

Strategy Focus

Carving out Energy Stocks from the S&P/TSX 60 ESG Index using S&P/TSX Energy Index* Futures (SXY) & iShares S&P/TSX Energy Index ETFs (XEG)

Responsible investing is booming globally, with a growing number of institutional investors and asset managers integrating ESG integration into their investment decisions. The trend has created increasing demand for ESG ETFs and derivative solutions, such as the S&P/TSX 60 ESG Index futures. These derivatives allow investors to track the performance of the parent S&P/TSX benchmark indices while remaining aligned with their investment values, and enable them to hedge and diversify their portfolio further. ESG screening or exclusionary investing is one of several widely used investment approaches that enable investors and asset managers can use to implement a responsible investment policy across their investments.

For instance, many investors and asset managers have been encouraged to apply exclusionary screening due to rising concerns over climate change, growing pressure to adopt socially responsible investing, and a desire to screen out companies that are not aligned with evolving global standards. In addition, governments are increasing actions to cut greenhouse gas emissions through agreements such as the Paris Climate Agreement. These trends have also led investors to divest from their portfolios companies that are involved in activities seen as incompatible with their beliefs, values, or ethics (i.e.: tobacco, alcohol, military weapons, fossil fuels, nuclear energy, etc.).

Consequently, investors interested in further reducing their carbon footprint can link index futures management with responsible investing by combining ESG index futures with energy sector index futures and energy sector ETFs.

For example, investors can carve out constituents of the energy sector from the S&P/TSX 60 ESG Index. When combined, these constituents represent 12.5% of the weight of the S&P/TSX 60 ESG Index. Examples of tactical strategies that can serve this purpose are: (1) holding a long position in the S&P/TSX 60 ESG Index futures (SEG) and a short position in the S&P/TSX Energy Index futures (SXY), and (2) holding a long position in the S&P/TSX 60 ESG Index futures (SEG) and a short position in the iShares Energy ETF (XEG). Below are two practical examples of how these two strategies can be used.

FIGURE 1

Using S&P/TSX Energy Index Futures (SXY)

→ The results show that for every 2 S&P/TSX 60 ESG Index futures contracts (SEG), 1 S&P/TSX Energy Index futures contract (SXY) is required to carve out the energy constituents from the S&P/TSX 60 ESG Index.

	MARKET CAPITALIZATION	RELATIVE WEIGHT IN THE S&P/TSX 60 ESG INDEX
S&P/TSX 60 ESG INDEX	\$1.77 trillion	-
S&P/TSX 60 ESG INDEX ENERGY CONSTITUENTS	\$221 billion	12.5%

	FUTURES CONTRACT VALUE (A)	FUTURES MULTIPLIER (B)	FUTURES PRICE (C)	% OF ENERGY CONSTITUENTS TO CARVE OUT OF THE ESG INDEX (D)
S&P/TSX ENERGY INDEX FUTURES (SXY)	(A) = (B) * (C) \$13,000	\$200	65.00	-
S&P/TSX 60 ESG INDEX FUTURES (SEG)	(A) = (B) * (C) * (D) \$5,959	\$50	953.40	12.5%
# OF SXY CONTRACTS REQUIRED TO CARVE OUT THE ENERGY CONSTITUENTS IN 1 SEG FUTURES CONTRACT	0.46 SXY contracts \$5,959 / \$13,000	To carve out the energy constituents in 1 S&P/TSX 60 ESG Index futures contract (SEG), 0.46 S&P/TSX Energy Index futures contracts (SXY) are required (or, for every 2 SEG Index futures, 1 SXY Index futures is required)		

FIGURE 2

Using iShares S&P/TSX Energy Index ETFs (XEG)

→ The results show that for 1 S&P/TSX 60 ESG Index futures contract (SEG), 1,419 iShares S&P/TSX Energy Index ETF units (XEG) are required to carve out the energy constituents from the S&P/TSX 60 ESG Index.

	MARKET CAPITALIZATION	RELATIVE WEIGHT IN THE S&P/TSX 60 ESG INDEX
S&P/TSX 60 ESG INDEX*	\$1.77 trillion	-
S&P/TSX 60 ESG INDEX ENERGY CONSTITUENTS	\$221 billion	12.5%

	ISHARES ETFS VALUE (A)	ETF UNITS (B)	ETF PRICE (C)	% ENERGY CONSTITUENTS TO CARVE OUT OF THE ESG INDEX (D)
ISHARES S&P/TSX ENERGY INDEX ETFS (XEG)	(A) = (B) * (C) \$4.20	1	\$4.20	-
S&P/TSX 60 ESG INDEX FUTURES (SEG)	(A) = (B) * (C) * (D) \$5,959	\$50	953.40	12.5%
# OF XEG ETFS REQUIRED TO CARVE OUT THE ENERGY CONSTITUENTS IN 1 SEG FUTURES CONTRACT	1,419 XEG ETF Units \$5,959 / \$4.20	To carve out the energy constituents in 1 S&P/TSX 60 ESG Index futures contract (SEG), 1,419 S&P/TSX Energy Index ETF units (XEG) are required.		

Source: S&P Dow Jones Indices and Montréal Exchange Research

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