Global Sustainable Bond strategy FAQ

Mackenzie Fixed Income Team

The sustainable debt market is evolving rapidly, creating significant opportunities for investors. Whether through green bonds, social bonds or other forms of sustainable debt, the market is providing new ways to invest in a future that aligns financial goals with positive environmental and social outcomes.

The growth in this market is being fueled by active management and innovative strategies that continue to enhance performance potential and diversification benefits for investors, demonstrating that sustainable investing is not only possible but also profitable in today's fast-changing world.

Aligning financial capital with both natural and human capital is essential to mitigate the staggering economic costs of climate change. The shift is not just about adhering to personal values or philanthropic goals — it reflects an understanding that the world is rapidly changing and that the most compelling opportunities will lie in addressing the global challenges we face, including climate change.

The Mackenzie Global Sustainable Bond strategy seeks to provide a steady flow of income and moderate capital growth by investing primarily in fixed income securities issuers anywhere in the world, focusing on sustainable and responsible issuers. This will include ESG-labelled debt and bonds from "best-in-class" issuers.

In this Q&A, members of the Mackenzie Fixed Income Team share their perspectives on the current landscape of sustainable fixed income and highlight the compelling opportunities available for investors in the ESG space.

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Q: How do you define “sustainable” in your approach to fixed income investing and how do you think your team’s ESG integration strategy differs from your peers?

KB: We define “sustainable” by adhering to robust ESG criteria and analysis, focusing on government and corporate issuers who demonstrate a genuine commitment to environmental and social impact.

Our journey in sustainability started a decade ago and I am proud that our team is recognized among best-in-class sustainability leaders in Canada by an independent consultant. It took a lot of hard work and commitment, but we are there, and we remain committed to do more to advance sustainability goals. We manage a broad range of strategies, from core government bond portfolios and flexible aggregate mandates to high-yield credit strategies and sustainability-oriented mandates emphasizing labelled debt.

In our research, we go beyond surface-level ESG ratings. Rather, our process is centred around proprietary research and direct engagement to assess the true sustainability of issuers. Prior to investment decision making, sovereign and corporate investments are analyzed including ESG materiality and risk factors using distinct models. Traditionally, financial attractiveness drives much of the investment decision, for us it is critical that we are not only aware of any ESG risks and but also to ensure we are adequately compensated. From that perspective our ESG integration is compelling, front and center, and differentiates from other managers.

Having developed proprietary quantitative models to determine dynamic and materiality-weighted ESG scores for corporate and sovereign issuers, our team is committed to the continued optimization of our ESG-oriented portfolio management strategies. Our strategies possess increased tilts towards positive ESG scoring, with consideration to the Paris Agreement and advancement of sustainability and social objectives.

Q: How do you handle potential conflicts between financial performance and ESG objectives?

KB: This is probably the most common concern I hear from clients, and my answer is unequivocal: No, we are not sacrificing returns. In fact, we believe sustainable bonds offer the potential for competitive returns while simultaneously reducing long-term risks linked to environmental, social and governance factors. This dual benefit offers the potential to enhance overall portfolio resilience.

Our approach is holistic and deeply integrated. ESG considerations are woven into every part of our investment process, from the earliest stages of research and security selection to portfolio construction and risk management. By doing so, we don’t just assess financial performance; we also identify hidden risks and opportunities that others might overlook. This allows us to construct a portfolio that is not only aligned with our ESG values but also positioned to deliver attractive financial outcomes.

We don’t see ESG goals and financial returns as conflicting priorities. Instead, they work together, driving what we believe is a more resilient and forward-looking portfolio. By embedding sustainability at the core of our strategy, we are better equipped to navigate market complexities and achieve consistent, long-term value for our investors.

Q: How do you evaluate the ESG credentials of issuers?

AV: Our investment research spans global fixed income markets, analyzing both sovereign and corporate, using our proprietary ESG frameworks to analyze a broad universe of opportunities. For example, our sovereign framework covers more than 80 countries and incorporates a holistic, double-materiality approach, capturing both current and momentum data across 12 sustainability themes and 75 metrics.

We are aware of the challenges associated with ESG data — its inconsistency, lack of transparency and often unaudited nature. Therefore, we minimize reliance on third-party scores, ratings or targets, which we find subjective and opaque in their methodologies. For example, in our corporate ESG model, third-party data accounts for only about 10% of the total weight, using selected indicators from providers like S&P Capital IQ (governance), Sustainalytics (social) and another from Sustainalytics (environment). For the sovereign model, third-party data constitutes about 20%, given that some academic and industry data may be subjective.

We've encountered challenges, particularly with "black box" risk scoring frameworks and issues like emissions data at the bond level. To address these, we engage directly with data providers and have aligned our methodologies with academic research and industry best practices. Our proactive engagement with providers, such as Sustainalytics, has led to meaningful improvements, including re-evaluations of issuers, especially in emerging markets. This proactive stance gives us two significant advantages: a deep understanding and control over our ESG risk assessment processes and full transparency on the assumptions behind the data we use.

Ultimately, our approach combines rigorous in-house analysis with selective use of external data, ensuring we maintain both transparency and credibility in our ESG evaluation.

We also believe that just as credit risk assessments vary between industries, our process to analyze ESG positioning should be uniquely targeted to suit the characteristics of individual issuers. In addition to providing clarity towards the standing of a specific credit, this methodology reduces the risk of exposure to "greenwashed" securities, where capital is directed in a manner immaterial to the business to provide the illusion of corporate social responsibility. Through this process, we ensure that each of our strategies considers ESG risk and opportunities in a manner that holistically balances the team's core ESG principles and unique investment objectives.

Q: How do you engage with issuers to improve their ESG practices?

AV: We have a strong commitment to engage with issuers on critical ESG concerns throughout the duration of our investments. Starting from our initial executive meetings with corporate issuers, our team is dually focused on addressing ESG risks and fallacies that threaten the success of global stewardship initiatives, as well as the financial and reputational stability of issuers. Following the United Nations' Principles for Responsible Investing's recommendations on the value of strategic engagements [UN PRI – Divestment], Mackenzie's efforts have resulted in increased disclosure and accountability, with engagements spanning an expansive range of sustainability themes, investment sectors and geographies.

Since 2018, the Mackenzie Fixed Income Team has initiated hundreds of ESG conversations with management teams, highlighting concerns with respect to factors such as workplace safety, executive diversity and the transition away from high emission energy sources such as thermal coal. Our team has been engaging in reverse-interest engagements in which our team has proactively expressed interest in financing targeted sustainable debt projects. It is our core belief that innovation is required across all sectors, and that the strategic investment in issuers with positive momentum and sustainable use of proceeds within sectors with high ESG risk exposure will support and enhance the transition to improved social standards and a decarbonized economy. The Mackenzie Fixed Income Team's continued engagement has led to the issuance of sustainable and green labelled debt oriented towards the decarbonization of corporate operations and increased investment in renewable energy technologies.

Q: What role do third-party ESG ratings play in your research?

AV: They serve as a reference point, but our investment decisions rely on our own in-depth research and engagement. We do consult third-party ratings from an exclusionary perspective — such as Sustainalytics or MSCI ESG ratings but these are used only if there are significant red flags (such as controversy level five or lowest decile scores). Our methodology also involves a second review of controversies sourced from Sustainalytics, which helps us maintain an objective and informed approach to ESG evaluation. When building our own scoring system, we sought to use almost entirely primary data which can be externally verified and validated as part of corporate governance and ESG reporting. While some metrics may present some degree of variance or estimation (including GHG emissions), the team has worked to best comprehend these methodologies at the industry level, and when necessary, engage with data providers to understand the replacement methodology.

The same can be said on the sovereign, supranational and agency (SSA) bond side, with data taken from leading academic, supranational and economic publications. This same methodology was largely extended to the team's labelled debt impact scores, with a focus on structure and reporting, having constructed in-house scoring systems rather than relying upon external evaluations.

Q: How do you construct a diversified portfolio while maintaining ESG integrity?

HD: The first layer of diversification in our sustainable strategies comes from leveraging the expertise of portfolio managers who oversee both traditional and sustainable strategies within their areas of specialization. As the global portfolio manager, I am responsible for managing both non-ESG global strategies as well as our global sustainable and green bond strategies. This dual responsibility allows us to ensure that the best ideas we identify across global markets are fully integrated into our sustainable strategies, enabling a seamless and comprehensive ESG integration across all investment strategies. We use a multi-layered approach to portfolio construction that balances labelled sustainable investments and best in class issues. Investments are generally aligned to specific thematic objectives which are carefully tailored to suit different credit issuers and the use of proceeds. This alignment is guided by the Mackenzie Fixed Income ESG Leadership Group in consultation with the Mackenzie Sustainability Centre of Excellence.

To maintain ESG integrity, we apply proprietary ESG scores for corporate and sovereign issuers throughout the investment process. These scores are crucial in our screening protocols and influence our selection decisions. Issuers with strong ESG credentials benefit from what we call a "green or sustainable premium," where we capitalize on securities that offer an attractive risk-return profile due to their effective ESG risk mitigation. We actively seek out undervalued credits — those with current market valuations that do not yet reflect their best-in-class ESG fundamentals.

We also remain open to investing in credits that may initially have weaker ESG profiles if there is a compelling case for improvement. Our research team works closely with these issuers, engaging with them to drive material enhancements in their ESG practices, whether through sustainable use of proceeds or direct engagement strategies. These investments are closely monitored, and once the market begins to recognize the issuer's ESG improvements, we reassess the credit. If we determine that the issuer has reached a fair or high valuation, we may choose to sell the position.

Our strategy is designed to fund sustainable investments while adhering to our core credit research principles. We aim to achieve compelling risk-return ratios across our strategies, ensuring that each investment is appropriately compensated for its risk profile.

Q: Do you apply exclusions in your investment analysis?

HD: Diversification is a key priority for us as a team; excluding entire sectors or markets would limit the breadth of opportunities available. Instead, we maintain a broad analytical scope, evaluating all potential investments based on our rigorous evaluation process and the overall exposure within the portfolio. While our exclusion policies, particularly for sustainability-focused strategies, continue to evolve in response to client expectations, we view divestment as a measure of last resort.

We also recognize that clients may have specific exclusion preferences regarding certain sectors or issuers. We are fully equipped to implement customized screening criteria upon request and provide ongoing monitoring to ensure alignment with those preferences. Currently, strategies with a sustainable investment objective do exclude specific industries such as tobacco and adult entertainment.

Q: How do you balance short-term performance pressures with long-term sustainability goals?

HD: Balancing short-term performance pressures with long-term sustainability goals is a core part of our strategy. We understand that focusing on long-term value creation, underpinned by sustainable practices, ultimately leads to more resilient financial outcomes. In the fixed income space, this requires a disciplined approach to both security selection and portfolio construction. We build a diversified ESG portfolio by carefully selecting issuers across various sectors and regions that align with our rigorous ESG standards or exhibit rapid improvements in their ESG metrics that are not yet fully recognized by the market. In doing so, we capture both the stability of strong ESG performers and the potential upside of “rising stars” — those issuers whose ESG trajectories are improving quickly.

Our strategy involves a deep analysis of a broad universe of opportunities. We scrutinize a large volume of deals, looking beyond the obvious choices to uncover issuers that may be overlooked or undervalued due to a lack of market awareness or understanding of their ESG transformation. This allows us to be first movers, identifying and investing in credits with strong upside potential before the broader market catches on. Moreover, we actively engage with issuers to understand their ESG strategies, identify risks and encourage positive changes. This engagement not only reinforces our commitment to sustainability but also provides us with unique insights that help us navigate short-term market volatility. It allows us to maintain our focus on long-term goals while optimizing for performance in the near term. By integrating ESG factors into our credit analysis, we mitigate downside risks associated with environmental, social and governance challenges — risks that traditional financial analysis might overlook. We view these factors as leading indicators of creditworthiness and financial health, helping us build a portfolio that can withstand both market cycles and evolving global sustainability trends.

Ultimately, our approach is about creating a portfolio that is resilient, forward-looking and capable of delivering consistent returns. We believe that by investing in sustainable fixed income, we are not only aligning with the future of finance, but also positioning ourselves to achieve strong performance over both the short and long term.

With regards to sustainability goals, currently, we’re particularly focused on financing the transition to net zero, which includes investments in renewable energy, sustainable infrastructure and companies with credible transition plans. There’s also significant opportunity in emerging markets, where sustainable development is becoming a priority.

Q: How do you measure the ESG impact of the strategy?

HD: We employ a distinct sustainable investing methodology to measure and optimize the impact derived through our strategies. Our ESG and credit analysts are responsible for analyzing the status of the respective issuer relative to industry peers and a broad market benchmark, highlighting best-in-class performance or potential sources of material red-flag risk. In addition to our core issuer assessment, our proprietary models assess the impact created by a credit's designated use of proceeds.

Our team is unique in our decision to measure our impact in a dual capacity. We recognize that, contrary to equity investment, labelled debt contains the possibility to invest in individual targeted sustainability initiatives, as well as in the respective debt issuer.

We have positioned ourselves as industry leaders through our integration of increasingly sophisticated methodologies that balance these dual objectives. This strategy enhances the ability of our portfolios to improve sustainability by investing in present innovators while also directing our investments expressly towards transformative change. The issuer ESG assessment empowers our team to invest in issuers with an established best-in-class position as a known innovator with high ESG scores and low carbon emissions. Jointly, the use of proceeds and momentum models may be likened to investing in issuers who, either through capital expenditures or use of proceeds, have established science-based targets and intentions to materially reduce their carbon footprint and subsequently improve their ESG standing and credit quality.

Q: What is your favorite investment so far?

HD: Creating the world's first wildlife conservation bond focused on growing the black rhino population in Africa, a highly endangered species. Called the "Rhino Bond" Mackenzie was the co-lead investor. Issuance was for $150 million (USD) and it fit into some important sustainability themes: biodiversity, conservation and community empowerment among them. This was an exciting way to contribute positively to the United Nations' SDGs and generate competitive returns for our clients.

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