

Sustainability challenges and opportunities in emerging markets

At the beginning of the year, **Tell Media Group**, in cooperation with **Ninety One** and **Stewart Investors**, organised a roundtable discussion in Stockholm with Swedish investors, focusing on sustainable opportunities in emerging markets equities. Tell Media Group founder Niklas Tell moderated the discussion.

By: **Niklas Tell** Photo: **Christer Salling**



The discussion started out with Niklas Tell asking the investors about their general view of emerging markets and whether now is the time to change the allocation to emerging market equities.

SUSANNE BOLIN GÄRTNER: "I would say that emerging markets is an area that's always of interest to us. But that said, we're actually working on some searches specifically on emerging markets right now."

GABRIEL LUNDSTRÖM: "The primary focus for us is getting more ESG-focused funds onto our unit linked platform and that has been more of a challenge when it comes to emerging markets compared to global or Swedish equities. We hope to see more. With new regulation, we also need to be more transparent and provide more data and that's also more difficult when it comes to emerging markets."

CHRISTINA BERG: "We don't have any exposure to emerging market equities in our institutional portfolio and one of the reasons was sustainability concerns given the fact that we invest passively when it comes to our equity exposure. We could have exposure to emerging markets through green bonds but not on the equity side. On the unit-linked platform, we have a handful of emerging market funds and we recently added an Article 9 fund, of which there are not many to choose from yet. We haven't seen flows into emerging markets on the platform yet but I guess that will come as performance improves."

GABRIEL LUNDSTRÖM: "Christina, you mentioned that one reason for not having exposure to emerging market equities

was sustainability concerns. Is that mainly due to the fact that there are no funds that fulfil your criteria, is it lack of data or something else?"

CHRISTINA BERG: "When we took the decision, we couldn't find an index fund that fulfilled our criteria and we also found there was a lack of data. We also had other concerns regarding emerging market equities and it wasn't only about sustainability. The allocation decision was a few years back."

JULIANA HANSVEDEN: "I fully understand that because we don't have enough quantitative data when it comes to sustainability in emerging markets, so I think it's difficult to have a passive sustainable strategy in this area. You need to sit down with each company and ask your questions in order to do a deep analysis of sustainability."

SUSANNE BOLIN GÄRTNER: "When you did that search for a new fund to the platform, did you only search for Article 9 funds or did you search broader than that? Personally, I think it's a bit early to limit searches to specific numbers."

CHRISTINA BERG: "The focus was on Article 9 funds but we also looked at some Article 8 funds where we knew that the sustainability work was good."

SUJAYA DESAI: "I think it's fair to say that all of the sustainability challenges that we're facing in the world today are just heightened in emerging markets. For us, it's about ensuring that the companies that we invest in are either aware of and can handle these sustainability challenges or alternatively that they are coming up with solutions to address the challenges."

NIKLAS TELL: HOW MUCH OF A CHALLENGE IS EMERGING MARKETS FOR INVESTORS LOOKING TO HAVE "GOOD" ESG PORTFOLIOS? ONE EASY SOLUTION WOULD BE TO SKIP EMERGING MARKETS BUT THEN AGAIN, EMERGING MARKETS ARE IN NEED OF INVESTMENTS TO IMPROVE.

JULIANA HANSVEDEN: "I think the numbers tell the story. There are estimates that says that the capital needed to reach the Paris Agreement and the SDGs for emerging markets is USD 2.5 trillion. Yet, some 80 per cent of all capital is invested in developed markets when it should be 70 per cent in emerging markets to address that gap. To me, it's both a need as well as an opportunity. We see that some 88 per cent of all sustainable investments are focused on developed markets. This is a misallocation and the reason is of course that it's hard to do sustainable investing in emerging markets. Emerging markets are complex and challenging as it is with a range of different countries, different reporting and accounting standards and different languages. Then you add sustainability on top of that. Yes, it's complex but that's where the capital flows should go."

SUJAYA DESAI: "When we look bottom-up at where the best opportunities can be found, we think many companies leading on sustainability are based in emerging markets. We also have a sizeable allocation to emerging markets in our global mandates."

NIKLAS TELL: WOULD YOU SAY THAT INVESTORS SO FAR HAVE USED ESG AND SUSTAINABILITY INSIGHTS TO AVOID RISKS RATHER THAN TO DRIVE CHANGE AND HAVE AN IMPACT?

CHRISTINA BERG: "I think it was like that in the beginning but now I think it's more about having an impact and that it's an opportunity for good performance within the theme. I think that through for example green bonds investments, you could have a more direct impact on sustainability."

GABRIEL LUNDSTRÖM: "I think we also need to discuss the definition of sustainability. Originally it came from ethics and moral with customers and asset owners not willing to make money from certain companies or industries. But as an investor, having an impact on the world shouldn't be the primary focus. It should be about managing risks and returns and if that leads to a positive impact, that's great. That said, I agree there's a need for capital to flow in a

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ROUNDTABLE - SUSTAINABLE OPPORTUNITIES IN EM EQUITIES



SUSANNE BOLIN GÄRTNER

Head of fund selection and management at Danske Bank. Before joining Danske Bank in 2020, she spent 10 years as head of fund selection & ESG external funds at Folksam. She is chair of Swesif, a board member of Eurosif and sits on the board for the Mistra programme Biopath.



CHRISTINA BERG

Senior manager research analyst at Länsförsäkringar since 2003. In addition to manager research, she has also worked with risk control, risk budgeting for institutional accounts, ALM studies for companies within Länsförsäkringar and also done peer-group analyses of Länsförsäkringar Liv.



GABRIEL LUNDSTRÖM

Head of ESG at SEB Life & Pension since March 2022. He joined SEB in 2013 as an international graduate trainee and has held several roles related to sustainability since 2014. He joined the board of directors of UN Global Compact Sweden in 2018 and was named chairman in 2022.

different direction but it's not the duty of investors unless that's beneficial in terms of risks and returns."

JULIANA HANSVEDEN: "I agree. It's not about charity work because my clients need the returns. It's not about compromising on risks and return but rather approaching emerging markets with a credible sustainable framework to generate those returns. We will only look at a company if it's an interesting financial case. We look at the positive and negative externalities across natural, social and human capital to understand what's material and then we try to price that. We will measure the impact where it's possible and often it's the driver of revenue growth anyway. But we don't promise to do that for all holdings and that's a reason for why we're not an Article 9 fund."

SUSANNE BOLIN GÄRTNER: "I also think the fact that there's less data available when it comes to sustainability in emerging markets can create an opportunity for managers that know their companies inside and out."

JULIANA HANSVEDEN: "We're currently working on our impact metrics where we're going from two to six metrics. Only a handful of the companies we work with already report on the data that we need and for the others we have to engage with the companies."

SUJAYA DESAI: "Sustainability for us is really an integral part of being a long-term investor. At the end of the day, looking at sustainability factors simply help us mitigate risks or it will help us find opportunities."

NIKLAS TELL: AS SELECTORS, ARE THERE ANY SPECIFIC CHALLENGES WHEN YOU EVALUATE EMERGING MARKET MANAGERS COMPARED TO MANAGERS OF DEVELOPED MARKET EQUITIES?

SUSANNE BOLIN GÄRTNER: "I actually asked my team that question before coming here and we concluded that it's not really that different. However, I think it becomes more complex when you look at sustainability in emerging markets. Not least when it comes to social issues."

GABRIEL LUNDSTRÖM: "One challenge is that some markets are structurally not great from an ESG point of view. You have, for example, a lot of coal companies in Brazil and I think it's difficult to find great transition companies in the coal industry. Data is another challenge that we've already talked about. If it's not available in databases, we will have to rely on the data we get from fund managers and if they don't have it, we end up with blank spots in the portfolio, which is a challenge when we're asked to report."

SUJAYA DESAI: "We certainly think that third-party data is useful but we sometimes struggle to understand the full picture with only the data they report. To us, finding companies with truly sustainable business models offering necessary products and services is very important versus only reporting on operational sustainability."

JULIANA HANSVEDEN: "I think we need to be honest here and recognise that even market-leading sustainability data providers can be absolutely wrong in emerging markets. You really need to go in-depth to fully understand the sustainability challenges in emerging markets."

GABRIEL LUNDSTRÖM: "I think listed companies have a responsibility to follow what external data providers are saying about them and make corrections when necessary. When I worked at the bank, I used to have a lot of meetings with companies and constantly reminded them on these issues. Some companies are actually not aware of what ESG data providers are saying about them."



SUSANNE BOLIN GÄRTNER: "I think this is why you see a lot of proprietary models where you import data from several different providers. That's the first step and then you have to do your own qualitative work. If you meet with a fund manager that only rely on one source, that would be a red flag to me."

JULIANA HANSVEDEN: "Standardisation is tricky."

NIKLAS TELL: IS IT EVEN DESIRABLE?

JULIANA HANSVEDEN: "Yes, I think so. We encourage companies to sign up to the Science Based Targets initiative because we think that's best practise for setting net zero targets and then companies actually have to submit their net zero plans to the organisation. We will still accept a company's own net zero plan if we think it's good enough but the aim is always to have them sign up. Then there are, of course, other areas that are more difficult to standardise."

CHRISTINA BERG: "I think there are challenges but hopefully we will see some more standardisation."

SUSANNE BOLIN GÄRTNER: "I think we need to be careful because it's really easy to believe it's true because it's a published number. You need to do the qualitative work as well."

GABRIEL LUNDSTRÖM: "That we will have standardisation on a global scale is probably wishing for too much. But at the same time, it should be in everyone's interest to have

more standardisation and to have a common platform for these challenges we're facing."

SUJAYA DESAI: "We also need to be aware that more reporting and standardisation will typically always favour larger companies with teams that are able to work on this."

NIKLAS TELL: WHAT WOULD YOU SAY ARE THE BIGGEST CHALLENGES WHEN IT COMES TO ESG AND SUSTAINABILITY WORK IN EMERGING MARKETS?

JULIANA HANSVEDEN: "It's very much case-by-case and what's material for each company. The common theme, however, is patchy data and the fact that many companies don't even report on these things. What can be useful is having an independent framework for what's material for different industries and there you can use an organisation such as SASB and their materiality map. But in general, I would say it's the quality of information that's the main challenge."

SUJAYA DESAI: "I fully agree. It's about access to information where some companies might not have the resources to produce extensive sustainability reports. We try to have dialogues with management to understand some of these areas better."

NIKLAS TELL: HOW WOULD YOU SAY THAT SUSTAINABILITY IS DRIVING RETURNS IN EMERGING MARKETS AND HAS THAT CHANGED OVER THE YEARS?



SUJAYA DESAI
Portfolio manager at Stewart Investors, based in Singapore. At the asset manager, she co-manages the global emerging markets all-cap sustainability strategy. She joined the team in 2016 as a graduate.



JULIANA HANSVEDEN
Portfolio manager in the sustainable equity team within the multi-asset team at Ninety One and responsible for the emerging markets sustainable equity strategy. Prior to that, she was the lead portfolio manager of the Euro emerging stars and the Asian stars equity strategies at Nordea Asset Management.

SUJAYA DESAI: "In our view, it's very much the same - it's about finding long-term, growing profit pools from a bottom-up perspective. We launched a dedicated fund in 2005 and it was not about a change in our philosophy but rather explicitly recognising that sustainability is a driver of returns. Since then, it has been all about building sustainability into the investment process."

GABRIEL LUNDSTRÖM: "Do you see common themes that are more interesting across emerging markets?"

SUJAYA DESAI: "We're a bottom-up investor but when we look at our holdings, there are certain themes that stand out. One is that we focus more on companies that provide the inputs to certain broad sustainability themes, or the picks and shovels, because for us, it would be riskier to single out who the end winner will be in, for example, electric vehicles. We rather invest in a company providing parts, like inverters or electric motors, that go into these vehicles."

JULIANA HANSVEDEN: "We're also a bottom-up investor but there are, of course, themes that are more interesting. Financial inclusion is a large one because a third of the world population don't even have a bank account. Here, there are some selective banks that are interesting but we also see microfinance and different fintech solutions. It's very much about niche businesses that find a problem and solve it. Decarbonisation is another area and here I agree with Sujaya that it can't be businesses that are based on subsidies."

NIKLAS TELL: WE HAVE TOUCHED ON ENGAGEMENT EARLIER. WHERE IN THE PROCESS DOES THAT COME IN AND ARE THERE TOPICS OR THEMES THAT ARE ALWAYS PRESENT OR IS IT VERY MUCH CASE-BY-CASE AND COMPANY-BY-COMPANY?

SUJAYA DESAI: "We typically own 30 to 50 companies and we don't invest in a company only in order to engage. We try to find high-quality companies but even if you strive to find great companies, there will always be things you want to engage with management about and things that can be improved on, particularly if you own shares in a company for a decade. Engagement for us is typically bottom-up and case-by-case but there are topics like carbon emissions where we engage more broadly. We also recognise that engagement is an earned right and that we're not always correct. We also learn from the companies where we are shareholders."

JULIANA HANSVEDEN: "We try to be as transparent as possible and we publish an annual sustainability report for each strategy where we list every single holding with a summary of the investment case, our sustainability assessment and also the engagement points. When we do our research on companies, you almost always find some challenges. We will walk away if we find significant negative externalities that overshadow the business but we will not walk away from a company that has some challenges that can be improved and being a long-term investor helps. We're a partner and we want the companies to improve."

NIKLAS TELL: I WOULD LIKE TO MOVE ON TO REGULATION AND ASK ABOUT SDFR. HOW MUCH OF A CHALLENGE IS IT AND IS IT HELPING OR HINDERING YOU?

GABRIEL LUNDSTRÖM: "I think the intention is great but it's early days and the jury is still out. I also think the way it was introduced was a bit unfair to the financial industry. Not least that companies wasn't forced to report on data before we as investors need to report on that data. It's also a bit of a mess with all different methodologies companies use in their self-assessments. The positive side of me thinks it will improve over the next couple of years but worst case, it will be a huge administrative exercise without any value."

SUSANNE BOLIN GÄRTNER: "I also think that where you end up depends on the internal strength of the fund company and the different departments. With a strong marketing department, you may say it's an Article 9 fund but with a stronger compliance team that same fund might be an Article 8. And we're seeing that funds are being reclassified, moving from Article 9 to 8. I think it's too early to say how this will all play out."

NIKLAS TELL: MANY OF YOU HAVE OPEN PLATFORMS WHERE YOU SELECT FUNDS. I ASSUME THERE'S A PRESSURE TO HAVE MORE FUNDS CATEGORISED AS ARTICLE 8 OR 9 COMPARED TO 6?

CHRISTINA BERG: "Yes. One example is that insurance or pension brokers evaluate all the platforms and they often look at how many Article 9 funds we have as one measure of sustainability. I do think it will become increasingly important to have more Article 8 and 9 funds on the platform going forward."

SUSANNE BOLIN GÄRTNER: "I would argue it's unfair to look at it like that. Especially at this stage. As I mentioned, we're seeing funds being reclassified and also in some asset classes, you might not be able to find Article 8 or 9. Should you then not have funds from that asset class or category? We also need to educate our clients."

NIKLAS TELL: LOOKING AHEAD, WHAT ARE THE MAIN WORRIES WHEN IT COMES TO SUSTAINABILITY AND EMERGING MARKETS?

JULIANA HANSVEDEN: "As already mentioned, we're bottom-up investors, so we obviously don't see any big obvious

stock-specific risks in the portfolio. But more broadly speaking, the healthcare situation in China as they're opening up is one worry and the China/US/Taiwan tension is another."

SUJAYA DESAI: "One worry is that we all have carbon tunnel vision. Carbon emissions reductions are a fundamentally important area and not least in emerging markets but we must not forget to think about and address other sustainability areas that are all closely interwoven."

NIKLAS TELL: I GUESS YOU'RE ALSO SEEING OPPORTUNITIES?

JULIANA HANSVEDEN: "Yes, I'm very positive. Emerging markets in general get too much negative coverage and I would like to see more balanced reporting. There are, of course, challenges but there are also miracles happening when it comes to individual companies. I'm also very happy that we're increasingly seeing companies coming to us to discuss and improve on sustainability. It's like reversed engagement."

SUJAYA DESAI: "As long-term equity investors, we're in the business of being optimistic. On a more serious note, I think it's important to remember that in the macro environment we're facing right now, there's a lot of inter-generational memory in management teams in emerging markets. Many are family-owned businesses and they have dealt with rising interest rates and inflation before. From a bottom-up perspective, I think many are very well-positioned with high-quality stewards and franchises run for the long term." ●

