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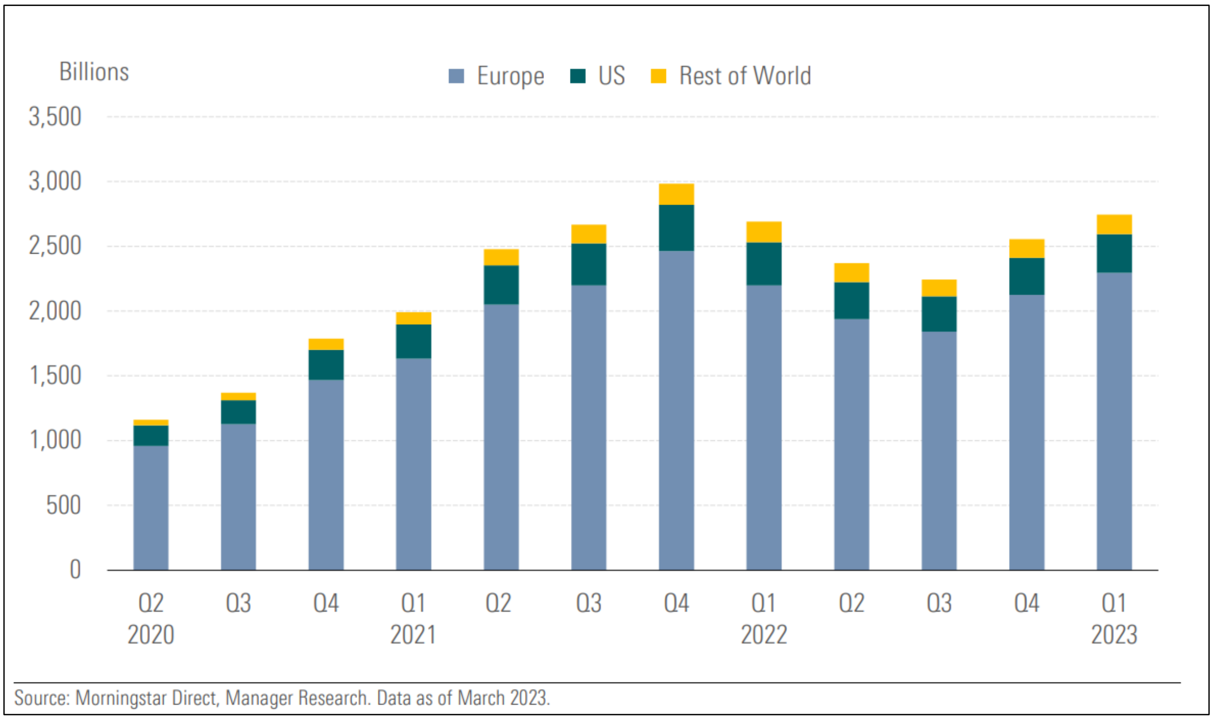
ESG Investing in The Era of Chaos

According to Morningstar Direct's "Q1 2023 Review on Global Sustainable Fund Flows", global sustainable funds attracted USD 29 billion of net inflow in the first quarter of 2023, down from nearly USD 38 billion in the previous quarter. However, despite the decline in inflows, the total assets of global sustainable funds showed a recovery trend, reaching USD 2.74 trillion by the end of March (Exhibit 1). This 7.5% expansion exceeds the overall global fund market growth of 4% in the three months through March 2023.

In terms of inflows, Europe emerged as the dominant region, attracting USD 32.3 billion (Exhibit 2). Over the past year, the increasing significance of ESG-related regulations, such as the European Union's Sustainable Finance Disclosure Regulation and Taxonomy Regulation, noticeably influenced the demand for sustainable funds. Malaysia saw some modest net inflows at USD 49 million in the first quarter of 2023.

Exhibit 1: Quarterly Global Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct

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Exhibit 2: Global Sustainable Fund Statistics

Q1 2023	Flows	Assets		Funds	
Region	USD Billion	Billion	% Total	#	% Total
Europe	32.3	2,296	84	5,410	77
United States	-5.2	299	11	638	9
Asia ex-Japan	1.7	63	2	515	7
Australia/New Zealand	0.1	31	1	201	3
Japan	-1.0	26	1	60	1
Canada	1.0	30	1	206	3
Total	**29.0**	**2,745**		**7,030**	

Source: Morningstar Direct, Manager Research. Data as of March 2023.

Source: Morningstar Direct

Despite the challenges posed by rising interest rates, inflation, and the potential for a looming recession, there remains a consistent and growing desire among investors to allocate their resources towards investments that promote a more sustainable future. Europe has taken the lead in adopting green and sustainable-focused policies. This trend is expected to be emulated by major Asian markets, serving as a critical catalyst for the growth of the sustainable investing market in the region. However, the political and regulatory landscape in the United States is charting a different course. Despite this divergence, recent policy measures such as the Inflation Reduction Act suggest that attractive investment opportunities will likely emerge, motivating companies and investors to redirect capital towards greener and more sustainable businesses.

Economists argue that it is inevitable that the transition to a clean energy-powered economy may have some inflationary effects. This is primarily due to substantial fiscal support and the significant influx of investments into technologies such as wind, solar, and electric vehicles. However, it is equally crucial to acknowledge that the failure to take decisive action in adapting to climate change could ultimately result in even greater inflationary consequences.

An example of this is the European heatwave experienced in the summer of 2022. The heatwave resulted in severe economic disruptions, including impacts on agriculture, energy systems, and infrastructure. These disruptions incurred significant costs, both in terms of immediate damages and long-term consequences. Such environmental events can trigger rising costs associated with repairing and rebuilding damaged infrastructure, addressing health issues, and managing the consequences of resource scarcity. Thus, it is essential to prioritise climate action to mitigate the long-term economic risks and avoid greater inflationary impacts in the future.

ESG Investing in Malaysia

ESG investing in Malaysia is gaining momentum as market participants recognise the significance of sustainable practices and responsible investing. Malaysian institutional investors, including pension funds and asset managers, have also shown a growing interest in ESG investing. They recognise that incorporating ESG factors into their investment decisions can contribute to better risk management and potentially generate sustainable long-term returns.

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Malaysia's market continues to face challenges due to global headwinds, as evidenced by the year-to-date decline of -5.61% in the KLCI Index (or -3.81% when accounting for dividends). Despite that, The FTSE4Good Bursa Malaysia (F4GBM) Index and FTSE4Good Bursa Malaysia Shariah (F4GBMS) Index have both exhibited better performance compared to the KLCI Index. These sustainable investing indices have experienced smaller declines of -2.48% and -1.60% respectively. This suggests that companies adhering to sustainable practices have fared relatively well in the current market conditions.

Exhibit 3: KLCI, F4GBM and F4GBMS Indices Return (including dividends)

Source: Bloomberg, as of 23 May 2023

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