Returns and real impact: the green-bond opportunity

The Generali Investments SICAV Euro Green & Sustainable Bond – one year on

Fund managers Mauro Valle and Fabrizio Viola reflect on a tumultuous first year and explain why they are more excited than ever about the future of this growing market.

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- 25 years of experience
- «+» rated by Citywire[1]

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- 20 years of experience

As the Covid-19 pandemic struck, the past year was a momentous one for markets and the first real test for green bonds. But the Generali Investments SICAV (GIS) Green & Sustainable Bond came through the year in good shape, and its managers are looking forward with confidence as the asset class evolves.

A baptism of fire

GIS Euro Green & Sustainable Bond has now come through its first full year – and what a year it was. The sub-fund launched in December 2019, so in its initial months, it was exposed to the full force of the Covid-19 pandemic and its extreme economic impact.

Green bonds are issued by governments, supranational organisations and companies to fund specific environmental projects. They have obvious appeal to investors interested in environmental, social and governance (ESG) concerns.

As the green-bond asset class only really came into being after the global financial crisis, the Covid-19 pandemic is its first real test. But we're pleased to report that both our sub-fund and its asset class have proved equal to the challenge.

Grace under pressure

At the start of 2020, we were looking forward to a good year. It's fair to say that things didn't play out as we expected, given the massive volatility produced by the pandemic. Credit spreads widened and risk assets fluctuated wildly. But green bonds were less volatile because their investors are less inclined to panic selling. That makes sense: given their inherently long-term focus on sustainable projects, green bonds are the last bonds that investors should want to sell. Green bonds also rebounded more strongly than other bonds after March.

Overall, both the benchmark index and our portfolio coped very well, and the sub-fund delivered returns in line with our initial expectations. The index and the sub-fund each returned more than 4% for the year – outperforming traditional fixed income market.[2]

[2] The index full name is Bloomberg MSCI Barclays Euro Green Bond Index. Source: Generali Investments Partners S.p.A. Società di gestione del risparmio as of 31.12.2020. Past performance provides no guarantee for the future. For more information please refer to page 3.

A rapidly growing market

At present, the market for green bonds is small and segmented. Green bonds currently account for only around 3% of global issuance, and demand far outstrips supply. Primary issues are massively oversubscribed, and specific bonds can be hard to find in the secondary market. This can make it a difficult market for most investors to access.

[1] Mauro Valle is rated «+» by Citywire as manager of the GIS Euro Short Term Bond and GIS Euro Bond 1-3 years sub-funds, as at January 2021.

The market is growing fast, however, and has roughly doubled in size every year. The ratio of corporate bonds to government and supranational issues is also steadily increasing.

Easy access and a rigorous investment process

GIS Euro Green & Sustainable Bond is designed to give investors convenient access to the asset class, along with the opportunity of adding alpha through active management. The sub-fund has at least 70% of its net asset value in dedicated green bonds included in the Bloomberg Barclays MSCI Green Bond Index, with the other 30% to be used at the managers' discretion.

It's important to note that the portfolio's off-benchmark holdings may not be 'green bonds' in the strictest sense, but they are still entirely appropriate for ESG-focused investors

The issuers of all bonds in the portfolio must pass our stringent ESG and proprietary ethical screens. These filters are designed to exclude controversial stocks by filtering out issuers that have poor ESG rankings or engage in improper behaviour. Importantly, we consider not only the 'E' and 'S' in ESG, but the 'G' (governance) too. In doing so, we take into account these companies' attitudes to staff, suppliers and customers.

We monitor our universe on a daily basis. We have two main sources of information in this: our internal ESG-analysis team and independent external providers, licences agreement with Sustainalytics and MSCI.

Underpinning this is the formal commitment that the Generali Group made to green investments in early 2018. Through this commitment, Generali aims to advance environmental protection, respect for human rights and clear and transparent governance. This commitment builds on Generali's establishment of its proprietary Ethical Filter[3] for investments in 2006 – the same Group Ethical Filter that is applied in the GIS Euro Green & Sustainable Bond sub-fund.

Watching out for greenwashing

An important issue here is 'greenwashing' – the use of green credentials to burnish companies' reputations and obscure their real behaviour. Some green-bond issuance amounts to greenwashing, so we need to be vigilant. Identifying greenwashing is not always straightforward, however. Not every company with a poor 'E' rating is greenwashing if it issues green bonds.

Some might be funding their transition into greener companies – think about some oil firms, for example.

So in our research, we need to audit both companies' financials and their green credentials.

This is hard work, but the pressure on companies to engage in greenwashing is increasing as investors become more ESG focused. We need to match this with greater scrutiny. Over time, the problem should decline simply because greenwashers will not be able to go to the market to finance themselves.

Portfolio positioning

We do not track the benchmark but are active managers, looking to add value through duration positioning and country, credit and sector allocation.

For now, we are mainly euro-denominated, but we may diversify in the months ahead into USD-denominated bonds. We are active in using derivatives, such as futures, to manage our duration and country exposures. We may also use credit-default swaps to adjust our corporate-bond exposure.

At present, we are slightly underweight in governments and somewhat more underweight in supranationals as a whole. Conversely, we are overweight in corporate bonds. We are quite defensively positioned, with a lower duration than the benchmark by about one year, although this may change according to market dynamics.

We are currently overweight in bonds rated A and BBB. We are underweight in issues rated AAA and AA. We also favour subordinated and senior non-preferred debt over senior unsecured, unsecured and secured bonds. We like corporate hybrids issued by utility companies, too.

At the security level, our overweight green positions include supranationals like EIB and Société du Grand Paris or utilities like Engie and Iberdrola.

2021 and beyond

So, after an unprecedented year, what happens next? We expect around €600 billion of new issuance in 2021, sustaining the trend of the market's doubling in size each year. This supported by investors' growing focus on ESG, and on the environment in particular, and by governments' declared ambition to "build back better" after the Covid-19 crisis.

Most obviously, the European Union will issue green bonds as part of its recovery plan for Europe,

[3] Applying the Group Ethical Filter is part of the discretionary evaluation of the investment manager and the results of such evaluation are confidential.

with €225 billion of planned issuance over the next six years. The German government issued its first green bond in September 2020, the UK government is set to enter the green-bond market in 2021, and even Italy has declared its willingness to tap this segment.

Over time, this rise in issuance should reduce the ‘greenium’ that investors currently pay for green bonds. This is the premium caused by a shortage of supply as investors increasingly favour green bonds over their conventional equivalents. So as green bonds go mainstream, they should offer investors higher yields.

Meanwhile, sentiment towards green bonds has improved considerably since the start of last year, because the Covid-19 pandemic has underlined the importance of the social and environmental aspects of ESG. This has accelerated corporate issuance: virtually all specialist property developers in the Eurozone are now active in issuing green bonds to fund the construction of new environmentally friendly buildings.

Banks are now issuing green bonds for various purposes, including the provision of green loans to small and medium enterprises. This trend looks set to accelerate. We are also seeing innovations in other industries; one Italian toll-road operator is looking to issue a green bond to improve the safety of motorways, for example.

Creative asset classes such a sustainability-linked bonds are another area to watch. Sustainability-linked bonds differ from green bonds in that they are not necessarily used to fund ESG-related projects, but instead penalise the issuer for failing to meet its sustainability targets and/or ESG objectives – chiefly through an increase in the coupon paid to bondholders.

Given these trends, we can easily envisage GIS Euro Green & Sustainable Bond doubling in size in the near future. We believe it offers an attractive means of accessing this exciting asset class – and of achieving both good returns and a positive impact on our planet.

Key features

ISIN	LU2036759335 (Eur BX Acc.)
Inception date	16th December 2019
Benchmark	Bloomberg MSCI Barclays Euro Green Bond Index
Fund Currency	Euro
Domicile	Luxembourg
Management fees	0.35%
Performance fees	Not applied
Management Company	Generali Investments Luxembourg S.A.
Investment Manager	Generali Investments Partners S.p.A. Società di gestione del risparmio

Performance analysis

	2020	1Y	3Y	5Y	SI
EUR BX Acc.	4.49%	1.86%	n/a	n/a	3.48%
Benchmark	*4.82%*	*1.79%*	-	-	*3.74%*

Source: Generali Investments Partners S.p.A. Società di gestione del risparmio as of 31.01.2021. Past performance provides no guarantee for the future. No express or implied liability or guarantee is assumed that the future performance will correspond to the performance described above. The value of and income from fund units or sub-fund units ("Units") may rise or fall. No guarantee can be assumed that the investment objectives of the fund will be achieved. The performance of and income from the Units have to be reduced by costs and taxes.

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