Introduction to Sustainable Asset Allocation

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- **Definition:** Sustainable asset allocation involves selecting investments that align with environmental, social, and governance (ESG) criteria (Abate, Ignazio Giorgio Basile and Ferrari, 2023).
- **Importance:** Increasing demand for responsible investments due to climate risks, regulatory pressures, and stakeholder expectations (Ramana Kumar Kasaraneni, 2021).
- **Objective:** Maximize financial returns while supporting sustainable practices.

Why Sustainable Strategies are Essential in Asset Allocation

- **Risk Mitigation:** Sustainable investments help manage risks from climate change, regulatory shifts, and reputational issues (Google Books, 2022).
- **Enhanced Long-Term Returns:** Evidence suggests companies with strong ESG practices often outperform due to resilience and operational efficiencies (Wang et al., 2023).
- **Alignment with Global Goals:** Sustainable investing supports the UN Sustainable Development Goals (SDGs) and the Paris Agreement on climate change.

Criteria for Selecting Sustainable ETFs

- **Paris-Aligned Benchmarks:** Prioritize ETFs aligned with the Paris Agreement, supporting a net-zero carbon goal by 2050.
- **ESG Screening:** Select funds with robust ESG screening to avoid high-emission or controversial industries.
- **Fund Characteristics:** Evaluate expense ratios, risk metrics, dividend yield, fund size, and liquidity for stability and cost-effectiveness.
- **Diversity of Holdings:** Ensure diversification across sectors and geographies to reduce volatility and avoid sector concentration.
- **Transparency:** Prefer ETFs with clear ESG reporting and regular updates on sustainability performance.

Portfolio Overview

- **Portfolio Goal:** To construct a diversified, sustainable portfolio that provides exposure to global markets.
- **Number of ETFs:** Selection of five ETFs based on geographic diversity, ESG alignment, and performance.
- **Investment Thesis:** Balancing growth potential and ESG impact by focusing on large-cap companies with strong sustainability practices.

ETF 1 – Franklin S&P 500 Paris Aligned Climate UCITS ETF

- **Overview** Tracks large-cap U.S. stocks aligned with the S&P 500 Paris-Aligned Climate Index (Lorenzi, 2023).
- **Key ESG Focus:** Reduces carbon emissions exposure, supporting net-zero targets by 2050.
- **Performance:** 3-year annualized return of 9.59% with low TER of 0.07% (Lorenzi, 2023).
- **Motivation:** Exposure to U.S. market giants, including tech leaders like Apple and Microsoft, offering stability and growth.

ETF 2 – Franklin STOXX Europe 600 Paris Aligned Climate UCITS ETF

- **Overview:** Provides exposure to European large and mid-cap stocks, tracking the STOXX Europe 600 Paris-Aligned Climate Index (Ullah et al., 2024).
- **Key ESG Focus:** Focuses on low-carbon sectors and reduces high-emission industries.
- **Performance:** Dividend yield of 3.26% with a TER of 0.15% (Ullah et al., 2024)
- **Motivation:** Diversifies regional exposure and includes sustainable European leaders like Novo Nordisk and ASML.

ETF 3 – iShares MSCI World ESG Screened UCITS ETF

- **Overview:** Invests in developed markets globally, focusing on companies with robust ESG practices (Lapčáková, 2023).
- **Key ESG Focus:** Screens out controversial sectors (e.g., weapons, fossil fuels).
- **Performance:** Stable returns with moderate TER, offering diversified global exposure (Lapčáková, 2023).
- **Motivation:** A broad global market ETF that enhances portfolio diversification and ESG focus.

ETF 4 – Invesco MSCI World ESG Climate Paris Aligned ETF

- **Overview:** Targets global stocks with strong ESG scores and aligns with climate goals (Gomes, 2022).
- **Key ESG Focus:** Emphasizes sectors aligned with a low-carbon economy, aiding in climate mitigation efforts.
- **Performance:** Competitive returns with a focus on climate-aligned growth.
- **Motivation:** Supports low-carbon transition with exposure to sectors driving sustainability initiatives (Gomes, 2022).

ETF 5 – Vanguard FTSE Social Index Fund

- **Overview:** A U.S.-based ETF that screens for strong social and environmental practices (Heinonline.org, 2024).
- **Key ESG Focus:** Excludes industries with poor social/environmental records.
- **Performance:** Consistent growth with a focus on socially responsible investments (Heinonline.org, 2024).
- **Motivation:** Complements other ETFs by focusing on social aspects of ESG.

Critical Analysis and Conclusion

- **Portfolio Summary:** Balanced mix across U.S., European, and global markets; focuses on low carbon and ESG-screened sectors.
- **Strengths:** Low-cost, diversified, and aligned with climate targets.
- **Challenges:** Potential trade-offs in returns and limited exposure to high-growth, non-ESG sectors.
- **Conclusion:** Sustainable ETFs offer a responsible approach to asset allocation, catering to both financial and ethical goals.

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