Incorporating climate-focused impact in European fixed income investments

As the chill around climate investing intensifies, are current strategies enough to deal with volatile markets and shifting policy agendas? How do fixed income portfolios fit into this equation?

By *Ronald Van Steenweghen*

According to a recent study by Bloomberg NEF, global energy transition investments exceeded $ 2.1 trillion in 2024, reflecting an 11% increase from the previous year. While this marks a significant milestone, it also represents a slowdown from the 25%+ annual growth rates seen in prior years. Is this level sufficient?

ESG debt will keep powering the energy transition

A two-speed transition is becoming increasingly apparent. Most investments continue to flow into mature technologies, such as electrified transport, renewable energy, and power grids, while emerging solutions – including hydrogen, clean shipping, and carbon capture and storage – have attracted only 7% of total investments. The main barriers to scaling these emerging technologies are technological complexity and economic viability. Without stronger policy support, these newer technologies may struggle to attract the level of capital needed to scale effectively.

A significant portion of energy transition investments has been financed through ESG debt markets, with green bonds serving as the flagship category. These instruments have been crucial in directing capital toward climate-focused projects. Green and ESG bonds allow investors to align their capital with measurable impact. While annual issuance in 2024 has already exceeded $ 1 trillion, there is considerable room for expansion, especially since the global fixed income market exceeds $ 15 trillion. With the substantial investment required for the energy transition, both mature and emerging technologies can qualify for green bond financing. Mature sectors are well-suited for bond financing due to their predictable cash flows, making them attractive to investors with low-risk appetites and/or long investment horizons.

There is currently no statistically significant difference in secondary market performance between green bonds and traditional bonds. While sectoral and credit quality biases exist at the index level, actively managed portfolios can effectively overcome and benefit from these differences. A recent Barclays study confirmed that investors view the green bond market as high quality, but noted that the willingness to pay a premium remains limited to a few basis points – a relatively small margin, particularly in higher interest rate environments. As the market continues to expand, further growth and diversification are expected to enhance its resilience and attractiveness.

While some concerns exist that regulatory shifts could deter issuers and investors from the ESG debt market, we believe it will continue to thrive. Although headline risks around climate investment have increased, the underlying economics remain solid, ensuring that capital will continue to flow.

Financial markets may struggle to price climate risks daily, and novel climate technologies might require public support to scale. However, this should not slow down the energy transition, nor should it prevent fixed income markets from playing a central role in funding the shift at a market-based cost of capital.

The rise of greenhushing

The 'greenhushing' trend refers to a situation where companies remain committed to climate action but are less vocal about their efforts. While this decline in transparency is not ideal, we believe that discreet yet effective capital deployment is preferable to high-profile pledges with little meaningful follow-through. However, this shift also means that investors will need to conduct deeper financial analysis and engage more actively to identify the true and credible 'green gems' in the market.

FIGURE 1: INVESTABLE UNIVERSE

Source: DPAM

> 'Although headline risks around climate investment have increased, the underlying economics remain solid, ensuring that capital will continue to flow.'

Despite slowing investment growth and increased policy uncertainty, ESG debt markets remain a fundamental pillar of climate finance. Green bonds continue to demonstrate strong market credibility, and while issuers may adopt a lower-profile approach, the capital needed for the energy transition is still flowing. Investors who take a proactive approach, engaging directly with companies, will be best positioned to capitalize on the next phase of the transition.

Achieving climate-related impact and performance

Climate investing needs action, both corporate and governmental. We believe that in climate finance, impact and alpha are not mutually exclusive. And through active management, environmental impact and performance can be maximized.

Fixed income offers a unique opportunity to combine environmental purpose with performance. ESG-labelled bonds – mainly green bonds – have driven over half of global energy transition investments since 2022, delivering tangible and real impact.

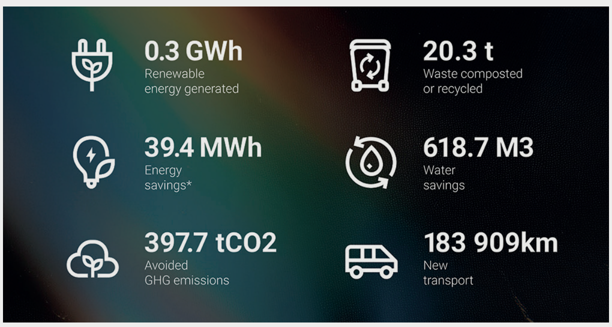
Although this market segment is growing and becoming more diversified, structural biases remain. This is something we want to avoid at all costs when running a fixed income portfolio. To ensure a balanced and effective approach, we propose to categorize eligible bonds into four categories:

- **Green bonds:** fund environmental projects - these remain the foundation.
- **Sustainability-linked bonds:** are tied to clear environmental KPIs.
- **Climate challengers:** refer to issuers leading the decarbonization efforts in their respective markets.
- **Climate enablers:** refer to companies with significant green revenue or capital expenditures.

For each type of ESG-labelled bond, we must assess the credibility and ambition of every issuer's framework. The principles of materiality, intentionality, and additionality must be present in the frameworks. For 'climate challengers' and 'climate enablers', we validate the climate strategy of the issuer.

In our approach, for every € 1 million invested, we generate significant amounts of renewable energy, drive gigawatts of energy savings and reduce CO_2 emissions. We also support waste recycling efforts, conserve valuable water resources and encourage the construction of sustainable transport infrastructure. We invest for a net-zero economy, not just a low carbon portfolio. We have our lens on the future and see the opportunities, but are aware that fixed income markets are driven by a multitude of climate and non-climate factors. Climate investing is investing with conviction to deliver purpose and performance. ■

FIGURE 2: IMPACT ALLOCATION



Source: DPAM

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SUMMARY

Energy transition investments have been significantly financed through ESG debt markets.

Green and ESG bonds allow investors to align their capital with measurable impact.

Despite slowing investment growth and increased policy uncertainty, ESG debt markets remain a fundamental pillar of climate finance.

Investors taking a proactive approach, engaging directly with companies, will be best positioned to capitalize on the next phase of the transition.

Climate investing is investing with conviction to deliver purpose and performance.