Investment News

Monthly Bulletin from the Insurance & Investment Team

August 2018

Last Month in Brief

The Bank of England has raised the interest rate from 0.5% to 0.75%. This is only the second rise in a decade and is the highest level since March 2009. Mark Carney, the Bank of England governor, indicated that there would be further increases in the rate in the future but they would be 'limited' and 'gradual'. The rate increase follows increased economic growth, 0.4% in the second quarter, and higher inflation than the Bank of England's 2% target at 2.4%

The value of the Pound against the US Dollar has fallen in recent weeks, with the Pound falling below $1.27 for the first time since June 2017. Economists suggest the fall is attributed to the increased strength of the US Dollar (as there has been little change in the value of the Pound against the Euro), compounded by political uncertainty regarding Britain's future relationship with the EU and weaker than forecast earnings growth figures released by the ONS in early August.

Recently, Apple became the first publicly traded company with a value of over US$1 trillion. Following behind are Amazon with a value of US$909bn, Google at US$862bn and Microsoft at US$835bn.

Chart 1: Equity Indices
All equity markets rose over the month

Chart 2: Sterling Credit Spreads
Credit spreads fell slightly over the month.

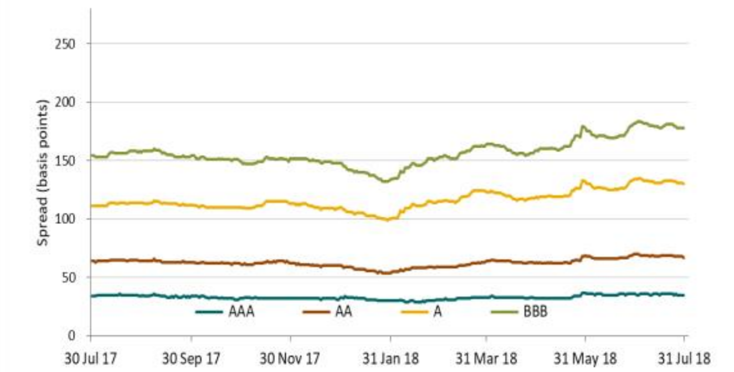


Chart 3: Gilt Yields
All gilts showed a gradual increase over the month.

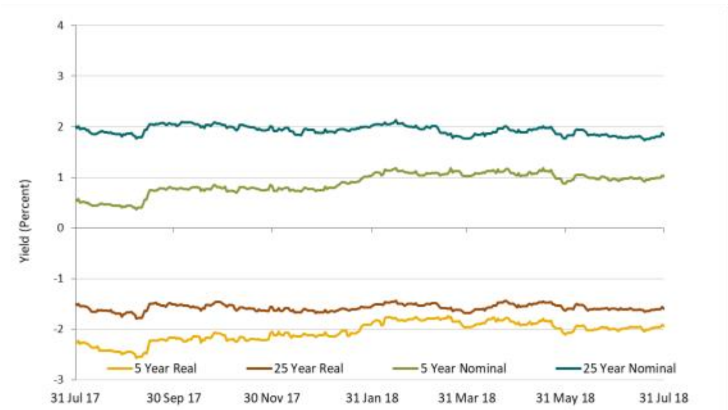
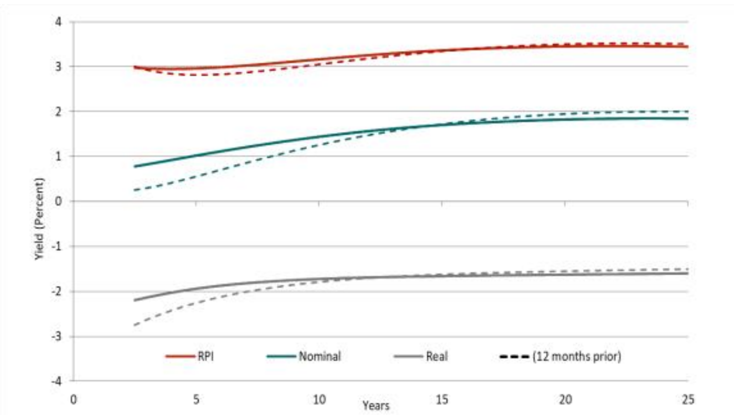


Chart 4: Gilt Spot Curves
The yield curves were stable over the month



Source: Bloomberg, Business Insider, MSCI, Merrill Lynch Bank of America and Bank of England.

	Latest	Previous		Latest	Previous
CPI (annual change)	+2.4%	+2.4%	**Base rate**	0.75%	0.5%
PPF 7800 funding ratio	96.3%	94.9%	**$/£ exchange rate**	1.31	1.32
Halifax house prices (monthly change)*	+1.4%	+0.3%	**VIX (volatility) index**	12.83	16.09

** Halifax have recently changed their methodology for calculating the above figures so the figures may not be consistent with previous updates*

Sustainable investing and green bonds

In recent years there has been a global push to combat climate change and this has led to a growing demand for more sustainably resourced investments. Sustainable, responsible and impact investing (SRI) is an investment discipline which considers environmental, social and governance (ESG) criteria in order to generate long-term financial returns and positive societal impact. One particular type of investment in this field is the green bond.

What are green bonds?

Green bonds are ordinary fixed income assets that are issued to fund projects that will have a positive effect on the environment, the global climate and society. These could fund initiatives such as investment in renewable energy, use of sustainable resources, pollution prevention, conservation and climate change adaptation.

Green bonds are similar to climate bonds. Climate bonds represent a broad universe of bonds whose proceeds are for climate related projects. In practice, the majority of green bonds could also be classified as climate bonds with the proceeds going to climate change projects.

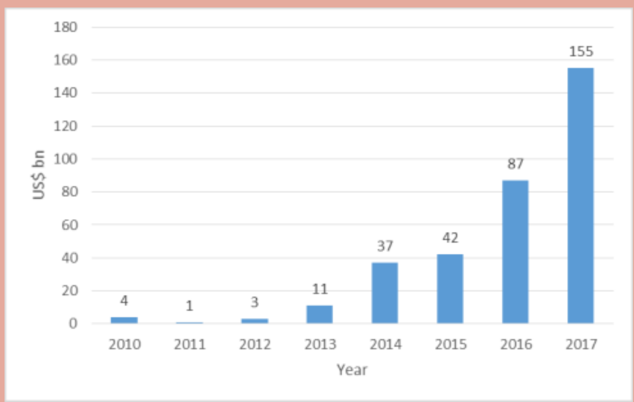
The growth of the green bond market

Green bonds continue to be in great demand, and the market for these bonds is expected to continue to grow with bond issues typically oversubscribed on average by nearly a multiple of 3.

The graph in figure (1) shows how green bond issuance has seen a significant increase from 2010 to 2017 due to their popularity and increased demand from investors. Total issuances in 2017 hit US$ 155 billion. This is a 78% growth in comparison to 2016. For many countries that are part of the green bond market, their green bond issuance in 2017 amounted to a significant part of their total bond issuance.

Figure 1: Amount of Green Bonds Issued

Source Climate Bond Initiative



This growth is set to continue into 2018, and is forecast to grow to around US$ 250-300 billion according to the Climate Bond Initiative- a UK based non-profit organisation that is working to mobilise the bond market for climate change solutions.

Financial considerations

A common question asked with respect to green bonds is whether there is a price premium attached to them in comparison to vanilla bonds. In general, the answer to this question is no. Green bonds like other types of bonds are priced with respect to their associated level of risk. However the smaller market for green bonds is often perceived as riskier due to their limited liquidity. As the market continues to grow market participants will likely expect the level of risk associated with the bonds to fall as their liquidity increases.

Why invest in green bonds?

Green bonds play a key role in debt markets by enabling capital-raising and investment for new and existing projects with environmental benefits. Bonds are determined to be ‘green’ based on the primary objectives of the projects.

The International Capital Market Association has produced a set of voluntary process guidelines called the Green Bond Principles (GBP), with the aim of increasing transparency and disclosure, and promoting integrity in the market. The GBP are intended to provide guidance to issuers on launching a credible green bond; and aid investors to evaluate the environmental impact of the bond.

The graph in figure (2) represents the use of proceeds in 2017 of green bonds. Investment in renewable energy continues to be the largest common use of green bonds making up 33% of all green bonds in 2017.

Figure 2: Use of Proceeds

Source Climate Bond Initiative

The future of green bonds in the UK?

In September 2017, the UK Government created The Green Finance Taskforce. This Taskforce makes recommendations that aim to increase the rate of growth of green finance in the UK.

In March 2018, The Green Finance Taskforce released a report to the UK Government which recommended that the UK should issue a sovereign green bond. Such a bond issue was recently undertaken in France. Further information on this report can be found in their report: Accelerating Green Finance.

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