GLOBAL FUND FLOWS: THE ESG GOLD RUSH

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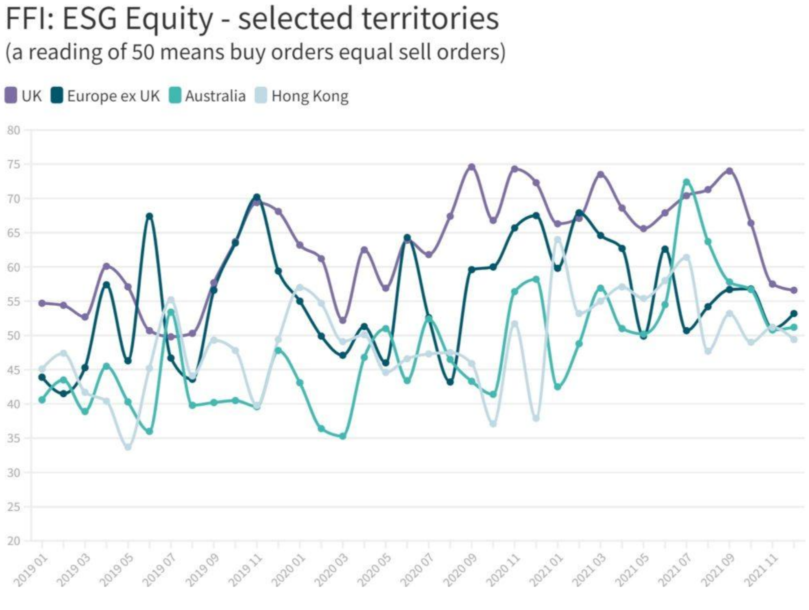
This is an extract from Calastone's most recent global fund flows report 'Confidence and cash – betting on the global recovery'. ***[View the report in full here.]***

ESG strategies are the hands-down winners in the fund flow race at present. ESG equity funds on our network gathered an incredible $32.1bn in new capital in 2021, equivalent to $3 in every $5 of new cash committed to equity funds of all kinds. This compares to $10.8bn in 2020 and just $309m in 2019. Some of this is about supply. Asset managers have devoted a huge marketing drive to ESG funds over the last two years and that has certainly driven awareness and uptake. Of course, it also reflects the huge and growing demand from consumers who want their investments to align with their values. Most funds consider all three of the ESG pillars – environment, social issues and good governance. Clearly environmental concerns are front of mind for investors, however, especially as the climate emergency has come to dominate the news agenda on a daily basis. Indeed, some funds focus exclusively on ecologically friendly investing – these accounted for about one eighth of the ESG inflows in 2021.

Trading activity in ESG funds is dominated by buy orders. In 2021, for every $1 of selling activity, investors bought $1.69 of ESG equity funds, generating a Fund Flow Index score of 62.8 (a reading of 50 means buys equal sells). This compares to a much more balanced 52.0 for equity funds without an explicit ESG mandate.



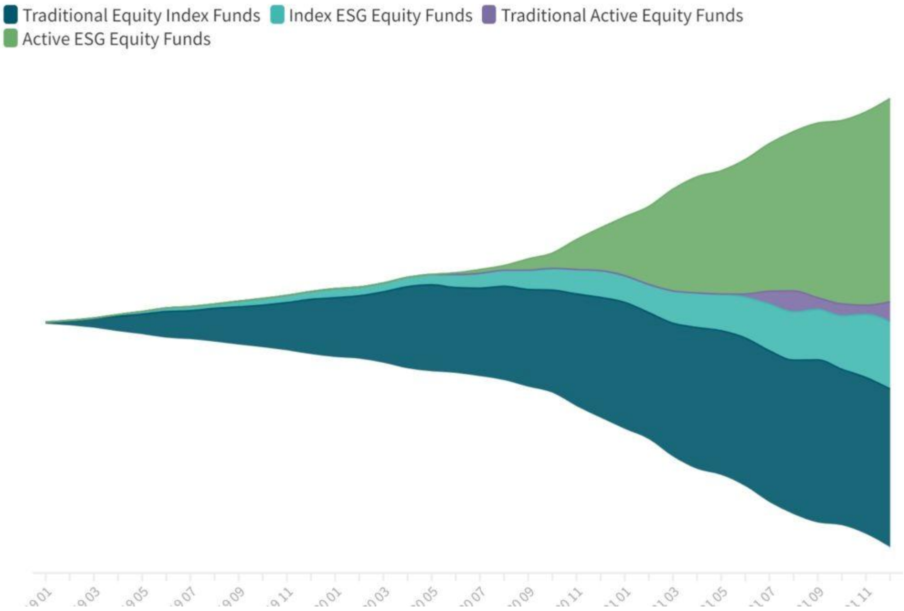
UK and European investors are ahead of those elsewhere

Investors in the UK and Europe are leading the charge. They more than doubled the new capital they committed to ESG funds in 2021 compared to 2020, and have increased it ten-fold compared to 2019. Australian investors have been much slower to adopt ESG. In fact 2021 is the first year we have seen inflows into the category at all, suggesting they are about three years behind their northern hemisphere peers. The $2.1bn net Australian inflow to ESG equity funds in 2021 was just than one sixth of the net new cash they added to equity funds of all kinds, while in the UK it was almost four fifths. In Europe, non-ESG strategies saw outflows. Investors in the rest of Asia are more in step with Australia than the UK and Europe. In Hong Kong, for example, inflows to ESG turned positive for the first time in 2021 and were less than a third of the total net inflow to equity funds. In Taiwan flows turned positive in 2020 and grew again in 2021, while in Singapore, the net inflow almost tripled in 2021 year-on-year and contributed two fifths of the total net inflow to equities.

Active funds are benefiting from the ESG gold rush

ESG funds tend to be actively managed, as asset managers are still wrestling with how to define the universe of potential stocks that meet their ESG criteria. Some managers have invested heavily in in-house screening, while others are relying on external rating agencies. All are alive to the potential for accusations of greenwashing to undermine their efforts. This helps explain why active management is winning the race for ESG capital. Until there is a clearer industry standard on what ESG means and until the companies funds invest into have fully developed robust, defensible policies across environmental, social and governance issues that they can demonstrate they are implementing, asset managers are going to want to continue to select their investments actively.

The ESG gold rush is benefiting active fund managers



The figures are quite startling. In 2019, index equity funds garnered $10.0bn in net new cash across our network, while active funds shed $11.2bn. In 2020 things began to improve for the active industry, with net inflows of $6.5bn, just under half the level of index funds. But in 2021 active funds saw inflows of $40.4bn, compared to just $12.5bn for index funds. Almost two thirds (64%) of the net new capital to active funds in 2021 was supplied by ESG strategies. By value about half of this ESG cash went into active global ESG equity funds. There are some index ESG funds, and inflows are growing, but they are relatively small.

Of the remaining $14.7bn of active cash, 'traditional' (i.e. non-ESG) global equity funds were the main winners on our network in 2021 (especially thanks to UK and European investors), followed by Asia-Pacific (principally from Singapore-based investors), Australian funds targeting the domestic market, and emerging markets.

About Calastone

Calastone is the largest global funds network, connecting the world's leading financial organisations.

Our mission is to help the funds industry transform by creating innovative new ways to automate and digitalise the global investment funds marketplace, reducing frictional costs and lowering operational risk to the benefit of all. Through this, we make investing more accessible, generating the opportunity for the industry to deliver greater value for the investor.

Over 3,000 clients in 52 countries and territories benefit from Calastone's services, processing £200 billion of investment value each month.

Calastone is headquartered in London and has offices in Luxembourg, Hong Kong, Taipei, Singapore, New York, Milan and Sydney.

A word about methodology

We have analysed tens of millions of buy and sell orders from 2019 to 2021, tracking investor cash as it flows into and out of investment funds. A single order is usually the aggregated value of a number of trades from underlying investors passed for example from a platform via Calastone to the fund manager. In reality, therefore, our research tracks the impact of hundreds of millions of investor decisions each month.

We have **not** adjusted our figures for our market share. This varies widely from one country to another, but is over 80% in some territories. Any figures that appear in this report therefore only refer to volumes that pass over our own network. With such precise and granular data, we are nevertheless confident that the picture we are painting is representative of wider market trends.

All figures refer to orders where they were placed, not where they were executed. Some markets like Australia see very little cash flow offshore. Others, like Taiwan, see almost all of it settled elsewhere. In the UK, about 15% of transactions by value takes place in funds domiciled offshore.

All the figures in this report have been converted to US dollars, with the exchange rate calculated for each individual trade on the day it was settled. This 'real-time' conversion means there are no distortions introduced, for example, by using average exchange rates for any given period.