Innovation

How fixed income can reinvent the future

The real action lies in fixed income

Around the world, innovative businesses are working to solve myriad challenges, ranging from fighting climate change to achieving social justice.

For many investors, portfolios are being reconstructed to achieve not only financial goals, but to create a better worth through innovation.

The stock market attracts a great deal of attention, but for investors who want to fund change, the real action lies in fixed income.

Companies focused on innovation require capital to fund change. Whether it's developing a new clean technology or improving their corporate climate footprint, many turn to the bond market for funding.

Konstantin Boehmer,

Senior Vice President, Co-Lead of Fixed Income Team, Head of Global Macro, Portfolio Manager

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Funding innovation

"Good environmental, social and governance (ESG) practices are critical factors that can affect the financial performance of bond issuers," says Konstantin Boehmer, Head of Global Macro and Quantitative Analytics, and ESG Integration Leader at Mackenzie Investments' Fixed Income Team.

All of Mackenzie's fixed income strategies include an upfront ESG risk assessment, which aims to eliminate exposure to controversial issuers and unethical activities.

The team's sustainable strategies, including Mackenzie Global Sustainable Bond Fund and Mackenzie Global Sustainable Bond ETF, go a step further. They include an impact analysis to assess the use of proceeds from a bond to ensure adherence to the funds' core thematic objectives.

Green bonds issued by traditionally "dirty" companies are often suspected of greenwashing – raising capital in the name of improving sustainability yet using the capital to fund its ongoing operations.

Avoiding these greenwashed bonds while engaging with companies seeking to improve requires intense research.

"This is not something that you can just pick up off the shelf," he says. "We don't rely on external ratings. We do our own research to make sure that an issuer isn't greenwashing."

Innovative research

Companies that are assessed with relatively low ESG scores may show potential for improvement. In such cases, the team believes engagement is better than exclusion. As bondholders, the team can work with an issuer to try and bring about positive change in their ESG practices.

After adding a bond to a portfolio, the team engages with issuers on critical ESG concerns throughout the duration of its investment, to ensure the stated improvements are made. These engagements are logged to monitor whether the issuer acts on concerns raised by the team, which have increasingly focused on climate change, as well as diversity and inclusion.

"Innovation is required across all sectors," Boehmer says. "Strategic investment in issuers with positive momentum and sustainable use of proceeds will support and enhance the transition to improved social standards and a decarbonized economy."

Part of the challenge is in determining the "greenness" of a new bond issue. That decision must look beyond traditional measures, such as an issuers carbon footprint.

For example, a steel producer may require funding to transition from coal to new electricity-based production methods. Its legacy carbon footprint as a coal consumer may overshadow its aspiration to become a "green steel" producer.

"If a company in a sector that is traditionally considered 'dirty' issues a green bond, we have to determine whether the proceeds of the bond are truly improving the company's sustainability," Boehmer says.

In the best-case scenario, continued engagement with issuers who presently score poorly has led to improving the company's sustainability and the issuance of sustainable and green labelled debt. Issuance of this green debt funds decarbonization of corporate operations and increased investment in renewable energy technologies.

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An innovative bond

New issuers are creating innovative bond structures with targeted impact. One example Boehmer cites is a nature reserve in Africa which is raising capital to fund protection of an endangered species. Payments on the bonds are tied to the growth of that species' population over the maturity of the bond.

"We've never seen this structure because it's completely new. It's curious and we find it interesting. It requires an entirely new type of research analysis which we find very exciting," he says. "We're investors, not a charity. We like this idea but it's going to require a lot of legwork to ensure it makes economic sense."

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