Get active in the growing green, social and sustainability bond market with ETFs

Financial markets are playing an important part in meeting global environmental and social challenges, thanks to support from governments and central banks combined with innovation and demand from the broader investment community.

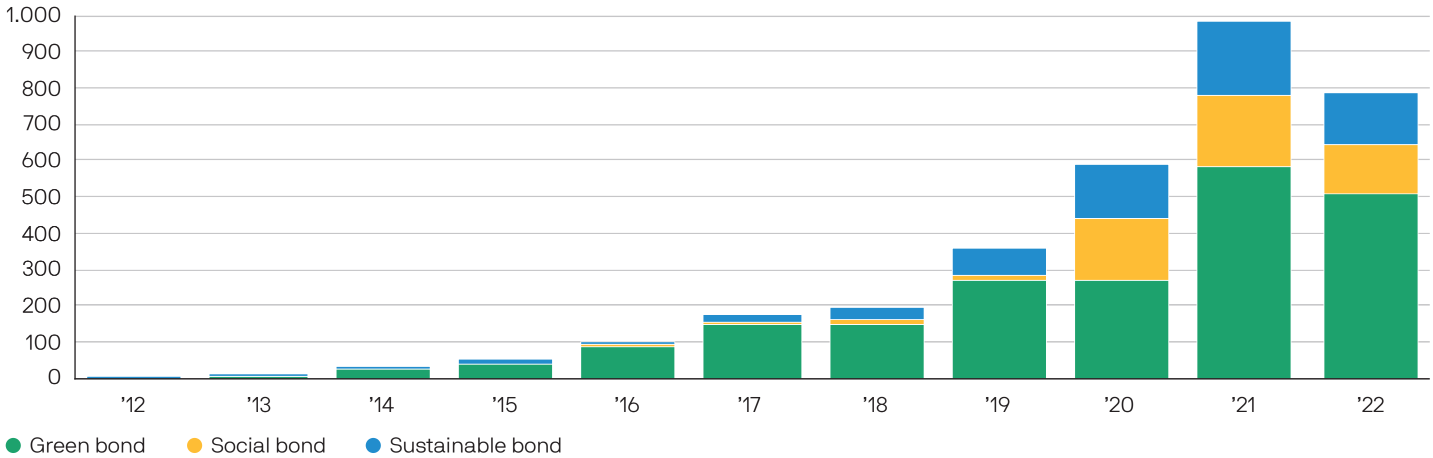
Green, social and sustainability (GSS) bonds – debt instruments issued to fund environmentally and/or socially beneficial projects – have a unique role because they directly link government and corporate efforts to fund sustainable activities and public interest in investing in a more sustainable future.

While the market for GSS bonds has boomed, global enforcement of standards is still lacking. Active management backed by deep research resources will be key to avoiding greenwashing and regulatory risks.

Size up the market. GSS bond have proven popular with both issuers and investors, leading to a significantly bigger, broader and more diverse market. Annual green bond issuance almost tripled from 2017 to 2021 and social bond issuance is now growing at a similarly rapid pace, increasing over 500% in 2020.[1] As a result, total GSS debt stands at roughly USD 2.6 trillion (**Exhibit 1**).[2]

Exhibit 1: Global sustainable, social and green bond issuance

USD billions



Source: Refinitiv Eikon, J.P. Morgan Asset Management. Green bonds are those where 100% of the net bond proceeds are allocated to green projects. Social bonds are those where the bond proceeds have a focus on delivering positive social outcomes. Sustainable bonds are those where the bond proceeds are directed to a mix of both green and social projects or if the bond coupon/ characteristics can vary based on achieving predefined sustainability targets. **Past performance is not a reliable indicator of current and future results.** *Guide to the Markets - Europe*. Data as of 31 December 2022.

This growth in market size is one piece of good news for investors; they can also cheer the increasing diversification of the GSS market, particularly by issuer type. For example, while the private sector still dominates green bond issuance, the growth in social and sustainability bonds is being fueled by governmental bodies and supranational issuers. With robust investor demand for GSS bonds and further plans from issuers to finance sustainable initiatives, these issuance trends look set to continue.

The bigger and more diverse GSS market has led to the inclusion of GSS bonds in global indices, further bringing the asset class into the mainstream. Bloomberg has launched a new Global Aggregate Green Social & Sustainability Bond Index, which includes over 1,700 issuers and exhibits core-like, high-quality characteristics, such as a yield of 4.1%, duration of 7.1 years and an average credit rating of AA-.[3]

[1] Refinitiv Eikon, J.P. Morgan Asset Management.
[2] HSBC Global Research, Green Bond Insights, 30 September 2022.
[3] Bloomberg. Data as of 27 October 2022.

Actively assess the "greenium"

As GSS bonds become increasingly viable for traditional fixed income allocations, investors should note several particular characteristics that make active management valuable, if not essential, to successfully investing in this market.

Due to strong demand, GSS bonds tend to trade at a premium – often known as the "greenium" – to non-green bonds, resulting in a lower yield. The greenium may vary by sector, credit rating and geography, as well as sensitivity to broader market liquidity conditions.

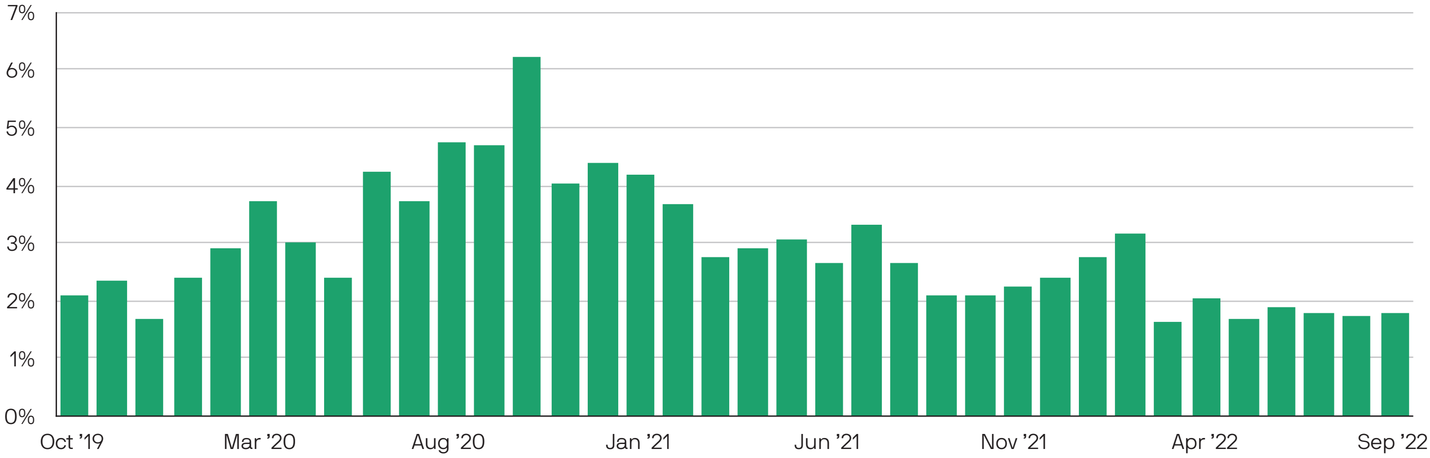
For investors, it's important to look at the greenium in context. It is a function of strong demand, which means it also provides technical support for GSS bond prices. The strong demand could also lead to increased issuance because the cost of capital is lower for GSS issuers, creating a positive feedback loop that helps further grow and diversify the market. In addition, with spreads wider and all-in yields higher following the repricing in fixed income markets last year, the greenium now accounts for a smaller proportion of the spread (**Exhibit 2**).

Critically, as the GSS market expands, premiums are increasingly differentiated. For example, social bonds appear to command a smaller premium than green bonds, while high yield and emerging market GSS bonds will trade at a discount to their investment grade counterparts.

The greenium, therefore, presents an advantage for active managers who can look across the entire spectrum of GSS bonds and may be able to find opportunities through a strong understanding of the technical factors related to demand and the drivers of relative valuations across sectors.

Exhibit 2: Corporate GSS premium as a percentage of overall yield

Corporate GSS greenium as a proportion of overall yield



Source: Bloomberg, J.P. Morgan Asset Management Quantitative Research Group; data as of 30 September 2022.

Guard against "greenwashing"

The potential for greenwashing– overstating or making unproven claims about a product's environmental credentials – demands active management in GSS portfolios.

Given the investor interest in GSS bonds and greenium's effect of lowering the cost of capital, issuers may have financial incentives to raise capital with GSS bonds. But definitions of and standards for sustainability may vary because issuers are not required to adhere to any one specific framework. The Green, Social and Sustainability Bond Principles from the International Capital Markets Association and the forthcoming EU Green Bond Standard are respected efforts, but they are voluntary for issuers.

As a result, GSS bonds may not necessarily meet requirements to qualify for inclusion in some of the more prominent regulatory frameworks, such as an Article 9 classification under the EU's Sustainable Finance Disclosure Regulation (SFDR). To meet this criteria, an issuer must have good governance and do no significant harm toward any EU Taxonomy objective. Yet these factors are not explicitly accounted for in international GSS bond frameworks or benchmarks. Instead, since investors must take on the risk of making these judgements; active management becomes essential.

Wrap GSS bonds in an active ETF

For investors interested in supporting sustainable initiatives through GSS bonds, an active exchange-traded fund (ETF) is a practical and efficient way to gain broad exposure to the asset class. In addition to being transparent, liquid and easy to trade, active GSS ETFs benefit from fixed income and sustainability insights from analysts and portfolio managers and can invest across the full range of GSS bonds.

For a GSS active ETF, it is important to choose an ETF provider with experience and strong capabilities in active management as well as sustainability. J.P. Morgan Asset Management's active ETFs are backed by the extensive research of our global credit teams, as well as our vast global trading and technology resources. We are also experienced ESG ETF providers, with more than 15 ESG ETFs classified as Article 8 or Article 9 under the SFDR regulation.

GSS bonds offer investors a unique opportunity to support environmental, social and sustainable initiatives. An active ETF from an experienced provider is an efficient way to gain exposure to the wide range of securities in this rapidly expanding asset class.

JPM Green Social Sustainable Bond UCITS ETF*

JGRN (acc – USD) | JGNE (acc – EUR-hedged)

The objective of the Sub-Fund is to achieve a long-term return in excess of the Benchmark by investing primarily in bonds where proceeds are directed to projects and activities that contribute towards a more sustainable and inclusive economy.

TER	0.32%
SFDR	Article 9

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