



Green bonds: An evolving marketplace but not yet compelling for UK investors

A growing segment of the fixed income universe is 'green bonds', reflecting the increasing importance being placed on environmental sustainability. Over the last two years, the market has tripled in terms of market value from \$41.8 billion in 2015 to currently \$130 billion. Funds raised finance the development of new or existing environmental projects, including renewable energy, sustainable water management and pollution prevention. As well as globally, corporate bond and commercial bank issuance is growing within the UK - Anglian Water issued its first green bond in August 2017 - with the trend likely to continue, creating greater diversification and a broader range of risk/reward opportunities.

Issuers at present are mainly quasi-sovereigns - the European Investment Bank was the largest issuer of green bonds in 2014 and 2015 - resulting in nearly half of the market being AAA-rated. Given the nature of current issuers, green bonds offer investors opportunities to source yield with lower levels of credit risk. That said, the relative yield is less than comparable maturity corporate bonds.

A constrained universe for UK investors

While 'green bonds' are appealing for their low risk characteristics, unfortunately investment opportunities are limited for UK investors. Currently, there are only five sterling-denominated bonds, all of which are relatively low-yielding versus the UK investment grade corporate bond market. This lack of diversity means that most UK investors need to look further afield across the global universe. The US and Europe are the largest markets, but China is the fastest growing market in terms of issuance, reflecting the broader policy impetus from China's government to create a low-carbon economy. There are, though, challenges for UK investors who choose to invest in non-sterling-denominated green bonds, since currency can be the overwhelming driver of returns.

For non-sterling investors or those willing to assume currency risk, access to this market can be made either directly in a specific bond or via various trackers for those seeking a broader pool of investments. Indeed, we expect passive vehicles, such as ETFs, to become more common as this market develops. Certain jurisdictions also offer tax advantages to investors in green bonds. In the US, for example, green bonds receive tax-exempt status and are treated similarly to US municipal bonds.

Within our Heartwood Ethical strategies, we have yet to invest directly in this market given the constraints for UK investors. However, it continues to be an area that we are actively researching and expect to participate in as this market evolves and develops longer term.

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Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

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