In our last paper\(^1\) we established how asset owners can include a sustainability budget alongside their risk and governance budgets. How to implement this at a total portfolio level is the next challenge that asset owners face. We believe that there are five practical issues asset owners need to address when implementing environmental, social and governance (ESG) considerations across assets:

1. Establish an overarching ESG philosophy that applies across the total portfolio.
2. Understand the effect on the total portfolio of using ESG asset components or removing asset classes that cannot incorporate ESG.
3. Decide whether ESG should be applied to asset allocation decisions.
4. Decide how ESG will be applied to the component asset classes.
5. Figure out how to evaluate the impact of ESG consistently across the portfolio.

In this paper we consider all of these issues, providing our views and approach to help asset owners with the same dilemmas we have faced when developing ESG multi-asset portfolios.

**Establishing an ESG philosophy at a total portfolio level**

While it is possible to put together a portfolio of individual ESG components, our view is that asset owners should select these to be consistent with their ESG philosophy. As we explained in our previous paper, there are many definitions of ESG and components could have very different characteristics. For example, a screened equity portfolio could remove all exposure to oil and gas companies whereas an integrated equity portfolio may retain companies that were demonstrating a commitment to carbon reduction.

Schroders’ ESG multi-asset investment philosophy is:

- ESG factors should be taken into account to make better investment decisions. The primary impact of ESG factors is in security selection, but we also believe it is important to consider ESG for asset allocation.
- The choice of investment universe is a critical part of building a multi-asset portfolio. We use the idea of a sustainability budget, measured as a percentage of the relevant capital allocation in the portfolio, which integrates ESG factors or is managed in a sustainable way.
- Some asset classes (e.g. commodities) or sectors (e.g. tobacco) can be removed from the portfolio if it is believed that these cannot be managed sustainably (and are unlikely to be in the future). Other asset classes and sectors may remain in the portfolio if they are either currently managed according to an ESG approach or if they could be managed with this approach in the future but are currently held for diversification reasons.
- A specialist sustainability team, that is also responsible for corporate engagement and voting, should facilitate integrating ESG into security selection.
- For multi-asset portfolios, we believe it is important to understand the aggregate impact of our investment choices rather than a piecemeal approach using different metrics.

**The sustainability budget and approaches to implementation across multiple asset classes**

In our previous paper, we explained that there is likely to be a trade-off between the sustainability budget and diversification in a portfolio. Practically this means that the asset owner/investor will need to make some decisions about these trade-offs and we attempt to quantify this trade-off in the following section.

There is a range of ways to implement a multi-asset portfolio that range from 0% sustainable to 100% sustainable as shown in Figure 1. However, there are portfolios between these two points that can be regarded as partially sustainable and fully diversified with differing impacts on diversification and the risk budget.

**What is the implication of incorporating sustainability for multi-asset portfolios?**

Building a multi-asset portfolio that meets the sustainability budget set by the asset owner depends in large part on the availability of sustainable components. Where components are not available for all of the asset classes in the asset owner’s strategic asset allocation, a compromise will have to be made between the extent of diversification and sustainability in the portfolio.

In order to improve the amount of sustainability in the portfolio (the sustainability budget), an asset owner has two options:

a) Replace non-ESG components with screened, integrated or sustainable components.

b) Remove non-ESG components from the portfolio if they can’t be managed in one of these three approaches.

First, we will examine the impact of removing non-ESG components. This will reduce diversification as we outlined in our previous paper, but to what extent?

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\(^1\) Managing sustainability from a total portfolio perspective, Schroders, March 2019
Figure 2 shows the starting strategic asset allocation portfolio. The diversification benefit, which reduces risk from around 8% to below 6%, is a significant 2.1% reduction in risk.

Our assessment of the availability of sustainable components (discussed later in the paper, see section Which ESG components can be used? on page 5) reveals that alternative assets, especially commodities and hedge funds, are the most difficult to implement in an integrated/sustainable way, so in Figure 3 we show the impact of removing them from the asset allocation. When we remove an asset class from a portfolio, the capital that was allocated to that asset class has to be reallocated to another asset class. In the case of alternatives, we have reallocated the capital to equities because alternatives are typically classified as growth assets.

Evaluating the impact of removing non-ESG components

In the most basic terms, portfolio risk is made up of two components: the risk of the individual components (standalone risk), and the relationship between the components (diversification benefit). In aggregate, the former will always have a positive contribution to risk, while the latter will reduce risk. Starting with a simple multi-asset portfolio (the ‘base case’), we can observe these two components of portfolio risk and assess their behaviour as and when components are removed from the portfolio.

The starting strategic asset allocation portfolio is made up of 40% equities (split ¾ developed, ¼ emerging), 25% global government bonds, 5% investment grade corporate bonds, 5% high yield, 5% emerging market debt, 5% cash and 15% alternatives (5% property, 5% hedge funds, 5% commodities).

Source: Schroders, for illustration only.

Figure 1: Implementing the sustainability budget requires decisions about the interaction with the risk budget

Source: Schroders, for illustration only. Data as of 28 February 2019.
The diversification effect is now only a 1.6% reduction in risk, and the total portfolio risk has increased to 6.5%. In addition, the standalone risk has increased to just over 8%.

We can also look under the surface of each of the asset classes by splitting them up into the key drivers or premia that explain their performance and risk. For example, corporate bonds are a combination of duration and credit premia. As can be seen from Figure 4, the sensitivities of the portfolio to some premia also increases, with increased concentration in equity, credit and emerging market risk.

Our research outlined in our last paper shows that the impact on emerging markets of ESG issues is significant but obtaining good quality data can be difficult. An asset owner may therefore choose to remove this asset class from the portfolio in pursuit of a high sustainability budget, at least until the data is more reliable.

In Figure 5, we look at the impact of removing both alternatives and emerging markets. For this analysis, we have reallocated the capital from emerging market equities into developed equities and the capital from emerging market debt equally into high yield debt and investment grade corporate bonds.
The diversification effect reduces risk by a mere 1.1%. Total risk is higher than in the starting portfolio, but standalone risk is lower because the portfolio now has more developed market exposure – in fact the concentration of risk in developed market equities is now extreme.

Looking at the factor sensitivities of this portfolio (in Figure 6), we can again see the increased exposure to equity and credit risk, but this time there is a negative exposure to emerging markets. Just as important as the magnitude and direction of these sensitivities is the hidden nature of these changes; such changes in the composition of a portfolio’s risk can go unnoticed unless diligent analysis is carried out to identify them.

Clearly, the crude approach of removing asset classes can be expensive in terms of risk, illustrating the importance of the availability of asset class components to a sustainable multi-asset portfolio. If an asset owner is on a journey towards a 100% sustainability budget, removing components to achieve this aim will compromise diversification in the portfolio.

Figure 6: Removing emerging markets and alternatives results in concentration of risk factors

![Figure 6](image.jpg)

Source: Schroders, for illustration only. Data as of 28 February 2019.

Figure 7: Portfolios with high levels of ESG screening can result in improved diversification

![Figure 7](image.jpg)

Source: Schroders, MSCI, for illustration only. Data as of 28 February 2019.

Evaluating the impact of substituting non-ESG components

Fortunately, the recent rapid growth in investor interest in sustainable investment has led to a proliferation of screened, integrated and sustainable components that asset owners and portfolio managers can use to create a multi-asset portfolio. This is evident from the table later in the paper (Figure 8 on page 5) that shows that almost every asset class can at least be screened.

The question then is whether a similar trade-off between non-ESG and ESG components exists that forces a compromise between the asset owner’s objectives of sustainability and risk. The challenge of doing this analysis well is that data for ESG indices is only available for around 5-10 years and, ideally, we need a longer history of data to draw statistically significant conclusions from the analysis.

Our research suggests no such compromise exists when replacing a non-ESG component with an ESG component. Given a reasonable sustainability budget, it appears that asset owners are able to achieve both their traditional risk and return objectives, as well as their sustainability objectives, in an actively managed multi-asset portfolio.

Figure 7 shows a measure of concentration risk for four global equity portfolios that have been screened on ESG criteria captured by ESG ratings. To be clear, this is not our preferred way to implement ESG (as we will discuss later), but it does allow us to evaluate the impact of switching in a straightforward way. We measure concentration at the security, region, sector and industry levels. The higher the number, the more concentrated the portfolio is by security/region, etc. The ‘base’ portfolio represents an unscreened global equity portfolio; the ‘ex CCC’ portfolio screens out the ‘worst’ securities; the ‘>A’ portfolio retains only those securities rated greater than A; and the ‘AAA only’ portfolio retains only the ‘best’ securities as rated by ESG criteria.

As can be seen, even the most aggressive pursuit of sustainability in a global equity component does not increase concentration risk materially. In fact, while concentration risk increases for stock, sector and industry concentration, the two more aggressive screens (>A and AAA only) actually result in a portfolio with lower country concentration risk. Substituting non-sustainable global equities for a screened version does not materially change the risk concentration profile within the component. While making no assumption about the relative returns of the alternative components, we can assume that substituting sustainable equities for non-sustainable equities is ‘low-cost’ in terms of risk. In addition, it is not necessarily the case that having fewer regions in the portfolio increases regional concentration. This is because the screen has actually reduced the portfolio’s exposure to heavyweight countries e.g. the US.

Therefore, given the low risk impact and qualitatively high upside to using sustainable components, it seems sensible to substitute sustainable components into the portfolio, where available.

Should ESG be applied at the asset allocation level?

Our third consideration involves deciding whether or not to apply ESG at the asset allocation level. There are two main types of asset allocation that most asset owners consider – strategic asset allocation and dynamic asset allocation. Strategic asset allocation is typically set over multiple economic cycles, perhaps 10-30 years. Over this time period we would expect sustainability to impact the return/risk and correlation assumptions used. It therefore seems reasonable that for asset owners who take sustainability issues seriously, the strategic asset allocation should incorporate ESG.

3 The concentration measure we use is the Herfindahl-Hirschman Index (HHI), which is a common measure of concentration often used to determine market competitiveness in an industry. It can be used in the context of portfolio construction as a measure of diversification within a portfolio.

4 We use MSCI ESG ratings in this example, but the results are robust to different rating providers.
For dynamic asset allocation, the situation is more nuanced. Decisions to overweight or underweight asset classes are typically taken on a shorter term (3-12 month) time horizon. Typical factors that are utilised in this decision include momentum, valuation, sentiment, economic cycle etc. ESG factors rarely have an impact over this time horizon, or if they do, are likely to be included in the valuation factor. For this reason, we do not think that ESG should play a material part in short-term market calls.

However, there may be medium-term “core active” positions, such as regional equity or bond allocations, which are present in the portfolio for periods of say three years. At this stage, the evidence about the impact of ESG factors over this time horizon is less clear than for longer horizons. However, we believe that ESG should be one of the factors that are evaluated amongst the more traditional areas of research, such as valuation or economic fundamentals.

**Which ESG components can be used?**

In our last paper, we outlined Schroders' definition of different approaches to ESG investing. We define three different levels of ESG implementation along a spectrum of sustainability:

- **Screened** – Negative screening beyond statutory requirements
- **Integrated** – ESG analysis is a building block of the investment process. It is systematic and there is a commitment to engagement and stewardship
- **Sustainable** – ESG analysis is a cornerstone of the investment process. The resulting portfolio has a strong sustainability profile, focused on generating returns that can truly be maintained over the long term.

We also highlighted how components can be managed along the sustainability spectrum (Figure 8). A combination of asset classes or risk premia is important to ensure diversification.

### Figure 8: How different investments can be managed along the sustainability spectrum

<table>
<thead>
<tr>
<th>Component</th>
<th>Screened</th>
<th>Integrated</th>
<th>Sustainable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed market equities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Emerging market equities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Government bonds</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Investment grade credit</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>High yield debt</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Commodities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private equity</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Real estate</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance-linked securities</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Direct lending</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securitised debt</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivatives</td>
<td></td>
<td></td>
<td>Sustainability spectrum not applicable to derivatives used for dynamic/tactical asset allocation purposes</td>
</tr>
<tr>
<td>Cash</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Schroders

Schroders' philosophy for managing each of these components is established by our Sustainability team in conjunction with the component manager team, documented in our ESG Policy. We have provided a short explanation by component:

**Developed market equities**

We believe that analysing exposure to and management of ESG factors, in addition to traditional financial analysis, will enhance our understanding of a company's fair value and its ability to deliver long-term returns. As we explained in our last paper, passive approaches fail to delineate and capture companies’ ability to adapt to ESG challenges.

In addition, governments have become more empowered to regulate and companies whose business models create the most social and environmental damage will come under increasing pressure to pay for the negative externalities they create (either by limiting the costs they impose or compensating for them). We expect the trend of rising government intervention to continue, reversing the imbalances that built during the decades in which public finances and future generations disproportionately shouldered the burden of companies’ negative externalities. Understanding the impact of these costs (and benefits for some companies) requires forward-looking risk analysis that considers the effects of internalising new costs on earnings and valuations.

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5 Environmental, Social and Governance Policy for listed assets, Schroders, October 2018
6 Managing sustainability from a total portfolio perspective, Schroders, March 2018
To address this, we developed SustainEx, our proprietary framework which quantifies the positive and negative impacts companies place on society and the environment.

Our aim is to have an integrated approach in all equity products.

**Emerging market (EM) equities**

ESG scores for EMs tend to be lower than for developed markets, and therefore have more scope for positive change. In recent years, EM have lead improvements in global ESG scores. However, disclosure has been much weaker in EM and a lack of transparency has made it difficult for investors in some emerging markets to accurately assess ESG concerns. However, research\(^7\) has shown that there is a stronger positive impact on corporate financial performance from ESG investing in EM versus developed markets.

EM represents a heterogeneous set of markets. This makes it a complex and large opportunity set. The increasing availability of quantitative screens and indices is making ESG investing progressively accessible and raising awareness of the importance of incorporating such considerations into investment decisions. We believe that understanding how ESG issues may impact these markets and the relevant companies is vital and that detailed, fundamental analysis is required to develop true insight and be able to apply it appropriately.

In particular, in the case of EM, conventional metrics of governance quality may be insufficient. Local market structure and cultural issues need to be taken into account. For example, research\(^8\) has shown that listed family-owned companies often have better governance overall and improved stock performance when combined with the benefits of access to funding via capital markets.

Similar to developed market equities, our aim is to have an integrated approach in emerging market equities.

**Sovereign bonds**

The relationship between ESG risk and sovereign bond performance is not linear; rising ESG risks may lead to relative outperformance of sovereign bonds in some cases. For example, in the wake of a cyber attack or a hurricane, investors will flee to the safety of sovereign debt. These are often referred to as ‘short tail’ ESG events. However, longer term issues such as social challenges, automation displacing jobs and climate change can impact longer-term performance of sovereign bonds. Even in the medium term, sovereigns have options at their disposal to deal with debt crises that companies do not, which can limit how exposed to ESG issues they are.

They frequently force investors, such as insurance companies, pension funds and banks, to buy their bonds. They can also use currency devaluation and quantitative easing, the effectiveness of which depends on the strength of a country’s institutions. Emerging markets, because of their weaker institutions, are more vulnerable.

As outlined in our sustainability and sovereign fixed income paper\(^4\), some studies conclude that good ESG practice is associated with lower default risk and spreads, especially in the long run.

We believe that the screened approach to the management of ESG within sovereigns is possible but should be considered carefully. Some investors require the sovereign not to be subject to EU or UN financial sanctions, and to have signed international conventions, such as the ILO convention, that protect human rights. Other requirements are vague, such as calling for support on anticorruption and bribery, working conditions violations, or human rights violations.

Human rights is usually the issue that raises the most questions; for example, should the US be excluded as it has the death penalty? Amnesty International's most recent report on human rights shows just how multi-faceted issues relating to this area are. The most respected voices in this area do not publish country level human rights indices, for fear that it will encourage relativism leading to the wrong type of behaviours. However, we note that countries that regularly appear on the list of the worst offenders such as Syria, North Korea and Zimbabwe do not have any outstanding sovereign debt.

There is also the risk of inconsistency between company level and country level exclusions. For example, company screens may result in not investing in bonds from companies that manufacture nuclear weapons but should that exclusion also be extended to the bonds of countries that own coal mines (which happens in some emerging markets) or power stations be excluded if you are excluding coal elsewhere?

On the environmental side, some investors require ratification of internationally recognised conventions, such as the Paris Agreement and the UN Convention for Biological Diversity. Obviously using the former would mean that the world's largest bond market, US Treasuries would be excluded, which could cause an issue. In the developing world, many governments are raising money for projects that ultimately support some controversial infrastructure projects, which may have negative environmental or social impacts. Some investors say that they avoid these investments, but it is unclear how they systematically screen for them. An appealing alternative could be to exclude emerging market debt, however most finance experts see sovereign bond issuance as an important step for a country developing and building financial resilience.

These are complex issues, and we have developed tools such as our Country Sustainability Dashboard to provide a framework for assessing ESG at sovereign level.

**Corporate bonds**

Non-financial considerations including ESG issues have a material influence on the sustainability of issuer cashflows, through changing consumer expectations, increasing regulation, supply chain risk, brand reputation etc. As a result, we use a themes-based research process that combines multiple ESG and non-ESG themes to identify how the real world is changing.

While fundamental analysis of individual issuers is important, especially at initiation, our thematic approach to ESG issues means we conduct proprietary in-depth research on ESG topics and their impact across our holdings. We draw on granular information sources such as official government statistics on meteorological data, employee turnover or wage trajectories to determine how a factor will impact issuers across countries or sectors. This deep exploration of how external factors will affect a company’s operating model and its operating environment ensures that we are capturing broader structural trends across portfolios.

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7 ESG and emerging markets, Schroders, August 2018 – available on request
8 Sustainability and sovereign fixed income, Schroders, June 2017 – available on request
Commodities
Many of our multi-asset portfolios use total return swaps to access the commodity market, ensuring that we invest in the portions of the commodity market that we feel are most likely to provide either diversification in the overall portfolio or return potential. As we discussed in our previous paper, we do not believe that derivatives can be evaluated on sustainability grounds, particularly as few liquid ESG derivative contracts currently exist.

When considering commodity funds, once again not all funds are the same; some directly invest in commodities, some in futures and others invest in a combination of the two. The range of commodities that these funds invest in is wide: from precious metals, to natural resources and agriculture commodities. Investors may decide to exclude certain commodities such as coal or oil, which reflect their policies elsewhere. They may decide to take a more draconian approach and decide that speculating on commodities creates volatility, an additional cost that is unwelcome for consumers and farmers, many of whom are at the bottom end of the economic pyramid. Finally, the extractives and agricultural industry supply chains are risky. Concerns are especially heightened around the overall health and safety records of artisanal mines for minerals, and modern day slavery and child labour risks for all commodities.

In general, while it is theoretically possible to screen out the worst fossil fuel-heavy industries to create an ESG commodities portfolio, at the current time we feel it is unlikely to result in a suitably diversified commodity portfolio. We therefore do not include commodities in our ESG multi-asset portfolios at this time.

Insurance-linked securities (ILS)
ILS are primarily linked to the (re-)insurance of natural catastrophe, mortality and pandemic risk - extreme events that can cause severe disruption to individuals’ lives and the communities they live in. The ILS universe brings a different responsible investment opportunity to capital markets participants. The societal benefits that ILS can offer to governments, businesses and individuals in the form of financial relief, should they be affected by an earthquake, hurricane, flood or other type of catastrophe, helps strengthen financial resilience and aids recovery. Given the scale of the global climate challenge, the necessity to mitigate the effects of the frequency or severity of natural disasters becomes a more prevalent concern.

Liquid alternatives and hedge funds
Theoretically, hedge funds, which tend to be invested in equities and fixed-income markets, should be able to incorporate ESG into their approaches. However, relatively few ESG hedge funds exist at this point and those that do exist are often costly. In addition, hedge funds are typically private investment vehicles that usually operate in a weaker regulatory environment than publicly-traded funds, resulting in less disclosure and a lower level of transparency.

It is possible to synthetically create hedge funds more cost-effectively using factor models (often called ‘alternative risk premia’) and indeed, extend this to ESG factors. However, these are often implemented using derivatives where the idea of sustainability is less applicable.

Illiquid asset classes
In this paper we specifically consider how to manage a liquid multi-asset portfolio and therefore illiquid assets are outside its scope. However, ESG issues are clearly very important for illiquid assets, particularly regarding impact investing.

Calculating total ESG impact on the portfolio
Once the ESG components have been identified, asset owners should aim to understand both the extent of the ESG decisions they have made in their overall portfolio and the quality of the sustainability, particularly the total impact of being sustainable. The latter is complex and requires a consistent methodology to evaluate the benefit to the overall portfolio of taking a sustainable approach.

We have suggested in our previous paper that the ‘amount’ of ESG in a portfolio can be measured by the sustainability budget (calculated using the capital allocations to ESG investments, not including dynamic positions taken using derivatives).

To understand the complexities of measuring the impact of the ESG positions in a portfolio, we have outlined below some of the issues we have encountered as we have worked on this:

- **Tools for evaluating impact at a company level are not easily used for sovereigns**: Earlier in this paper, we highlighted SustainEx, one of the tools that we have developed for evaluating and quantifying the social and environmental impact of companies, whether positive or negative.

- **This is fairly straightforward to calculate in relation to tobacco companies but how does this relate to governments that permit smoking in their country but heavily discourage it through taxation and other measures?**

- **Variability between underlying manager approaches**: Each manager not only has a different implementation approach (screened/integrated/sustainable) but also has different criteria they emphasise e.g. climate action versus gender equality (which are two of the 17 United Nation’s Sustainable Development Goals). This means that any tool used to measure overall ESG impact must measure multiple features. To calculate a simple impact ‘number’ for a multi-asset portfolio, different factors need to be evaluated on a level playing field.

- **Data issues**: the amount and quality of data available to evaluate companies and sovereigns is variable. This means that there is a risk of putting more emphasis on investing in areas that have better data but this may come at the expense of increasing concentration in the portfolio (as we discussed earlier in relation to emerging markets).

- **Transparency**: some managers, particularly hedge fund managers, do not provide full transparency of their holdings and this can make it very difficult to evaluate the impact of this portion of the portfolio.

- **Time horizon**: a single metric on impact generally evaluates the impact ‘today’. However, if companies/countries are on a path to improvement, this should be recognised in deciding whether they are included in the portfolio, the size of the position and the period over which the improvement will be recognised by the market.

This is a work in progress for us (and the subject of a future paper), but we strongly believe that it is important to have a consistent methodology across asset classes and to be able to report using an ESG ‘dashboard’.
Conclusion

Implementing an ESG policy across multiple asset classes is complex and requires thought to be applied to all parts of the process. We have shared some of the lessons we have learned in the process of creating ESG multi-asset portfolios.

Our key findings are that:

1. Asset owners and managers of multi-asset portfolios should have an ESG philosophy that can be applied across multiple ESG components. When constructing a total asset portfolio, asset owners can position their assets on a spectrum from non-sustainable to sustainable investing. An asset owner may choose to have a lower sustainability budget with some non-sustainable components in order to improve diversification and reduce risk.

2. Removing asset classes in pursuit of a high sustainability budget can be expensive in terms of risk, illustrating the importance of the availability of asset class components to a sustainable multi-asset portfolio.

3. Substituting non-ESG components for ESG components can result in improved diversification, at least in equities. Given a reasonable sustainability budget, it appears that asset owners are able to achieve both their traditional risk and return objectives, as well as their sustainability objectives, in an actively managed multi-asset portfolio.

4. There are two main types of asset allocation that an asset owner must consider – strategic asset allocation and dynamic asset allocation. For asset owners who are on a journey towards 100% sustainability in their assets, the strategic asset allocation should incorporate ESG. For dynamic asset allocation, the relevance of ESG to the decision depends on the time horizon of the view, with extra ESG insights more likely to influence the medium term than the short term.

5. There is a wide variety of ways in which each of the components can be managed using an ESG approach. We have shared some of the dilemmas we have faced when deciding how to manage these components appropriately. Where possible, we believe that the component should be managed with a sustainable approach as this seeks to identify truly long-term businesses.

6. The total impact of a multi-asset portfolio’s investments is the most important (though the hardest to measure!), to ensure it is making the best use of its sustainability budget.

Implementing ESG at a total portfolio level is not necessarily a straightforward process, and requires consideration of a number of factors, some of which are complex to address. However, we firmly believe that taking these considerations into account can help investors make better investment decisions and should be central to any investor’s ESG multi-asset portfolio construction process.

With additional thanks to: Belinda Gan, Jessica Ground, Lesley-Ann Morgan, Ben Popatlal

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