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Merrill Preps Advisors for Rise of the Green Bond

By Murray Coleman June 30, 2016

The Brexit vote's fallout might rattle investors for a long time. But one tiny yet emerging area of fixed income that some advisors are telling their clients could turn out to be a big winner is the market for so-called green bonds.

So how could U.K. voters' rejection of European Union membership play a role? The Brexit aftermath is expected to pressure more central bankers around the world to push monetary policies promoting economic growth.

At the same time, the green bond corner of global fixed income markets is becoming a hot avenue for investing in projects focused on everything from building environmentally friendly offices to developing renewable energy storage facilities and more efficient water treatment technologies.

As **Michael Hartnett**, chief investment strategist at Merrill Lynch**,** put in a note after last week's referendum: "Fiscal stimulus is the best route to jump-start the zombification of aggregate global demand." He adds that such "helicopter money" – that is, the printing of money by central banks and subsequent bond sales – should increasingly go to public infrastructure projects.

While not specifically addressing so-called green bonds, Hartnett's report identifies energy efficiency and water scarcity as key investment themes that advisors and their clients should keep in mind as "new deal" policies to spur economic growth take hold in coming years.

Separately, Merrill's **Beijia Ma** is forecasting green bond issuance could reach as much as $90 billion in 2016. The London-based analyst tells FA-IQ that such activity would mark a doubling in the past year invested in "green" related projects.

That would push total outstanding green bonds to $185 billion in worldwide assets, estimates Ma. "This is a part of the market which has produced so many consecutive years of record issuance now," she says, "that we think it's fair to view green bonds as moving into fixed income's mainstream."

Mark Peters

Along those lines, Ma observes that computer giant Apple sold $1.5 billion in green bonds in the first quarter. That's a development the strategist says represents the single biggest issuance by an American company in the young market so far.

At Merrill, a special "green shelf" has been created to help advisors choose ETFs, mutual funds and separately-managed accounts targeting environmental, social and governance issues for clients.

"We've created resources for financial advisors to go in and work with asset class experts to pick out specific green bonds," says Ma.

Benjamin Bailey, a fixed income portfolio manager at **Everence Financial** in Goshen, Ind., finds these days it's not just clients on the cutting edge of ESG investing who are asking about green bonds.

"People who don't know anything about environmentally friendly fixed income alternatives are usually excited when we tell them how much potential this market possesses, both in terms of meeting their faith-based objectives as well as their long-term financial goals," says Bailey.

Everence Financial, which was founded in 1945 by the Mennonite Church, adheres to a socially conscious investing strategy. The diversified financial services company and wealth management firm now oversees about $2.8 billion, mainly through a family of mutual funds and separately-managed accounts.

In fact, the firm considers itself a pioneer in the green bonds market since it was an original investor in the World Bank's first U.S.-denominated green bond issued in 2009.

"As more companies get involved in the market we're expecting greater opportunities to invest in issues offering higher yields than a typical government or supranational bond from global development banks -- both of which have dominated green debt markets in the past," says Bailey.

Meanwhile, green bonds are also likely to keep seeing growing popularity from public agencies around the world post-Brexit, notes **Mark Peters**, a Boston-based managing director at **Pathstone Federal Street** in Fort Lee, N.J., which manages $7 billion.

"As governments and central banks look to deploy capital, the green bonds market is one area within fixed income that stands to be seen as a natural fit," he says.

Right now, Peters estimates that Pathstone is allocating 3-5% of an average moderate risk client's fixed income portfolio to green bonds.

Although pure-play funds and managed accounts are increasingly being rolled out for U.S. investors, he warns that green bonds are "still in their infancy."

As a result, Peters prefers to stick to broad-based funds whose managers are selectively wading into the field, not diving in head first.

"While we see long-term benefits to holding meaningful exposure to such a rapidly growing market," he says, "green bonds are still only a tiny segment of the broader fixed income universe."