe and North America, and was even becoming a beta strategy in the Eurozone.
- 3) More recently the trends between North America and the Eurozone have somewhat diverged with ESG performance in North America lagging the sustained advances made in the Eurozone.
- 4) In 2018-2019, a move became apparent from best-in-class selection policies to the implementation of more active strategies to integrate a dynamic view of ESG scores.
- 5) The social pillar came to the fore in 2018-2019 after lagging from 2014-2017, likely due to growing concern for social themes such as rising inequalities.



“Since the last update in 2019, we have lived through a global pandemic that profoundly reshaped the global economy and society, in addition to an eventful change of leadership in the United States.”

Takaya Sekine,
Deputy Head of Quantitative
Research

This paper, covering the period June 2019-June 2021, continues our work looking at trends in the North American and the Economic and Monetary Union (EMU) universes, but also expands its horizons to the Emerging Asia market for the first time.

*<https://research-center.amundi.com/article/esg-investing-recent-years-new-insights-old-challenges>
<https://research-center.amundi.com/article/alpha-and-beta-esg-investing>

Key findings

1 Joe Biden's election was originally predicted to energize ESG investing

The so-called "Biden effect", which it was assumed would drive ESG performance in North America, was actually anticipated much earlier by investors in the light of increasing ESG consciousness. Positive performance across all three pillars is evident in the market well before the election.

2 But it nonetheless set off a "Green momentum"

Focusing on the environment pillar, it can be argued that the election of Joe Biden fuelled a trans-regional "green momentum" as the post-election period showed a clear outperformance from the *Energy and Emissions* sub-pillar. The "green momentum" of the election translated into investors better integrating companies' CO₂eq emissions when carrying out stock selections.

3 Rise of the Social pillar in North America

The first quarter of 2020 saw the Social pillar outperform other ESG metrics in North America. Analysing the sub-pillars making up the Social pillar across the wider period, it can be observed that this development has been dominated by *Working Conditions*, a trend which can likely be linked to the Covid-19 crisis and subsequent instability in labour markets. The effects of Covid-19 hindered the Social pillar's dominance, but it has begun to regain importance again more recently, although not yet returned to pre-crisis levels.

4 Governance most robust pillar during crisis

Prior to the pandemic, the three regions studied exhibited differing drivers of ESG performance, but the trends converged dramatically at the heights of the Covid-19 crisis when the Governance pillar emerges strongly as the most resilient pillar in all regions. Companies with strong governance practices markedly outperformed other pillars.

5 Better governance = lower cost of capital

In North America, the Covid-19 crisis sparked a huge need from companies for extraordinary external financing which was ultimately met by the credit market. Governance became the most decisive factor as firms with good governance practices increased their advantage through a lower cost of capital.

6 Emerging Asia is the outright ESG winner

In extending our analysis to the Emerging Asia region, we find that the region has exhibited the strongest returns on all ESG aspects since November 2020 of all the three regions studied. Governance performed steadily across all periods confirming investors' particular focus on this area, and more broadly, the critical role of governance in emerging markets. An interesting phenomenon in particular was remarked in Emerging Asia around the *Ethics* sub-pillar, which was found to be the largest contributor to the governance return and highlights a growing concern on this theme, not solely limited to the impacts of the pandemic.

Context of study environment

It is important to note that this study covered a period of unprecedented disruption. The Covid-19 outbreak in early 2020 not only shattered the markets worldwide, but also population and trade movement. The implications of these are still causing significant headwinds on today's markets. Covid-19 also fostered significant disruptions to business

models and accelerated changes in collective attitudes towards numerous ESG themes. The US political scene simultaneously paved the way for potential policy U-turns. Nevertheless, uncertainty remained over the outcome of the presidential race and whether Biden would be able to effectively implement the promised ESG-focused policies

Did Biden's election generate an ESG effect in North America?

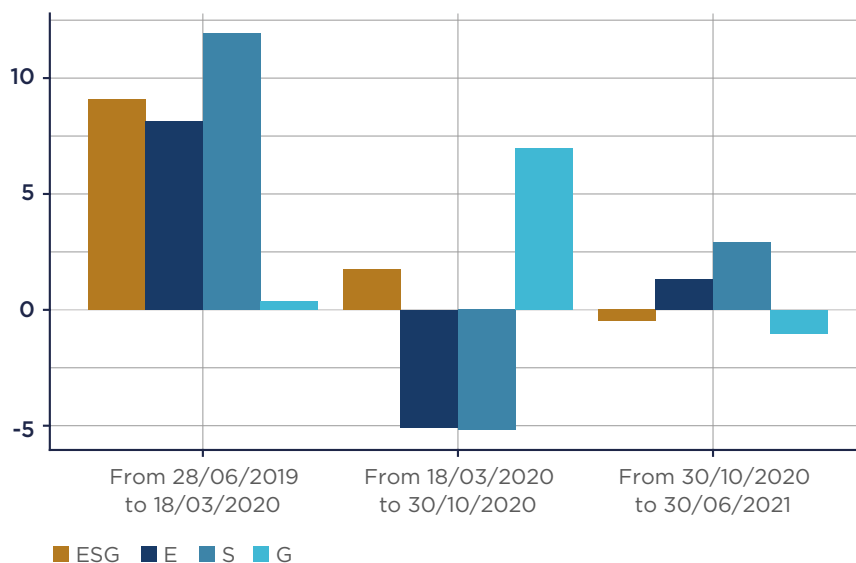
Our previous studies have shown that ESG investing began to be rewarded by markets in 2014. Since then, awareness around environmental, social and governance challenges have steadily increased, supporting the theory that ESG should increase in importance in the asset pricing of firms, while benefiting all stakeholders.

However, as already observed in our previous papers, advances in ESG and their corresponding impact on financial markets are at different stages across the world, a phenomenon notably illustrated by the transatlantic divide. A possible justification for this divergence had been the Trump administration's conflicting environmental stance. It could be expected therefore that the election of Biden would lead investors to assume deeper integration of ESG in North America that would be triggered by the new administration's policy focus on climate and racial equity.

Yet these results show that the trend for ESG integration had in fact started well before Biden's election. The election actually occurred in a context where ESG integration in North America had already started responding positively to different factors.

We identified in previous research that ESG, S and E pillars performed strongly after they were triggered by the Covid-19-related stress in the equity market. While the Governance pillar initially lagged, it emerged as the most resilient during the crisis. However, since the election, the Governance momentum has slightly faded, while the Social and Environmental pillars have renewed their upward trends, although they have not yet regained pre-pandemic levels.

Figure 1: North America - ESG and E, S and G Pillars (Long-Short Return %)



Source: Amundi Quantitative Research (2021).

Emissions and Energy

According to the 2020 report of the International Energy Agency, CO₂eq emissions in the US decreased between 2018 and 2019. In fact, in 2019, the US showed the largest country decline in energy-related CO₂eq emissions, thanks to its increased use of natural gas for power generation as opposed to coal.

However, our analysis shows (Figure 2) that this was not priced into the equity markets at that time with the *Emission & Energy* sub-pillar continuing to deliver negative performance. Interestingly, since Joe Biden's election in November 2020, a turnaround has occurred: investors are now moving towards companies that limit their emissions.

Figure 2: NAM - Emissions & Energy

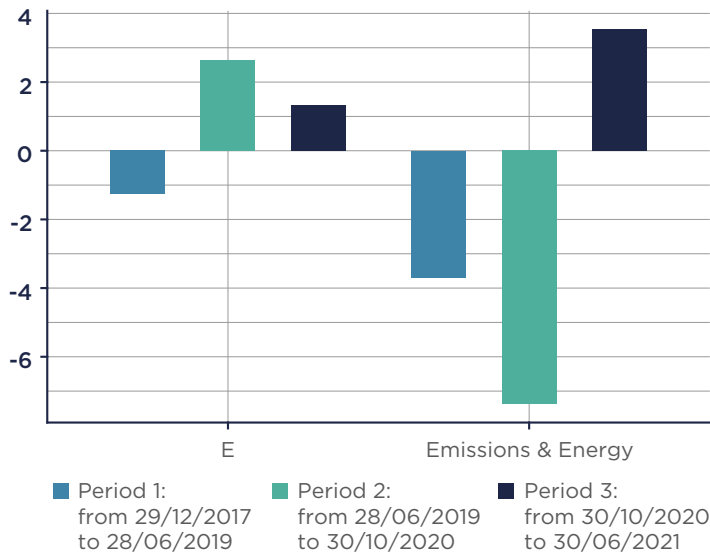
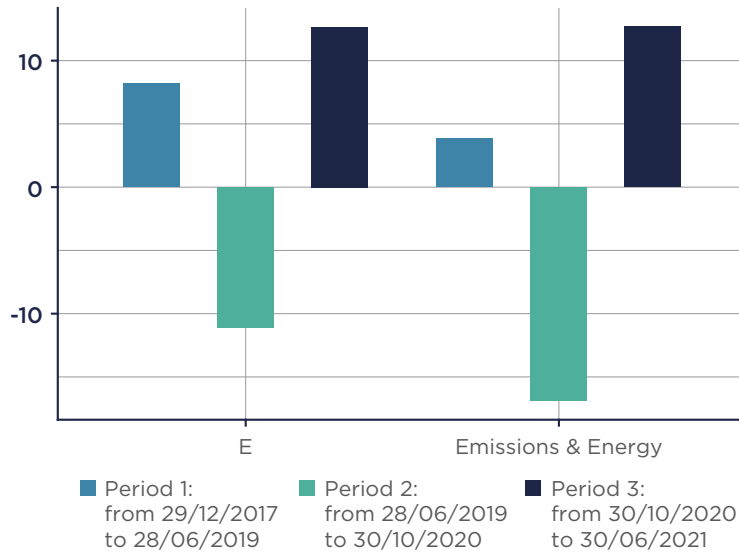


Figure 3: EMU - Emissions & Energy



Source: Amundi Quantitative Research (2021).

Growing influence of the social pillar in North America

Recent studies (Lepetit & Sekine, 2020) have shown the Social pillar emerging in North America as it outperformed other ESG metrics in the first quarter of 2020. When analysing returns in the MSCI North America universe over the period, and in particular the individual sub-pillars making up the Social metric, it can be observed (Figure 4) that *Working Conditions* have been particularly valued by investors, rewarding companies who scored well on this aspect. This phenomenon does not appear to be coincidental. The Covid-19 crisis triggered deep uncertainty in North American labour markets, traditionally perceived as fairly flexible, raising fears of unemployment for millions of workers. In this context, companies who took a stance on the matter, such as announcing no redundancies, sent a positive signal to stockholders.

Also performing well since 2019 are the *Supply Chain - Social* and *Community Involvement & Human Rights*

pillars, which indicates that the well-being of employees, but also of other stakeholders, are also being prioritised by investors.

However, whilst the Social pillar was the outright winner in North America in the first quarter of 2020, the trend did not persist across the rest of the year, although it has recently rebounded. In EMU, we witness a similar trend, although the Social pillar was less prominent when the pandemic hit financial markets. Here a slightly negative trend continued throughout the remainder of the period examined. In contrast to North America, the *Working Conditions* sub-pillar is not a dominant driver of performance in EMU and the *Supply Chain - Social* and *Health & Safety* sub-pillars significantly underperformed across the period of analysis, illustrating divergent domestic laws as well as differing investor focus, particularly concerning recent supply-chain controversies within EMU.

Figure 4: North America: Social Sub-Pillars (Long-Short Return % between 28/06/2019 and 30/06/2021)

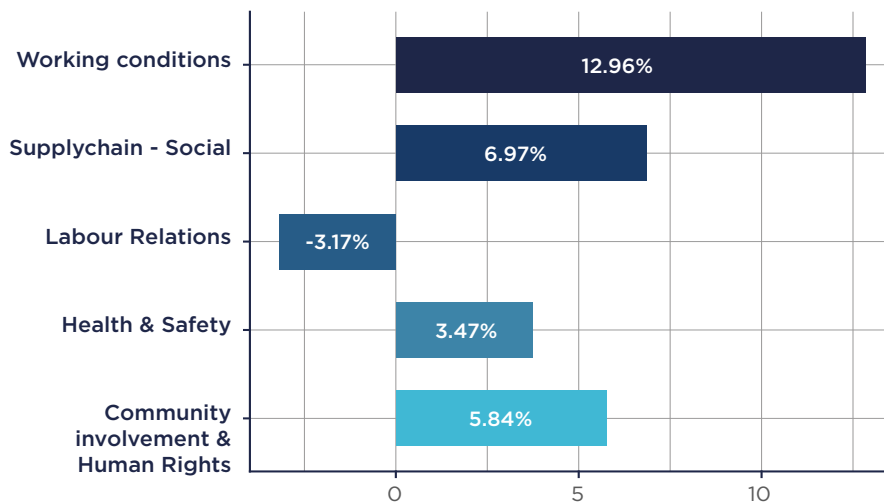
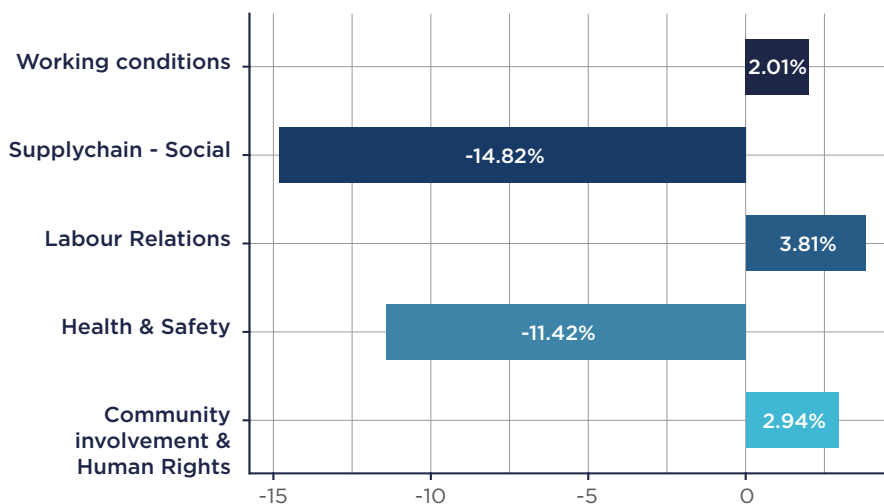


Figure 5: EMU: Social Sub-Pillars (Long-Short Return % between 28/06/2019 and 30/06/2021)



Source: Amundi Quantitative Research (2021).

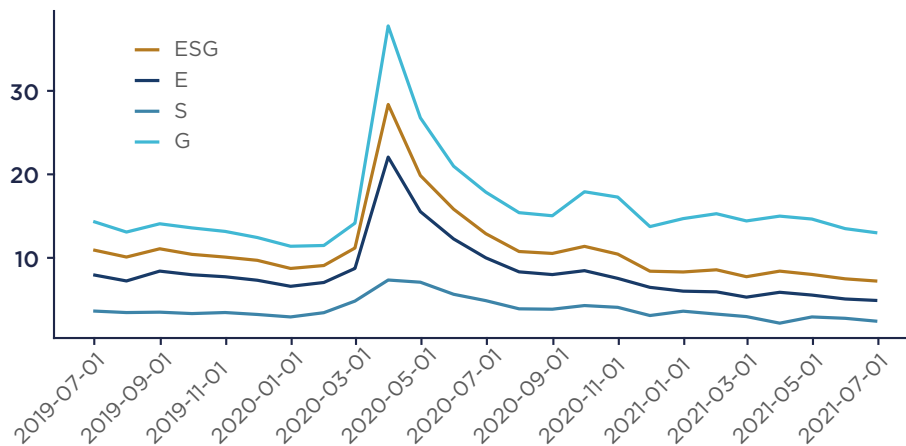
Better governance bolsters financing

One outcome of the pandemic was the increased requirements from corporates for external capital financing. Analysis (Halling *et al.* 2020) indicates that only 5% of capital raised came from equity compared to bond issues in the US.

Extending our research to credit issues, we find that governance is the key differentiator and this was particularly apparent during the Covid-19 outbreak when the cost of debt spiked (Figure 6).

Since March 2020, governance has become a powerful discriminating feature where companies with good governance have been rewarded by the market with lower cost of debt, whilst the reverse has been true for poorly governed companies.

Figure 6: Cost of Debt Differentials by Pillars (bps)



Source: Amundi Quantitative Research (2021).

Focus on Emerging Asia

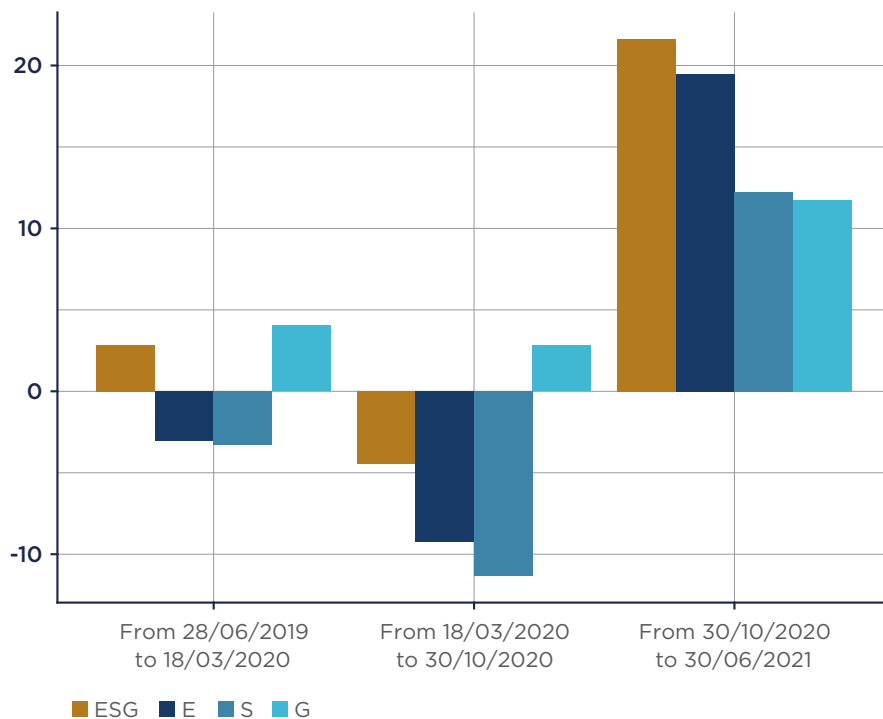
ESG in emerging markets is a thorny issue and these markets are often faced with strong challenges on various sustainability aspects. Past studies (Odell and Ali, 2016) have showed that weak institutions or uneven regulatory regimes may be responsible for social concerns. On the environmental front emerging markets are more exposed to climate change, but also to resource scarcity challenges and local pollution. Standards of governance and levels of disclosure compared to developed markets are also instrumental. In this update, we extend our analysis to emerging markets, concentrating on Emerging Asia, however we revise the selected break-points to account for the earlier arrival of the Covid-19 pandemic in Asia compared to Europe and North America. A one-day time lag is also applied between North American and EMU to reflect the reaction lag in EMU due to the time difference between the two regions.

Similarly to EMU and North America, we witness that Governance has been the most resilient pillar during the Covid-19 phase (Figure 7) corroborating the idea that investors are particularly focused on this area. Interestingly the outstanding contributing sub-pillar within governance was *Ethics*, starting before the Covid-19 outbreak, but continuing thereafter. This may highlight growing concerns over this theme in Emerging Asia. We should not forget that the Covid-19 period also coincided with major supply-chain disruptions, which shed light on complex international networks, but also on unequal working conditions, raising ethical concerns. The pattern of growing ethical concerns in Emerging Asia alongside the contrasting pricing of supply chain considerations in Europe and North America raises questions over the social and human aspects of production processes and is something we plan to study in more depth in the future.

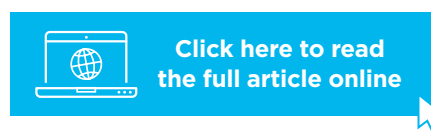
It should be noted that the number of new Covid-19 cases remained fairly contained in Asia during the last quarter of 2020, compared to other regions that were hit by new waves. Nevertheless all pillars bounced back strongly in Emerging Asia in the most recent period, with some hypothesis that the Biden election may have

been of significant help in relieving market uncertainty, which may have reinforced risk appetite, particularly from western investors who may have seen in Emerging Asia a new market to conquer. These flows benefited the ESG dimensions in the region.

Figure 7: EM Asia: ESG and E, S and G Pillars (Long-Short Return %)



Source: Amundi Quantitative Research (2021).



This document is solely for informational purposes.

This document does not constitute an offer to sell, a solicitation of an offer to buy, or a recommendation of any security or any other product or service. Any securities, products, or services referenced may not be registered for sale with the relevant authority in your jurisdiction and may not be regulated or supervised by any governmental or similar authority in your jurisdiction.

Any information contained in this document may only be used for your internal use, may not be reproduced or disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices.

Furthermore, nothing in this document is intended to provide tax, legal, or investment advice.

Unless otherwise stated, all information contained in this document is from Amundi Asset Management S.A.S. and is as of November 2021. Diversification does not guarantee a profit or protect against a loss. This document is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The views expressed regarding market and economic trends are those of the author and not necessarily Amundi Asset Management S.A.S. and are subject to change at any time based on market and other conditions, and there can be no assurance that countries, markets or sectors will perform as expected. These views should not be relied upon as investment advice, a security recommendation, or as an indication of trading for any Amundi product. Investment involves risks, including market, political, liquidity and currency risks.

Furthermore, in no event shall Amundi have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages due to its use.

Date of first use November 2021.

Document issued by Amundi Asset Management, “société par actions simplifiée”- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GPO4000036 - Head office: 90 boulevard Pasteur - 75015 Paris - France - 437 574 452 RCS Paris - www.amundi.com

Composition: Art6 - Photo credit: Getty Images