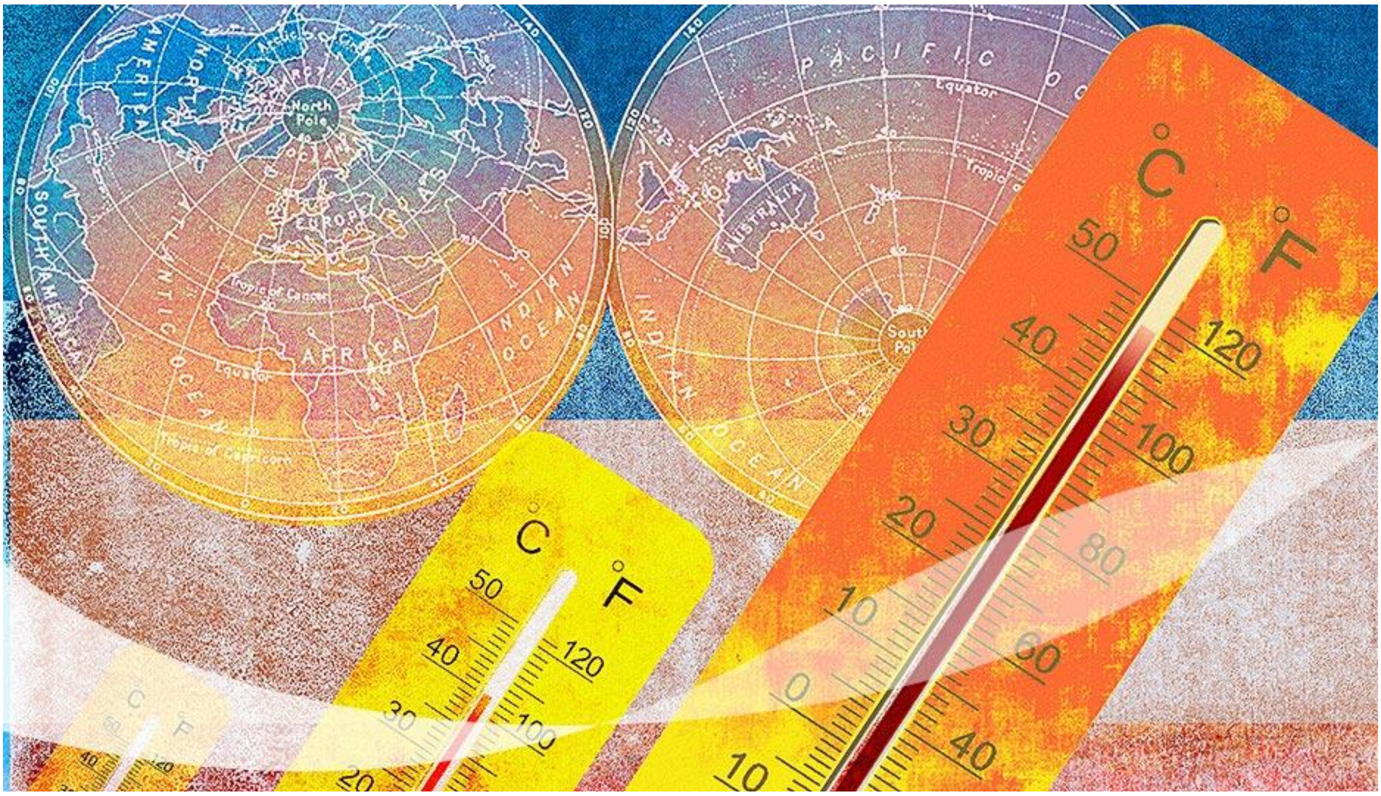

The Trump effect on ESG investing

Market Insight

Donald Trump, a climate-change sceptic, has been elected the most powerful man in the world. Unsurprisingly, his inauguration is raising questions around the sustainability of progress around environmental issues.

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Macro political events are increasingly influencing financial markets; with environmental, social and governance (ESG) a rapidly growing trend amongst institutional investors, it is natural to question the sustainability of this trend under President Trump.

Under the Obama administration, significant progress was made on various ESG-related issues, at a federal and international level. For example, Obama signed the Paris Agreement on climate change, put in place methane emissions regulation in the US energy sector and coal power generation in the US power utility sector. He also promoted better access to healthcare and sought improvement around areas such as the ethical sourcing of materials and human rights practises. From a governance perspective, progress is being made on the potential for mandatory public corporate ESG disclosure via the securities regulator.

Whilst these steps alone are not solely responsible for catapulting ESG investing to the forefront of many investor's minds, the fact that major economies such as the US have actively engaged in supporting climate change and other ESG related issues, cements the view that ESG investment is a viable long-term consideration.

However, the potential for further progress appears to be at risk of stalling or halting completely. During his election campaign, President Trump outlined intentions to withdraw the US from the Paris Agreement and remove environmental regulations which negatively impact the fossil fuels industry and reduce the powers of the US environmental regulator.

With the US being the second-largest CO_2 emission producer globally[1], any efforts to undo the policies adopted could impact any possible progress and potentially dis-incentivise other countries from taking action.

However, we think initial concerns voiced, whilst valid, may be somewhat overstated. Whilst some of his actions (in appointing key individuals to posts in his administration) appear to reaffirm some of his pledge, we have already seen a softening of some of Trump's election 'promises' and therefore any claims made prior to inauguration need to be substantiated now he is in office.

We think it is unlikely Trump will be able to pull out of the Paris Agreement, although he could fail to take any action. Furthermore, whilst he could influence federal laws, individual states will still be able to take action and go beyond federal standards.

Internationally, other major players such as China and India appear to remain committed to taking action on climate change.

It is clear to us that sustainable development and ESG investing is increasingly moving beyond White House decisions, reflecting the view that economics is again moving markets more than politics. Advancements in technology are leading the private sector to take decisions based on simple economics. For example, the challenges facing the coal industry are being constrained by market forces.

A combination of financial and technological breakthroughs is positioning renewable energy as increasingly price competitive in a number of markets. In transportation, advances in battery technology (coupled with global emissions regulation) is driving down costs and making electric vehicles a credible option, leading to a continued increase in market share faster than anticipated.

Similarly to how financial markets are treating the Trump administration with caution, ESG investors are keeping close counsel for now. We think Trump's presidency may slow the pace of progress in the US on tackling some environmental issues, climate change, healthcare and corporate ESG transparency. However, some of these (especially healthcare) are particularly politically contentious and may be hard to reform. As such, Trump's priorities are likely to be the most emotive issues through which he can achieve quick results, such as tax reform, immigration and trade.

If Trump turns his attention to ESG-related matters, we believe investors should be prepared for some level of uncertainty and volatility in the sectors impacted. But will Trump derail the ESG investing momentum? He's certainly influential, but perhaps ESG has now grown too big for Trump to tackle?

In our view, this ought to extend the recent improvements we have witnessed in both the revenue and earnings performance of HY issuers more generally (although we remain sensitive to the impact of US dollar strength).