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SEG S&P/TSX 60 ESG Index Futures

MONTRÉAL EXCHANGE

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ESG Index Futures Outperform their Parent Index Benchmark

There is a growing realization that good ESG performance and financial performance are linked and that integrating material ESG factors correlates with long-term financial returns and can help generate alpha[1]. A BlackRock research report published in 2020 found that 94% of sustainable indices outperformed their parent benchmarks[2].

With global investors transitioning from existing index benchmarks to sustainable alternatives and Paris Agreement-aligned reference benchmarks, there is considerable interest in ESG integration in derivatives. The recommendations of Canada's Expert Panel on Sustainable Finance, the new U.S Administration's Plan for a Clean Energy Revolution and pledge to reach net-zero emissions no later than 2050, and the EU's Action Plan on Sustainable Finance and Green Deal mean that the momentum towards ESG integration in derivatives will accelerate in this decade, as a growing number of institutional investors around the world incorporate ESG principles into their investment approaches and decision-making processes[3].

As sustainable investing continues to gain momentum, part of this "new normal" is the emergence of derivatives as a powerful tool to help facilitate the integration of ESG investing.

Canadian investors can now manage and integrate environmental, social, and governance (ESG) exposure into their investment strategies using ESG index futures. More specifically, with the launch of S&P/TSX 60 ESG Index* Futures (SEG), Canadian investors can use index derivatives to gain ESG exposure, hedge, and facilitate relative value trading opportunities while taking advantage of a cost-efficient solution for ESG risk management and ESG integration.

SEG is a futures contract on the S&P/TSX 60 ESG Index that measures the performance of constituents of the parent S&P/TSX 60 Index* that meet sustainability criteria, while offering a risk and return profile similar to the S&P/TSX 60 Index. It essentially enables investors to bring ESG considerations into investing in a core Canadian equity portfolio.

The S&P/TSX 60 ESG Index starts with the same number of constituents as the parent S&P/TSX 60 Index less exclusions based on the United Nations' Global Compact Ten Principles. Index constituents are re-weighted based on an "ESG Score" derived by assessing each constituent's relative ESG risk. Constituents with higher ESG Scores are re-weighted higher relative to their weight in the parent S&P/TSX 60 Index, and constituents with lower ESG Scores are re-weighted lower.

In fact, since the launch of the SEG on December 14, 2020 **SEG outperformed its parent benchmark, the S&P/TSX 60 Index futures (SXF) by 0.41% (4.8% annualized) or by 3.70 index points in the period from December 14, 2020 to January 15, 2021.**

	PRICE 12/14/2020	PRICE 01/15/2021	PRICE CHANGE	PRICE DIFF (SEG-SXF) INDEX PTS	% PRICE CHANGE	% DIFF (SEG-SXF)	% ANNUALIZED
SEG	1014.30	1051.10	36.80	3.70	3.63%	0.41%	4.80%
SXF	1028.00	1061.10	33.10		3.22%		

Source: Bloomberg L.P.

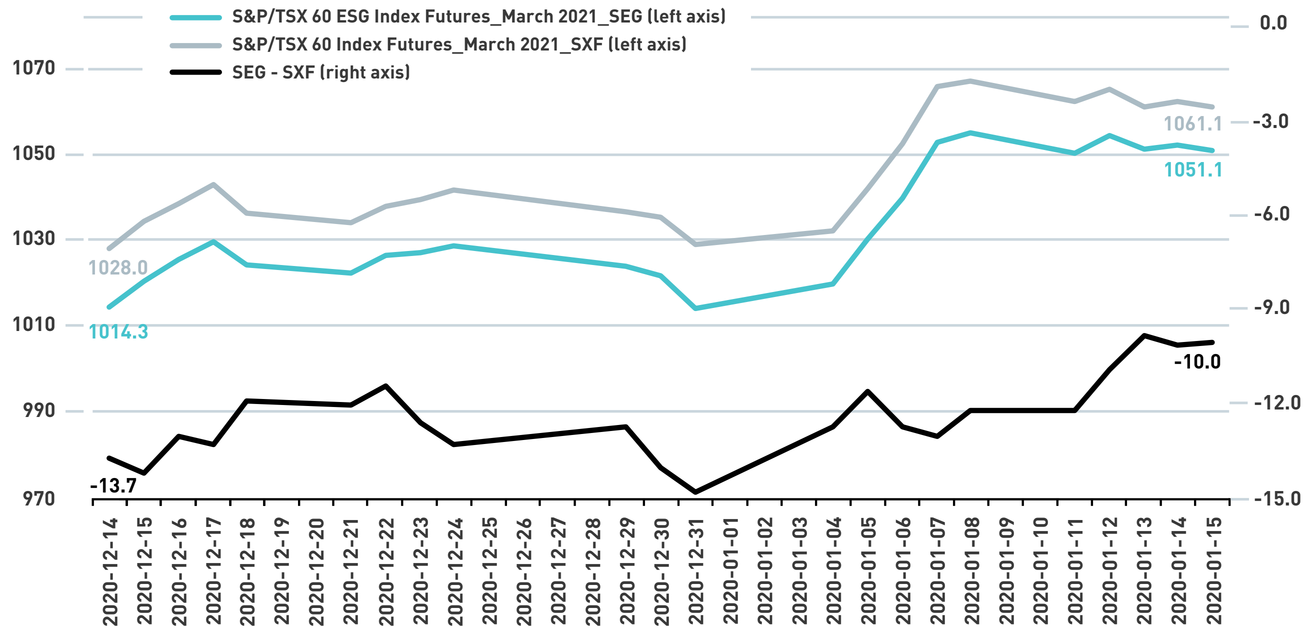
1 https://www.goldmansachs.com/insights/pages/sfi/key-takeaways-2018.pdf

2 https://www.blackrock.com/corporate/literature/investor-education/sustainable-investing-resilience.pdf

3 http://www.rbc.com/newsroom/news/2020/20201014-gam-investing-report.html

FIGURE 1

Changes in the spread between SEG (STSH1) and SXF (PTH1) since the launch of SEG



Based on the price data observed in the first month following the launch date of the SEG, the spread between the SEG and the SXF has narrowed from 13.7 index points on December 14th to 10.0 index points on January 15th – a net change of 3.70 index points.

The launch of ESG index futures on Montréal Exchange creates opportunities for investors to adopt relative value strategies, whereby the investor buys one index futures contract and sells a different index futures contract, known as a spread trade, to take advantage of the outperformance/underperformance of ESG indices relative to their parent index benchmark or any other index with the benefits of cost-efficiency and margin offset available by using ESG index futures.

For more information

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