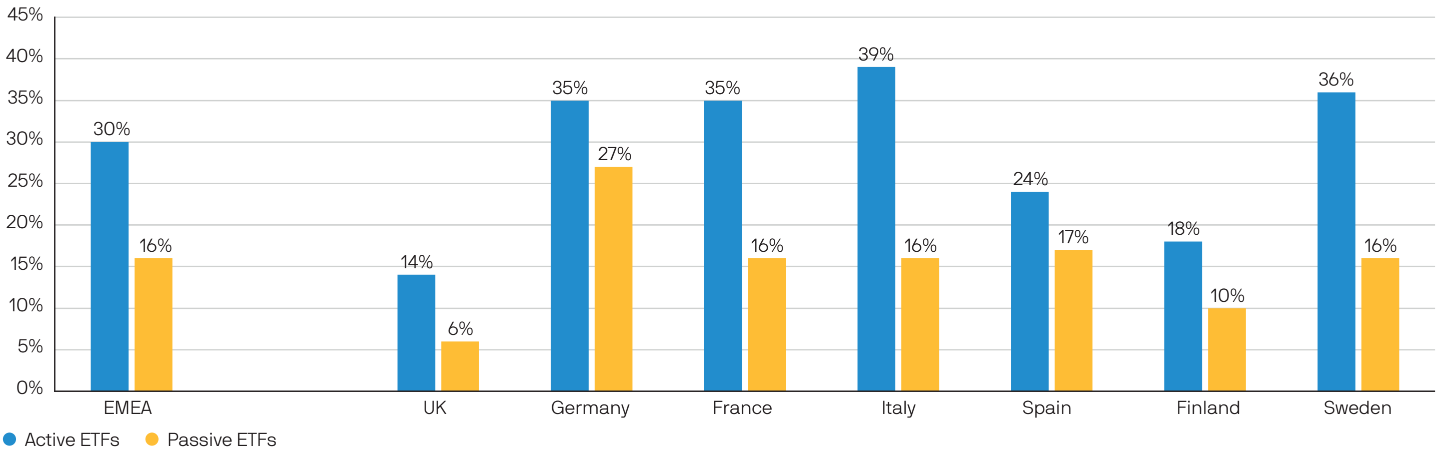
The use of active ETFs in ESG investing

Environmental, social and governance (ESG) factors are increasingly being used alongside traditional financial metrics to inform investment decisions. There are several ways that investors can deploy ESG factors in their investment portfolios. In the ETF world, passive strategies are the dominant force, but our recent investor survey showed that active strategies are becoming a popular avenue for investors to access ESG opportunities.

J.P. Morgan Asset Management's Future Focus survey questioned 1,000 professional investors across Europe. The research explored the existing ESG investment landscape and the evolution of ESG investing. One key area of interest was the use of ETFs for ESG investing. The results showed that almost a third of respondents use active strategies to meet their ESG goals, compared to only 16% who use passive ETFs.

Allocation of ESG investments among active and passive ETFs by region



Source: J.P. Morgan Asset Management Future Focus Survey 2022.

Why are active ETFs so popular for ESG investing?

Active ETFs work by tapping into the research skills of professional portfolio managers and analysts, who look to exploit inefficiencies in stock or bond indices to boost risk-adjusted returns. For example, active fixed income ETFs can use sector and security selection to maintain a very similar duration and credit exposure over time, making them ideal for investors looking to change their yield curve positioning or sensitivity quickly and efficiently to credit spreads.

Active strategies can also provide efficient exposure to specific investment criteria, such as securities with strong ESG characteristics. Our survey showed that investors realise effective sustainable investing involves searching for companies that are making a positive contribution and actively modifying their business models to be more sustainable. Passive ESG ETFs typically do this by applying exclusions of controversial sectors or, if a sharper ESG focus is required, they track ESG indices, such as Socially Responsible Investment (SRI) or Paris-Aligned benchmarks. By selecting a passive ESG ETF, investors are fully reliant on the index providers' ESG analysis.

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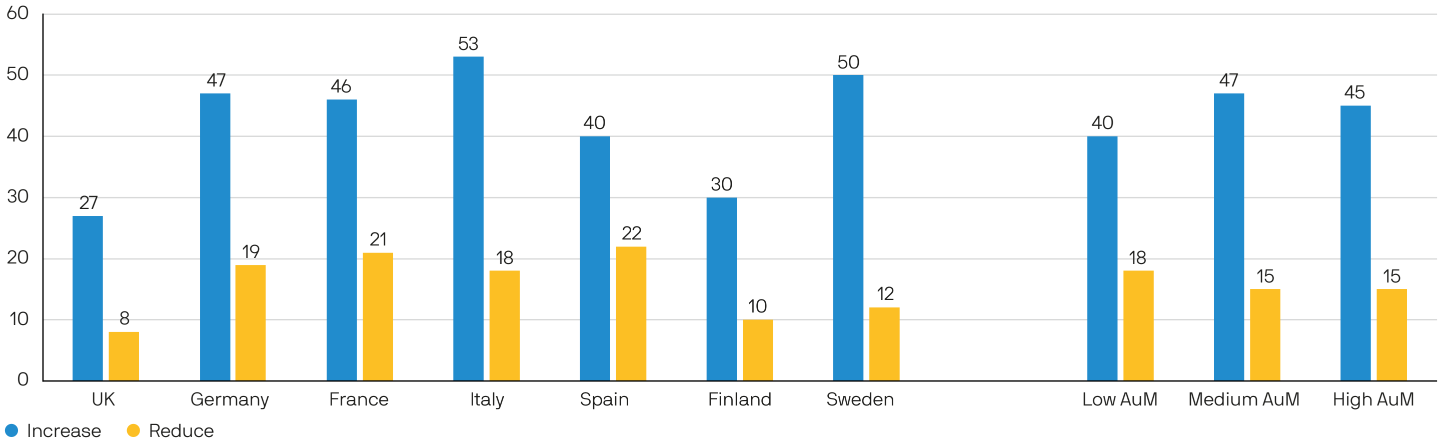
Active managers, by contrast, can use proprietary ESG research to help them seek out sustainable opportunities and avoid ESG risks, rather than rely on third-party analysis or corporate disclosures alone. An active approach can therefore allow for a more in-depth assessment of ESG characteristics. Additionally, an active approach permits more effective corporate engagement.

While index trackers may seek to influence companies through proxy voting, active investment teams can embed ESG considerations throughout the investment process and engage with companies to create value, or to help them avoid ESG risks – potentially enhancing risk-adjusted returns over the long term.

Likely allocation changes of ESG investments via active ETFs over the next 5 years



Source: J.P. Morgan Asset Management Future Focus survey 2022.

JPMAM's approach to active ETFs

While it seems clear that investors would like to increase their exposure to active ETFs, there are several factors that should be considered when selecting a provider. These include investment resources, stewardship policies and price.

J.P. Morgan Asset Management's (JPMAM), active ETFs are backed by the extensive research, trading and technology resources of one of the world's leading asset managers. It's this combination of investment expertise and ETF know-how that allows us to track indexes more efficiently, provide competitively priced access to new opportunities and enforce robust investment processes. Our ESG ETFs draw on the active insight and in-house data of our global research teams and our smart beta innovation.

The scale and reach of our investment stewardship programme is another key differentiator. As mentioned, investment stewardship is a crucial component of active ESG investing and central to maximising shareholder value over time. A large global network of research analysts and stewardship specialists is necessary for this. Large active asset managers with broad, global research capabilities can facilitate powerful engagement with company CEOs, CFOs or Board chairs.

At JPMAM, we maintain active engagement with the companies in which we invest, exercising our voice as a long-term investor in industry participation and proxy voting. We harness our influence to encourage positive corporate change and industry developments that benefit our clients. For example, in one of our flagship active ETFs, the JPM Global Research Enhanced Index Equity (ESG) UCITS ETF, we engaged with 294 of the 730 stocks in that ETF in the first nine months of 2022. That's equivalent to 58% of its AUM. Of that number, we engaged with 130 companies on climate change issues. It is also worth noting our engagement is not just focused on US companies. Over the period, we engaged with around 60 companies in Japan and 70 in Europe.

With investors becoming more demanding of asset management firms, particularly with regards to investing sustainably, active ETFs appear to provide a sweet spot of more rigorous exposure to ESG themes while maintaining the benefits of the ETF wrapper.

JPMAM's active ETF offering stretches more than 15 ESG ETFs classified as Article 8 or 9 under the SFDR regulation. From core building blocks with robust ESG frameworks to targeted thematic solutions, investors can choose from a wide range of J.P. Morgan ESG ETFs to express sustainability preferences in their portfolios.

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