dated 20 May 2019

AFFARI&FINANZA
SETTIMANALE: ROMA

extract from page 49

"Bonds, good governance wins"

The man behind it

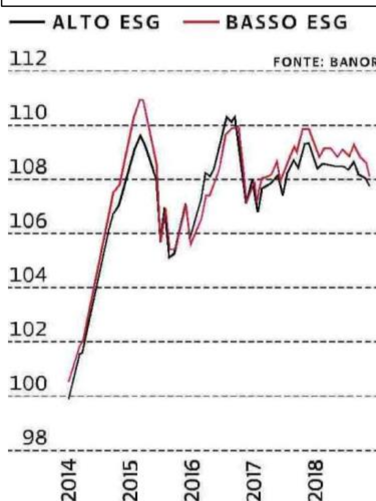
Angelo Meda, Head of Equities at Banor SIM, and independent financial firm founded in 1989, with offices in Milan and Turin

Following their breakthrough in the equities field, the principles of responsible finance are now making modest progress in the bonds sector. In addition to registering slower progress, in the fixed income sector, the three letters of the ESG acronym—environmental, social and governance—do not carry the same weight, at least not in relation to yield. This is the conclusion reached by a study conducted by Banor, one of the first Italian securities firms to adopt investment strategies that include principles of responsible finance. According to a survey, following the one that was published last year in relation to the equity sector, the letter that merits the most attention is the G for governance, the one parameter that can guarantee outperformance.

DIFFERENCES

Quite a different situation with respect to equities where all three macro-themes contribute towards improving stock market performance. "Given that all investors, even those who are socially responsible, seek a return," explained Angelo Meda, head of equities at Banor Sim, "we analysed the performance of bonds on the basis of their ESG rating, and it emerges that those with good governance are better than others, even those that pay attention to the environment and social aspects. This can be explained by the fact that these latter two factors have long-term prospects and are therefore more of interest to the shareholder than the bondholder, whose investment time horizon is limited to the term of the bond". Banor's expert proceeds in his reasoning to say that good governance is the aspect that is of most interest to bond holders who do not want any unpleasant surprises before repayment. And the choice of a company that is well-managed and transparent with its stakeholders is the best way to ensure this. The results of Banor's research project, in which the analysis was split into a first part, dedicated to investment grade bonds, and a second part, dedicated to high yield bonds, are very clear. for investment grade bonds, in the 2014-2018 period, the cumulative yield of bonds with a high E (environmental) rating, and therefore considered ethical, did not perform as well as those with a low rating: 7.2% compared to 8.4%. The same is true for the S factor (social). On this front, bonds that were less sensitive to social aspects registered a performance of 7.9% compared to 7.3% for bonds that were more socially responsible. On the other hand, the situation is redressed with good governance, bringing back the balance for ESG bonds to be slightly positive with respect to bonds with an overall low ESG rating. Their performance over the five-year period under examination was 9% compared to 6.3% for bonds issued by companies with scarce governance. Over the five years under examination, the funds with a high ESG rating yielded 8.8% compared to 7.7% for those with a low ESG rating.

The numbers
OUTPERFORMANCE
INVESTMENT GRADE BONDS



HIGH YIELD

Moving on to the analysis of the high yield sector, there is a decisive confirmation of the result that emerged for the investment grade sector. After all, things could not be otherwise. By definition, junk bonds are more at risk of default than investment grade bonds, and therefore good management practices have become of fundamental importance to avoid missing out on bond repayment. Among the high yield bonds, in the 2014-2018 period, those with a high ESG rating yielded 20.9% compared to 16.3% for bonds with a low rating. Once again, it is the letter G that makes the difference. The debt of companies with good governance had a cumulative yield of 18.5% compared to 14.7% for those with scarce governance. Values are inverted for E and S, where bonds with lower ratings perform better than those with a higher rating. In the first case, the latter win with 15.9% compared to 10.9%, while in the second case, the gap further

MARCO FROJO, MILAN

In the words of Angelo Meda (Banor Sim): "With ESG bonds, companies managed with greater transparency perform better"

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increases to 16.4% compared to 8.2%. “And so the hypothesis that bond investors are especially alert to good governance as an antidote to the worsening probability of insolvency seems to be reinforced,” Banor’s study concludes, “This seems to be particularly marked for the bonds with bad ratings, and in this case, even the efforts aimed at improving social and environmental performance seem to be damaging in the context of short-term default risk”.

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