



## Asset TV: Climate transition – threats and opportunities

Nikko AM's Head Portfolio Manager – Core Markets, Steven Williams, recently participated in Asset TV's Masterclass on the threats and opportunities for investors in the climate transition. Here are the highlights of Steven's contribution to the discussion. Please click [here](#) to watch the programme in full.

By Steven Williams, Head Portfolio Manager – Core Markets  
19 July 2023

### Key Takeaways



- For fixed income investors, impact and engagement are going to be key factors in the transition to net zero.
- Green and sustainable bonds provide a unique opportunity to achieve direct impact.
- Supporting transitioning companies in the hard-to-abate “brown” sectors will be the most impactful, as they contribute most to the carbon output.

### Q: Climate transition is a complex topic with lots of nuances – what are your key focuses?

In the transition to net zero, our idea is to focus on impact and engagement. We are engaging in the global fixed income markets, and using green and sustainable investments in the transition towards overall sustainability in order to meet net zero targets. We are particularly trying to focus on those companies which have ambitious targets for net zero and carbon reduction.

This is an area that is going to affect us all going forward so we have a vested interest in tackling this issue. However, for investors, impact and engagement are going to be key.

## **Q: As a sustainably-orientated fixed income investor, do you think you are better able to generate returns by avoiding the looming risks on the horizon or by tapping into real opportunities?**

Fixed income provides a unique opportunity, especially in green and sustainable bonds, as they enable direct impact. To clarify, green bonds are part of the wider sustainable bonds universe. Sustainable bonds encompass everything in terms of social and green bonds, which are currently the majority subset of this wider universe and focus more on pure carbon impact.

So by investing in green bonds, we are working with companies looking to finance projects with environmental benefits. We have a focus on companies in the traditional and developed industries—those that actually contribute most to the carbon output. We believe that investing in this space is going to have a significant impact in transitioning these traditional brown industries away from contributing to climate change.

Tax incentives, such as the Inflation Reduction Act in the US, are going to have a significant impact going forward in terms of meeting net zero targets by helping these traditional brown industries readjust.

Green bonds are also having an impact on emerging markets, particularly investments via the multilateral development banks which allocate capital to emerging markets. We think this will help those economies emerge from poverty and align their standards of living with the rest of the world.

## **Q: Do investors need to prioritise values over performance when considering sustainable investments?**

In terms of green and sustainable bonds, there has been an issue around the notion of “greeniums” and yield premiums historically, which we think is reflective of the more limited liquidity in this up-and-coming space. Now that the market has grown, to slightly less than USD 4 trillion, these issues have become less of a factor and we are now seeing yields in the sustainable space comparable to those in the traditional global fixed income universe, therefore we do not believe investor returns will need to be sacrificed. In our view, you can create a green and sustainable portfolio that will equal the returns from traditional fixed income.

## **Q: Is it true that for some sustainable bonds the coupon will go down a little if targets are being met?**

This refers to sustainability-linked bonds, which is an emerging sector that has merit but where, at present, uncertainties remain. For example, it’s unclear whether the EU Taxonomy will qualify them for inclusion in Article 9 funds, which will be determined in the autumn.

Overall, we think a system of incentives, rather than a defined use of proceeds, is positive but more work needs to be done as these covenants are often toothless and could be developed further. However, we don’t want to discount this area entirely. There are certainly some companies that have stated some ambitious carbon transition targets, but doing your due diligence is particularly important for these investments. [Click here](#) for further insight into the case for sustainability-linked bonds.

## **Q: Do you use conventional mainstream bond indices and try to beat them through active and sustainable management, or do you use tilted benchmarks?**

We use tilted benchmarks that are filtered to reflect the sustainable universe. However, the issue with some of these tilted universes is that they focus on services and tech companies that traditionally don’t have a lot of climate impact. In our view, most impact is going to come from the brown space—traditional oil and gas and hydrogen producers and companies looking to transition away from the grey space.

## **Q: As you have stated, the only way the world is going to get better is if we reform some of the sinners in these brown areas. How do you align having such companies in your portfolio?**

Instead of just passively investing, we actively engage with the issuers, analysing where proceeds are going, what are these companies doing, how transparent they are, what data they are providing and whether we can monitor these investments. We even consider the character of the management – are they going to do what they say, do we believe

them, are they credible? All of these factors and doing your own due diligence can confirm whether what they are saying is true.

## Q: How can you influence corporates as a bondholder, as opposed to an equity holder who has voting rights?

Simple things, such as taking a meeting with an issuer or going to a conference can make a difference. Debt investors may not have a vote, but we can vote with our feet and simply not invest while continuing to follow what these companies are doing. We can also ask questions of investor relations departments—they are usually responsive and cordial – and therefore you generally receive a response regardless of how large/small an investor you are. So while we can't vote, we can still ask, and we believe that's very important on the engagement side for fixed income holders.

## Q: What are the areas you are most focused on?

Electricity generation is going to be critical as it is such a high contributor to the global carbon output, so providing capital to enable that transition to green and renewable power sources will be essential. Particularly when you consider forecasts suggest electricity consumption is going to double or perhaps quadruple over the next 30 years; much of the capital needed for that expansion is going to come from the debt markets so picking and choosing the utility providers that have ambitious targets is going to be key.

**For any questions in regard to this report, please contact:**

**Nikko AM team in Europe**  
Email: [EMEAenquiries@nikkoam.com](mailto:EMEAenquiries@nikkoam.com)

---

**Important information:** This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (Nikko AM) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

**Japan:** The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

**United Kingdom:** This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

**Luxembourg and Germany:** This document is communicated by Nikko Asset Management Luxembourg S.A., which is authorised and regulated in the Grand Duchy of Luxembourg by the Commission de Surveillance du Secteur Financier (the CSSF) as a management company authorised under Chapter 15 of the Law of 17 December 2010 (No S00000717) and as an alternative investment fund manager according to the Law of 12 July 2013 (No. A00002630).

**United States:** This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

**Singapore:** This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

**Hong Kong:** This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

**New Zealand:** This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

**Kingdom of Bahrain:** The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

**Kuwait:** This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

**Kingdom of Saudi Arabia:** This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

**Oman:** The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

**Qatar (excluding QFC):** The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

**United Arab Emirates (excluding DIFC):** This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

**Republic of Korea:** This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.