

SUSTAINABLE FIXED INCOME SECURITIES: POISED TO OUTPERFORM?

James Rich, senior portfolio manager

You have likely seen headlines in the financial press this year disparaging the performance of ESG fixed income investments. Exhibits 1 and 2 illustrate why: overall fixed income performance has declined during 2022 with the total return of the Bloomberg MSCI US Aggregate ESG Weighted Index underperforming the total return of its non-ESG counterpart, the Bloomberg US Aggregate Bond Index, year-to-date by about 20 bps.

Exhibit 1: Overall performance declined 1H 2022

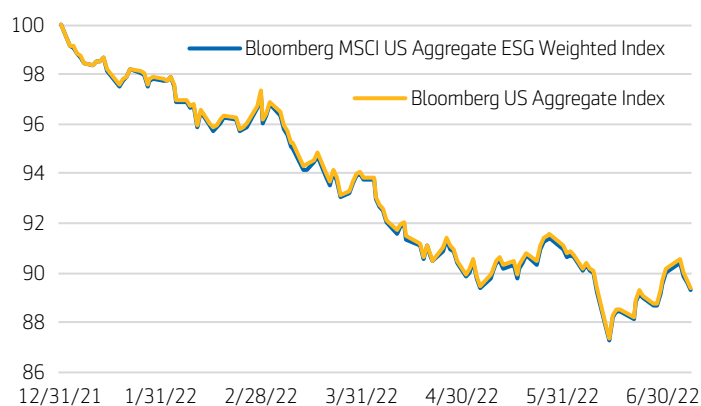
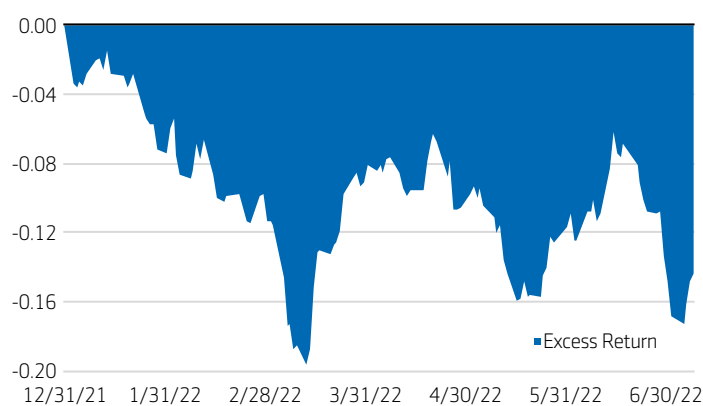


Exhibit 2: ESG aggregate underperformed non-ESG counterpart



Source: Bloomberg as of July 8, 2022. Returns normalized as of December 31, 2021. Excess return represents the total return of the Bloomberg MSCI US Aggregate ESG Weighted Index minus the total return of the Bloomberg US Aggregate Bond Index.

There are several probable reasons for this underperformance.

- 1. Energy outperformed.** Some of the least sustainable-friendly sectors in the US aggregate index, such as integrated energy and independent energy, have performed the best. Oil prices rose from \$75/barrel at year end 2021 to above \$120/barrel in early June 2022 amidst the Russia-Ukraine situation. Many of those energy companies are not represented in the ESG aggregate index.
- 2. Demand slowed.** While demand for sustainable investments outstripped supply in 2021, most investors have focused their efforts on stopping the bleeding in their overall portfolios in 2022 rather than continuing to march toward a more sustainable portfolio, thus reducing demand for ESG-specific issues.
- 3. Duration mismatched.** Duration mismatches can easily be managed by portfolio managers, but at the index level, the ESG aggregate index began the year about 0.12 years longer option-adjusted duration relative to the US aggregate index. Normally that would be insignificant; however, in a year like 2022 where the 10-year Treasury rose by almost 200 bps from the beginning of the year to its peak a couple weeks ago, it's made a difference.

Headwinds become tailwinds?

As we start the second half of 2022, each of these headwinds may be poised to flip to tailwinds. Oil prices have already dropped to about \$100/barrel as fears of a recession, and with it the potential for declining oil demand, take hold in the markets. More importantly, little has accelerated the desire to transition away from traditional energy to renewable energy sources more than Russia's invasion of Ukraine, particularly in the European Union. And lastly, if the Fed successfully slows inflation, with or without a recession, the markets will likely transition to pricing in a recovery in 2023 or 2024, allowing investors to refocus their efforts on the long-term sustainability of their portfolios. And if there is a recession, let's not forget that the ESG aggregate index outperformed the US aggregate index by almost 40 bps during the pandemic-induced recession of 2020. If any or all the above are true, sustainable fixed income investments may be poised to rally as we head toward the end of 2022.

Disclosures

Unless otherwise noted, the information in this document has been derived from sources believed to be accurate at the time of publication.

This material is provided by Aegon Asset Management (Aegon AM) as general information and is intended exclusively for institutional, qualified, and wholesale investors, as well as professional clients (as defined by local laws and regulation) and other Aegon AM stakeholders.

This document is for informational purposes only in connection with the marketing and advertising of products and services, and is not investment research, advice or a recommendation. It shall not constitute an offer to sell or the solicitation to buy any investment nor shall any offer of products or services be made to any person in any jurisdiction where unlawful or unauthorized. Any opinions, estimates, or forecasts expressed are the current views of the author(s) at the time of publication and are subject to change without notice. The research taken into account in this document may or may not have been used for or be consistent with all Aegon AM investment strategies. References to securities, asset classes and financial markets are included for illustrative purposes only and should not be relied upon to assist or inform the making of any investment decisions. It has not been prepared in accordance with any legal requirements designed to promote the independence of investment research, and may have been acted upon by Aegon AM and Aegon AM staff for their own purposes.

The information contained in this material does not take into account any investor's investment objectives, particular needs, or financial situation. It should not be considered a comprehensive statement on any matter and should not be relied upon as such. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to any particular investor. Reliance upon information in this material is at the sole discretion of the recipient. Investors should consult their investment professional prior to making an investment decision. Aegon AM is under no obligation, expressed or implied, to update the information contained herein. Neither Aegon AM nor any of its affiliated entities are undertaking to provide impartial investment advice or give advice in a fiduciary capacity for purposes of any applicable US federal or state law or regulation. By receiving this communication, you agree with the intended purpose described above.

Responsible investing and ESG investing is qualitative and subjective by nature, and there is no guarantee that the criteria utilized, or judgment exercised, by any company of Aegon Asset Management will reflect the beliefs or values of any particular investor. Information regarding responsible practices is obtained through voluntary or third-party reporting,

which may not be accurate or complete, and Aegon Asset Management is dependent on such information to evaluate a company's commitment to, or implementation of, responsible practices. Responsible norms differ by region. There is no assurance that responsible investing strategy and techniques employed will be successful.

Past performance is not a guide to future performance. All investments contain risk and may lose value. This document contains "forward-looking statements" which are based on Aegon AM's beliefs, as well as on a number of assumptions concerning future events, based on information currently available. These statements involve certain risks, uncertainties and assumptions which are difficult to predict. Consequently, such statements cannot be guarantees of future performance, and actual outcomes and returns may differ materially from statements set forth herein.

The following Aegon affiliates are collectively referred to herein as Aegon Asset Management: Aegon USA Investment Management, LLC (Aegon AM US), Aegon USA Realty Advisors, LLC (Aegon RA), Aegon Asset Management UK plc (Aegon AM UK), and Aegon Investment Management B.V. (Aegon AM NL). Each of these Aegon Asset Management entities is a wholly owned subsidiary of Aegon N.V. In addition, Aegon Private Fund Management (Shanghai) Co., a partially owned affiliate, may also conduct certain business activities under the Aegon Asset Management brand.

Aegon AM UK is authorised and regulated by the Financial Conduct Authority (FRN: 144267) and is additionally a registered investment adviser with the United States (US) Securities and Exchange Commission (SEC). Aegon AM US and Aegon RA are both US SEC registered investment advisers. Aegon AM US is also registered as a Commodity Trading Advisor (CTA) with the Commodity Futures Trading Commission (CFTC) and is a member of the National Futures Association (NFA). Aegon AM NL is registered with the Netherlands Authority for the Financial Markets as a licensed fund management company and on the basis of its fund management license is also authorized to provide individual portfolio management and advisory services in certain jurisdictions. Aegon AM NL has also entered into a participating affiliate arrangement with Aegon AM US. Aegon Private Fund Management (Shanghai) Co., Ltd is regulated by the China Securities Regulatory Commission (CSRC) and the Asset Management Association of China (AMAC) for Qualified Investors only; ©2022 Aegon Asset Management or its affiliates. All rights reserved.

Adtrax: 4841134.2GBL