



INSIGHTS FROM
CFA SOCIETY SINGAPORE

By Mark Fortune



Actively managed credit strategies can meet impact goals, alpha targets

A study finds non-linear relationship between sustainability, factor investing

EVEN as the inclusion of sustainability targets in investment portfolios grows in popularity, the challenge of balancing this approach continues to perplex investors.

But a *Financial Analysts Journal* study, *Bonds with Benefits: Impact Investing in Corporate Debt*, may offer encouragement. It finds that sustainability-oriented investors can meet their goals with corporate debt strategies, and that profit-oriented factor investors can achieve a portfolio with a certain sustainability level at a low cost.

I spoke with Desislava Vladimirova, who co-authored the study with Jieyan Fang-Klingler, for insights on the authors' findings and to produce an "In Practice" summary of the study, which can be found on our CFA Institute Research and Policy Center. Below is a lightly edited and condensed transcript of our conversation.

The study analyses some of the implications of sustainable investment in actively managed credit portfolios using carbon emissions, Sustainable Development Goals (SDGs) and green bonds, and reveals a concave relationship between outperformance and sustainability. A non-linear relationship between sustainability and factor investing is the salient finding, according to Vladimirova.

CFA Institute Research and Policy Centre: What does your research study have to tell bond investors?

Desislava Vladimirova: What we are trying to say is that there are two types of investors –

those who focus on returns and those whose investment beliefs include considering the environment, and thus they also target sustainable companies.

Because a focus on sustainable companies would limit the investable universe, investors intuitively expect returns to be reduced. We are trying to show with our research that this is not necessarily the case, and that depending on investors' preferences regarding the level of sustainability they are seeking, there might be optimal combinations that would allow them to stay profitable and still have sustainability.

CFA: Who should be interested in your research findings, and why?

Vladimirova: Our findings are interesting to institutional investors with a focus on corporate debt. The study aims to draw the attention of credit investors who need to fulfil regulatory requirements in terms of sustainability as well as investors with a strong sustainability focus. Our research provides useful insights for all investors willing to integrate sustainable investing because we find that there is an optimal solution for investors with different green preferences.

CFA: What motivated you to conduct this research and author this paper?

Vladimirova: Two reasons: one was the academic aspect – this was a niche that had not been filled in the literature. The second is we work for an asset management company, and we are interested in whether this is feasible and achievable with profitable strategies – to see how plaus-

Sustainability-oriented investors can meet their goals with corporate debt strategies, while profit-oriented factor investors can achieve a portfolio with a certain sustainability level at a low cost. PHOTO: UNSPLASH

ible it is to achieve these two goals together.

CFA: What is novel about your study?

Vladimirova: There has been no research on how to integrate sustainability into active credit strategies. We analyse measures that have not been discussed previously, such as SDGs. We confirm our findings for three different sustainable measures – carbon footprint, SDGs, and green bonds – and we are consistent with our results. We show that these three measures can be integrated into active factor strategies. The factors are quantifiable, and the sustainable measures are quantifiable.

CFA: What do you deem to be your study's most important findings or key takeaways?

Vladimirova: Our study analyses the relationship between sustainability and factor investment. The most important finding is that this relationship is not a zero-sum game. We find that constructing optimised dual-target portfolios reveals a concave relationship between factor investment and sustainability, meaning that investors' target trade-offs are not zero-sum in nature.

This implies that factor investors willing to comply with minimum sustainability standards can do so with minor impact on performance. And investors with a strong sustainability focus can benefit from exposure to profit-oriented strategies, while still being predominantly invested in sustainable assets.

CFA: What are the key practical applications of your research?

Vladimirova: We believe that our study can be applied to the portfolio construction process of factor strategies. We provide a dual objective optimisation methodology that can consider various investors' sustainability preferences and combine them with credit signals under plausible risk and turnover constraints.

Our results exhibit robustness for different sustainability measures and factor definitions. And, as such, investors only need to decide on their optimal factor sustainability mix. We show that for a practitioner who wants to be profitable and wants to reduce carbon emissions, this is very easily achievable.

But we also show that investors who want to participate in environmental projects and invest in green bonds can be profitable. We basically show that there is an optimal solution for everybody.

The writer has more than 30 years of experience as a financial writer and editor, with a focus on institutional investment management