

UNLOCKING SUSTAINABLE & TRANSITION INDICES

iShares
by BlackRock

Drivers of sustainable and low-carbon transition index sentiment in Q3 2024

Quick read

Know your beta

It is important for investors who are seeking to allocate to sustainable and transition exposures to dig deeper into the index methodologies, to select those that are best aligned to their investment goals. Differences in methodologies can lead to significant variations in performance and in the factors driving such variations.

Active stock and sector weights drive equity returns

Stock-specific effects were the main driver of sustainable and transition equity index returns in Q3, followed by sector active weights, which generated positive results in Climate PAB indices. Active country weights generally detracted from performance, except for ESG screened indices.

Traditional macro factors remain key in fixed income

Duration was additive in EUR and USD high yield (HY) in Q3, while the opposite was true for USD investment grade (IG). The impact of the quality factor remained muted. On the other hand, sector nuances contributed significantly to positive active performance in USD HY, while the liquidity factor was a notable detractor.

Setting the scene: rate cuts, earnings breadth and heightened sensitivity

Q3 failed to offer a summer lull in global markets, with August in particular characterised by positioning-driven cross-market volatility. Equity markets sold off at the start of the month, triggered by an undershoot in US non-farm payrolls data, which has since recovered to higher-than-expected levels. The selloff was matched by a sizeable recovery, with the S&P 500 subsequently hitting new highs in September and October. The US Federal Reserve (Fed) also delivered a 50bp rate cut to kick off its easing cycle in September; we expect earnings to broaden in the US and Europe, including in well-positioned cyclicals geared to benefit from developed market (DM) central bank rate cuts, such as utilities and real estate. Sustainable UCITS ETPs saw \$8.6B of inflows in Q3, up from \$5.5B in Q2. Equity and fixed income contributed almost equally, with \$4.5B into the former (52% of Q3 sustainable flows vs. 70% in Q2) and \$4.1B into the latter (48% vs. 30% in Q2).¹

Sustainable & transition equity indices: stock effects drive outperformance

Across the 32 sustainable equity indices evaluated, 63% outperformed their non-sustainable parent benchmark in Q3, down from 85% in Q2, with active returns averaging +0.87%, versus +0.11% in Q2.

Active sector weights generally had a neutral impact on active returns for ESG Screened and SRI Select RFF indices, while being additive for ESG Enhanced and Climate PAB indices. Overweights to the financials sector contributed positively to performance in Screened, Enhanced and SRI indices. However, for the latter, the largest contribution came from an overweight to the consumer discretionary sector.

Country weights detracted from returns in ESG Enhanced, Climate PAB and World SRI indices in Q3 and had a muted effect on ESG Screened indices. Underweights to the UK produced negative results in Europe and World Screened products, but positive results in Europe Enhanced. Overweights to the US proved a detractor in World Screened, while underweights to the US were additive for World SRI and World PAB.

Stock-specific effects were additive for performance in Enhanced, Climate PAB and SRI indices, while having a muted effect on Screened indices. An underweight to Boeing had a positive impact, while underweights to Coca-Cola and Philip Morris detracted from returns in USA and World Screened indices. An overweight to Tesla contributed positively to World and USA SRI indices' performance.

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Full performance data is available on pages 3 and 4. Source: BlackRock, as of 30 September 2024.

¹ Source: BlackRock and Markit, as at 30 September 2024. All figures in USD.

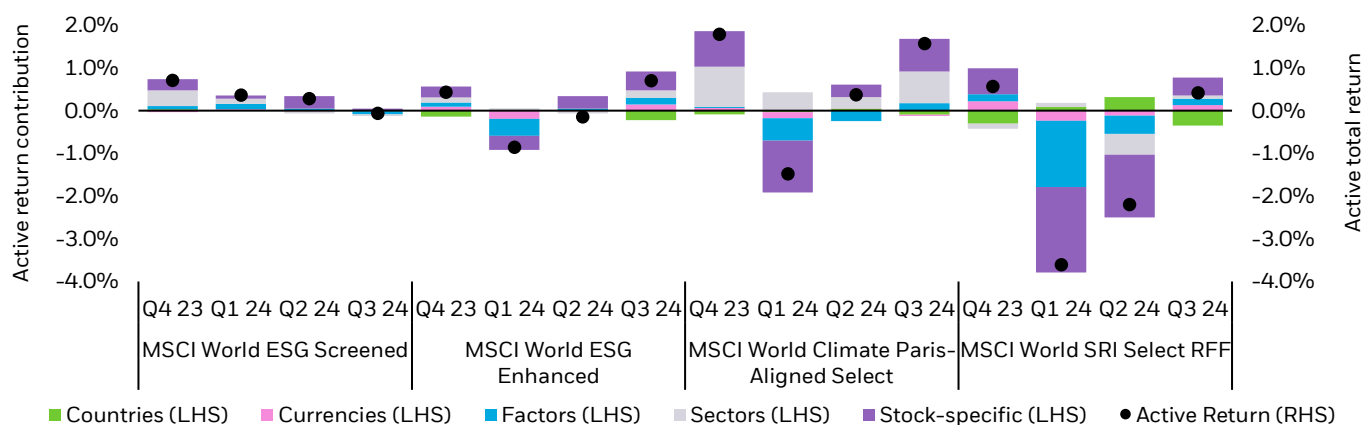
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Digging deeper: analysing index exposures



Figures 1 & 2 overleaf show how differences in methodologies across a range of sustainable and transition indices can lead to significant variations in composition and performance, helping to shed light on the drivers of active returns. **For more detailed analysis, please contact your relationship manager.**

Figure 1: Drivers of active returns vs. parent benchmarks, MSCI World sustainable index range, Q4 2023 – Q3 2024



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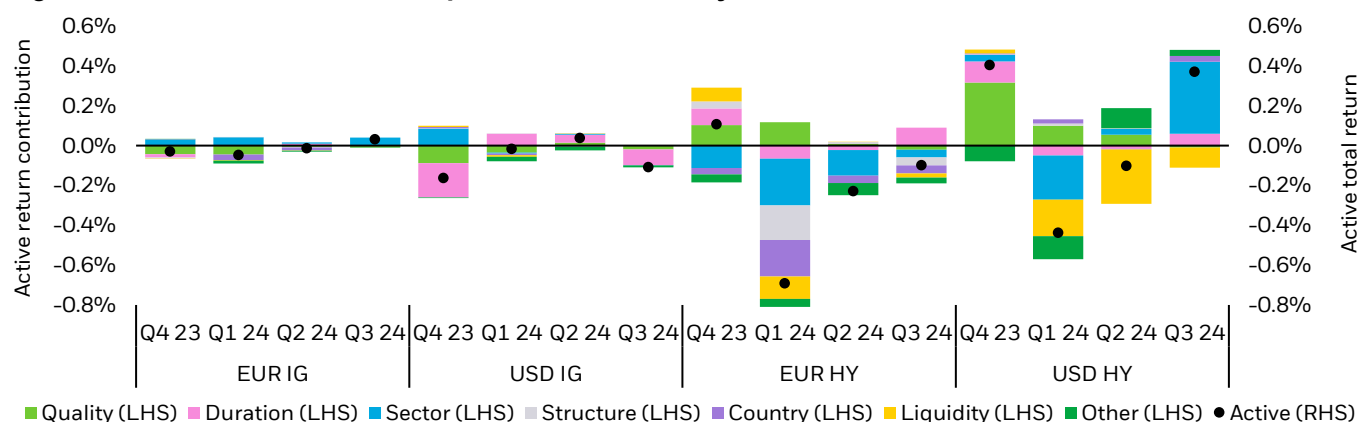
Sustainable & transition fixed income indices: duration and sectors stand out across IG and HY indices; liquidity also impacts USD HY

Across the 19 sustainable fixed income indices we analysed, 79% outperformed their non-sustainable parent benchmarks in Q3 2024, up from 47% in Q2. Average active return in Q3 was 0.16%, driven largely by the outperformance of the global climate government index, as well as sustainable and transition USD HY indices.

Traditional fixed income factors remained key in explaining active returns vs. parent indices for sustainable SRI credit indices. Duration was again an important driver: in USD IG, the shorter duration profile of the sustainable index vs. its parent was the main detractor from active returns, especially in July as the slowdown in June CPI and weaker-than-expected economic data bolstered the case for a potential US rate cut in September, triggering yield curve steepening. Conversely, the slightly longer duration profile of USD and EUR HY sustainable SRI indices vs. their parent indices added to active returns in Q3. Our research also shows that sustainable indices tend to display a higher credit quality tilt vs. their parent indices, as a by-product of the sustainable methodology. This quality tilt slightly detracted from active returns in Q3 across IG and HY sustainable indices given tightening credit spreads over the period.

Sector nuances had varying impacts, most notably adding to active returns in USD HY, where an overweight to financials – especially the banking sector – contributed positively to active returns in Q3. Similarly, in EUR IG, the outperformance of the sustainable SRI index was largely driven by an overweight to banking names. Conversely, in EUR HY, an underweight to industrials – specifically to the communication sector – detracted from active returns over the quarter. Country differences, namely underweights to Sweden and Italy, detracted from EUR HY returns in August and September, while the liquidity factor had a larger negative contribution to USD HY returns over the same period.

Figure 2: Drivers of active returns vs. parent benchmarks, key sustainable fixed income indices, Q4 2023 – Q3 2024



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Source: BlackRock, as of 30 September 2024. Active return is defined as the total return difference between ESG and non-ESG index. For each Total return component theoretical DxS tilt return is calculated, except for the duration return: $[Active\ DxS / Parent\ DxS * Excess\ Return\ of\ Parent]$

Components are additive and their ordering matters as previous tilt returns are subtracted from any additional tilt return. E.g. sector tilt will be calculated by combining quality and sector partitions and subtracting quality return (duration already being accounted for, as outlined above). See page 4 for full performance data. USD IG: Bloomberg MSCI US Corporate Sustainable SRI Index. EUR IG: Bloomberg MSCI Euro Corporate Sustainable SRI Index. USD HY: Bloomberg MSCI US Corporate High Yield Sustainable BB+ SRI Bond Index. EUR HY: Bloomberg MSCI Euro Corporate High Yield Sustainable BB+ SRI Bond Index.

Figure 3: Performance of equity indices used in this analysis

	Index	2019	2020	2021	2022	2023	H1 2024	Q3 2024
Global equities	MSCI World	27.67%	15.90%	21.82%	-18.14%	23.79%	11.74%	6.36%
	MSCI World ESG Screened	28.15%	17.56%	22.16%	-19.61%	26.23%	12.42%	6.30%
	MSCI World ESG Enhanced Focus CTB	28.36%	17.59%	22.34%	-20.19%	22.78%	10.70%	7.06%
	MSCI World SRI Select RFF	30.14%	21.20%	25.05%	-21.37%	24.96%	5.72%	6.78%
	MSCI World Climate Paris-Aligned Select	29.36%	18.35%	22.01%	-21.88%	25.48%	10.62%	7.93%
	Dow Jones Global Index	26.06%	16.21%	17.70%	-18.63%	21.32%	10.10%	6.90%
	Dow Jones Sustainability World Enlarged Index ex Alcohol, Tobacco, Gambling, Armaments & Firearms and Adult Entertainment	26.75%	13.94%	21.67%	-16.89%	26.84%	8.85%	6.14%
	MSCI World Small Cap	26.19%	15.96%	15.75%	-18.76%	15.76%	1.48%	9.39%
	MSCI World Small Cap ESG Enhanced Focus CTB	27.12%	16.08%	15.45%	-18.95%	14.07%	0.91%	9.39%
US equities	MSCI USA	30.88%	20.73%	26.45%	-19.85%	26.49%	14.64%	5.82%
	MSCI USA ESG Screened	31.29%	22.20%	27.14%	-21.14%	29.64%	15.37%	5.76%
	MSCI USA ESG Enhanced Focus CTB	31.82%	22.27%	26.70%	-21.58%	25.38%	13.47%	6.30%
	MSCI USA SRI Select RFF	31.80%	26.28%	30.49%	-18.80%	23.88%	5.63%	6.94%
	S&P 500	30.70%	17.75%	28.16%	-18.51%	25.67%	15.29%	5.78%
	S&P 500 ESG Net USD	32.54%	19.13%	31.22%	-18.08%	27.36%	15.53%	5.27%
	S&P 500 Paris-Aligned Climate Sustainability Screened	33.48%	23.56%	31.42%	-22.86%	30.14%	15.90%	5.76%
	MSCI USA Small Cap	26.74%	18.32%	19.11%	-17.55%	17.86%	2.03%	8.71%
	MSCI USA Small Cap ESG Enhanced Focus CTB	27.21%	19.12%	19.01%	-17.53%	15.53%	1.09%	8.77%
European equities	MSCI Europe	26.05%	-3.32%	25.13%	-9.49%	15.83%	9.05%	2.35%
	MSCI Europe ESG Screened	25.99%	-1.70%	24.77%	-11.60%	17.67%	9.46%	2.39%
	MSCI Europe ESG Enhanced Focus CTB	26.41%	-1.57%	25.26%	-12.62%	15.87%	9.03%	2.89%
	MSCI Europe SRI Select RFF	31.37%	3.80%	26.67%	-15.38%	16.99%	9.46%	1.48%
	MSCI Europe Climate Paris-Aligned Select	28.97%	2.20%	25.14%	-13.88%	16.44%	8.55%	3.91%
Eurozone equities	MSCI EMU	25.47%	-1.02%	22.16%	-12.47%	18.78%	8.33%	3.07%
	MSCI EMU ESG Screened	24.89%	-0.08%	22.46%	-13.42%	19.71%	8.86%	2.77%
	MSCI EMU ESG Enhanced Focus CTB	25.59%	0.90%	22.39%	-13.32%	18.28%	8.67%	3.65%
	MSCI EMU SRI Select RFF	32.10%	1.49%	20.93%	-15.31%	15.07%	8.37%	4.22%
	MSCI EMU Climate Paris-Aligned Select	27.72%	2.92%	21.95%	-15.38%	17.15%	7.54%	4.70%
Japanese equities	MSCI Japan	19.61%	14.48%	1.71%	-16.65%	20.32%	6.27%	5.72%
	MSCI Japan ESG Screened	21.02%	15.18%	1.58%	-17.04%	19.90%	5.83%	5.52%
	MSCI Japan ESG Enhanced Focus CTB	21.95%	15.26%	1.35%	-17.47%	19.82%	3.82%	6.16%
	MSCI Japan SRI Select RFF	25.63%	15.69%	1.68%	-17.93%	13.28%	1.96%	8.88%
Emerging market equities	MSCI EM	18.42%	18.31%	-2.54%	-20.09%	9.83%	7.39%	8.72%
	MSCI EM ESG Enhanced Focus CTB	17.86%	19.62%	-2.09%	-21.82%	8.93%	6.04%	9.95%
	MSCI EM SRI Select RFF	12.12%	19.00%	-0.44%	-18.33%	2.53%	2.44%	12.86%
	MSCI EM IMI	17.64%	18.39%	-0.28%	-19.83%	11.67%	7.41%	8.24%
	MSCI EM IMI ESG Screened	18.23%	19.25%	-0.82%	-20.72%	11.38%	7.42%	8.46%
Pacific ex. Japan	MSCI Pacific ex Japan	18.36%	6.55%	4.68%	-5.94%	6.44%	0.75%	14.29%
	MSCI Pacific ex Japan ESG Enhanced Focus CTB	20.81%	5.31%	4.86%	-6.49%	4.28%	-0.01%	14.24%

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Figure 4: Performance of fixed income indices used in this analysis

	Index	2019	2020	2021	2022	2023	H1 2024	Q3 2024
Ultrashort bonds	iBoxx GBP Liquid Investment Grade Ultrashort Index	1.20%	0.92%	0.19%	1.23%	4.80%	2.80%	1.34%
	iBoxx MSCI ESG GBP Liquid Investment Grade Ultrashort Index	1.17%	0.89%	0.19%	1.21%	4.79%	2.80%	1.33%
	iBoxx EUR Liquid Investment Grade Ultrashort Index	0.24%	0.14%	-0.28%	-0.28%	3.39%	1.98%	1.12%
	iBoxx MSCI ESG EUR Liquid Investment Grade Ultrashort Index	0.15%	0.20%	-0.31%	-0.30%	3.39%	1.99%	1.11%
	iBoxx USD Liquid Investment Grade Ultrashort Index	3.16%	1.41%	0.23%	1.43%	5.67%	2.72%	1.72%
	iBoxx MSCI ESG USD Liquid Investment Grade Ultrashort Index	3.11%	1.64%	0.22%	1.40%	5.68%	2.72%	1.72%
Investment grade (IG) credit	Bloomberg EUR Corporate 0-3 Year Index	1.00%	0.62%	-0.03%	-3.53%	4.66%	1.59%	1.93%
	Bloomberg MSCI Euro Corporate 0-3 Sustainable SRI Index	0.95%	0.62%	-0.04%	-3.61%	4.61%	1.55%	1.94%
	Bloomberg Euro Corporate Index	6.24%	2.77%	-0.97%	-13.65%	8.19%	0.54%	3.27%
	Bloomberg MSCI Euro Corporate Sustainable SRI Index	5.92%	2.70%	-0.99%	-13.48%	8.00%	0.48%	3.30%
	Bloomberg MSCI EUR Corporate Climate Paris Aligned ESG Select Index	-	2.59%	-0.95%	-13.88%	8.16%	0.54%	3.35%
	Bloomberg US Corporate 0-3 Year Index	4.65%	3.18%	-0.01%	-2.07%	5.47%	2.08%	2.68%
	Bloomberg MSCI US Corporate 0-3 Sustainable SRI Index	4.56%	3.32%	-0.06%	-2.14%	5.48%	2.06%	2.68%
	Bloomberg US Corporate Index	14.54%	9.89%	-1.04%	-15.76%	8.52%	-0.49%	5.84%
	Bloomberg MSCI US Corporate Sustainable SRI Index	13.81%	9.98%	-1.28%	-15.03%	8.40%	-0.46%	5.71%
	Bloomberg MSCI US Corporate Climate Paris Aligned ESG Select Index	-	10.94%	-1.09%	-16.10%	8.51%	-0.52%	5.86%
High yield (HY) credit	Bloomberg Pan-European High Yield (Euro) Index	11.33%	2.29%	3.43%	-10.64%	12.12%	2.83%	3.35%
	Bloomberg MSCI Euro Corporate HY Sustainable BB+ SRI Bond Index	-	1.74%	2.76%	-10.76%	11.02%	1.89%	3.22%
	Bloomberg Euro High Yield 3% Issuer Capped Index	11.27%	2.25%	3.44%	-10.64%	12.12%	2.83%	3.35%
	Bloomberg MSCI EUR Corporate High Yield Climate Paris Aligned ESG Select Index	-	-	3.19%	-11.08%	11.05%	2.51%	3.58%
	Bloomberg US Corporate High Yield Index	14.32%	7.11%	5.28%	-11.19%	13.45%	2.58%	5.28%
	Bloomberg MSCI US Corporate HY Sustainable BB+ SRI Bond Index	-	7.13%	4.81%	-11.98%	12.77%	2.03%	5.68%
	Bloomberg US High Yield 3% Issuer Capped Bond Index	14.32%	7.10%	5.28%	-11.19%	13.44%	2.58%	5.28%
	Bloomberg MSCI US Corporate High Yield Climate Paris Aligned ESG Select Index	-	-	4.46%	-13.09%	12.31%	2.11%	5.93%
Emerging market debt	JP Morgan EMBI Global Diversified Index	15.04%	5.26%	-1.80%	-17.78%	11.09%	2.34%	6.15%
	JP Morgan ESG EMBI Global Diversified Index	15.94%	5.78%	-2.35%	-18.92%	10.26%	1.87%	6.37%
	JP Morgan EMBI Global Diversified IG Only Index	16.57%	8.92%	-1.93%	-19.76%	7.08%	-0.45%	5.62%
	JP Morgan ESG EMBI Global Diversified IG Index	16.36%	10.12%	-2.29%	-20.43%	7.18%	-0.61%	5.69%
Aggregate indices	Bloomberg Global Aggregate Index	6.84%	9.20%	-4.71%	-16.25%	5.72%	-3.16%	6.98%
	Bloomberg MSCI Global Aggregate Sustainable and Green Bond SRI Index	6.74%	9.24%	-4.83%	-16.41%	5.76%	-3.24%	7.00%
	Bloomberg EUR Aggregate Index	5.98%	4.05%	-2.85%	-17.18%	7.19%	-1.21%	3.74%
	Bloomberg MSCI EUR Aggregate Sustainable and Green Bond SRI Index	5.84%	4.11%	-2.87%	-17.21%	7.26%	-1.21%	3.75%
Government bonds	FTSE EMU Government Bond Index	6.72%	5.03%	-3.54%	-18.52%	7.16%	-1.94%	4.01%
	FTSE Advanced Climate Risk-Adjusted EMU Government Bond Index	6.77%	5.57%	-3.47%	-18.26%	7.29%	-1.85%	4.06%
	FTSE World Government Bond Index	5.90%	10.11%	-6.97%	-18.26%	5.19%	-3.96%	6.95%
	FTSE Advanced Climate Risk-Adjusted World Government Bond Index	6.11%	11.91%	-8.05%	-22.08%	6.60%	-5.59%	8.42%

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