Global Sustainable Fund Flows: Q4 2023 in Review

First quarterly outflows on record, while passive funds continue to attract new money.

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Key Takeaways

- ► Global sustainable funds experienced net quarterly outflows for the first time on record in the fourth quarter of 2023. Investors withdrew USD 2.5 billion, while the broader market of open-end funds and exchange-traded funds also suffered redemptions against a continuously challenging macroeconomic and geopolitical backdrop.
- ► In Europe, sustainable funds held up better than the broader market and garnered USD 3.3 billion of net new money in the fourth quarter, thanks to passive funds, which collected USD 21.3 billion. Actively managed sustainable funds, however, bled close to USD 18 billion.
- ► Over the full year, European sustainable funds garnered USD 76 billion. By comparison, European conventional funds suffered annual outflows of USD 50 billion.
- ► Investors pulled USD 5 billion from U.S. sustainable funds in the last quarter, for a total of USD 13 billion over 2023.
- ► Supported by stock and bond price appreciation, global sustainable fund assets rose by 8% over the last quarter to USD 3 trillion at the end of December.
- ► Product development picked up. More than 120 new sustainable funds hit the shelves globally in the fourth quarter.

The Global Sustainable Fund Universe

The global sustainable fund universe encompasses open-end funds and exchange-traded funds that, by prospectus or other regulatory filings, claim to focus on sustainability; impact; or environmental, social, and governance factors.[1] (See the Appendix for more details on how we define the global sustainable fund universe.)

The global universe is divided here into three segments by domicile: Europe, United States, and Rest of World. There is more-granular data available in this report for Canada, Australia and New Zealand, and Japan. China, Hong Kong, India, Indonesia, Malaysia, Singapore, Taiwan, Thailand, and South Korea are grouped under the Asia ex-Japan label because of their relatively low assets.

This report examines recent activity in the global sustainable fund universe and details regional flows, assets, and launches for the fourth quarter of 2023. A summary is provided in Exhibit 1.

1 Note: This is not the same as the definition under the European Union's Sustainable Finance Disclosure Regulation, which defines "sustainable investments" at a holding level.

Exhibit 1 Global Sustainable Fund Statistics

Q4 2023	Flows	Assets		Funds	
Region	USD Billion	USD Billion	% Total	#	% Total
Europe	3.3	2,492	84	5,433	73
United States	-5.1	324	11	647	9
Asia ex-Japan	0.1	62	2	595	8
Australia/New Zealand	0.6	33	1	263	4
Japan	-1.2	25	1	235	3
Canada	-0.2	31	1	312	4
Total	**-2.5**	**2,967**		**7,485**	

Source: Morningstar Direct. Data as of December 2023.

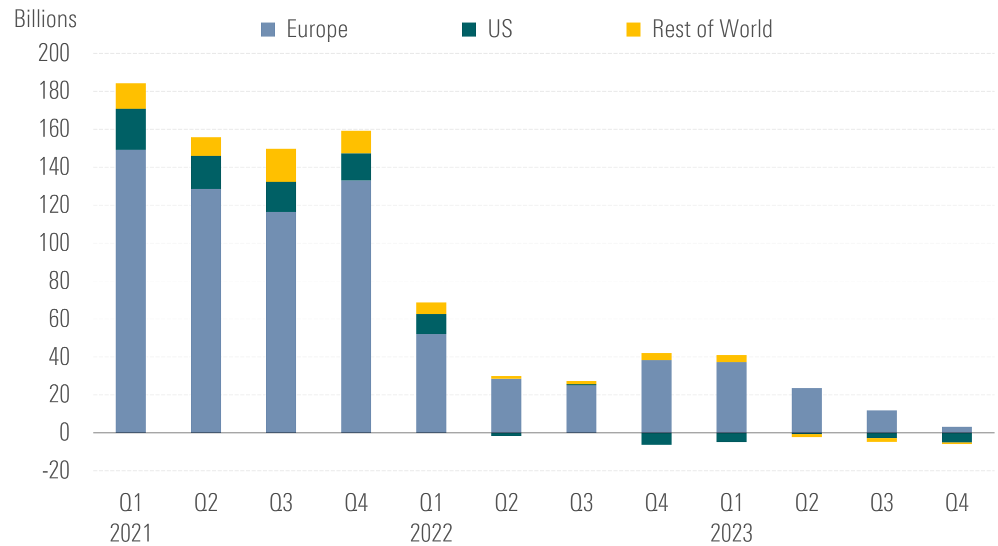
Global Sustainable Fund Experience Net Quarterly Outflows for the First Time

The global universe of sustainable funds saw redemption of close to USD 2.5 billion in the last quarter of 2023, which was the first time on record[2] that net quarterly flows fell into negative territory, as high interest rates and looming recession among some of the world's largest economies weighed on investor sentiment along with the escalation of global geopolitical risks from the Israel-Hamas war. In 2023, global sustainable funds gathered USD 63 billion, compared with USD 161 billion in 2022.

The outflows from sustainable funds echoed with the substantial redemptions from the overall fund universe from October to December. The global mutual fund and ETF universe suffered USD 17 billion of outflows in the last quarter of 2023, erasing the minor inflow gain of restated USD 14 billion in the previous quarter. Calculated as net flows relative to total assets at the start of a period, the organic growth rate of the global sustainable fund universe declined to negative 0.1%, from the restated 0.3% in the previous quarter. By comparison, the broader funds universe shrank by 0.05%.

2 Morningstar Manager Research started reporting on global ESG and sustainable fund flows in 2018.

Exhibit 2 Quarterly Global Sustainable Fund Flows



Source: Morningstar Direct. Data as of December 2023.

Europe, the biggest market for sustainable funds, attracted only USD 3.3 billion of net new money in the fourth quarter, down from the revised USD 11.8 billion in the previous quarter.

Other markets registering inflows were Asia ex-Japan, which collected USD 77 million in the last quarter, mitigating the USD 1.1 billion loss three months prior. Flows in Australia and New Zealand continued their recovery as the local sustainable funds attracted USD 567 million of flows.

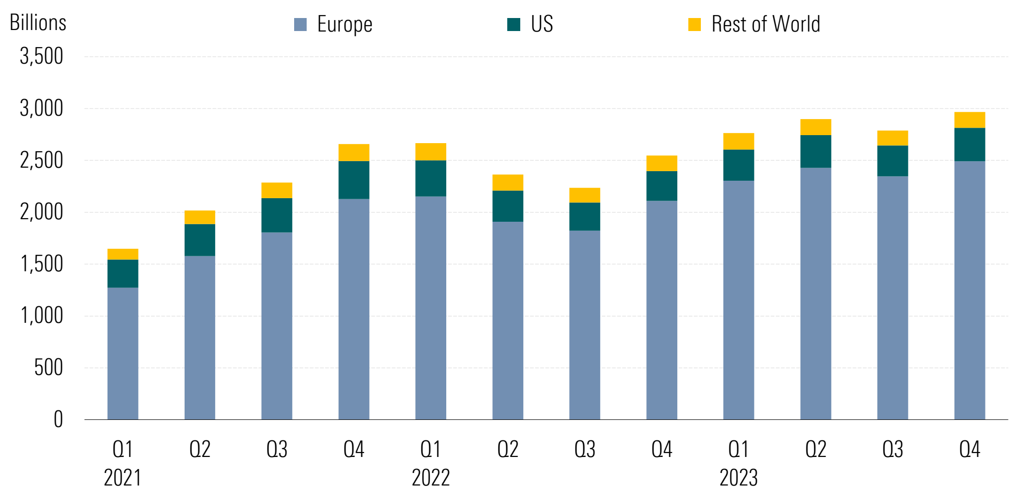
Meanwhile, outflows from U.S. sustainable funds escalated to USD 5.1 billion, almost double from the restated USD 2.7 billion in the previous quarter. In Japan, net withdrawals extended into the last quarter of 2023 and reached USD 1.2 billion, almost a 40% increase from the restated USD 900 million outflows registered in the third quarter. In Canada, net redemptions among sustainable funds also spiraled to USD 151 million, almost triple from the new flows of USD 52 million registered in the previous quarter.

Global Assets Rise Against Mixed Macroeconomic Backdrop

Global sustainable fund assets rose by 8.2% to USD 3 trillion at the end of the fourth quarter, from the restated USD 2.7 trillion three months earlier, against a mixed macroeconomic backdrop, including the end of a rate-tightening cycle, artificial intelligence boom, as well as rising geopolitical risks and fears of recession among some of the major world economies. It also leveled with the growth rate for the broader global mutual fund and ETF market. For context, the Morningstar Global Market Index achieved an 11.2% gain in the last quarter and a 22.1% gain throughout the entirety of 2023. Fixed-income markets, represented by the Morningstar Global Core Bond Index, also inched up by 8% in the last quarter, extending the year-to-date gain to 5.2%.

Europe continued to make up the lion's share of the sustainable fund landscape with 84% of global sustainable fund assets. It also remains by far the most developed and diverse ESG market, followed by the United States, which housed 11% of global sustainable fund assets at the end of December 2023. Asia ex-Japan, of which China is the biggest sustainable market with more than 63% of the region's asset base—down from 71% one year earlier thanks to the country's disappointing economic recovery—ranks third in terms of sustainable fund market size.

Exhibit 3 Quarterly Global Sustainable Fund Assets

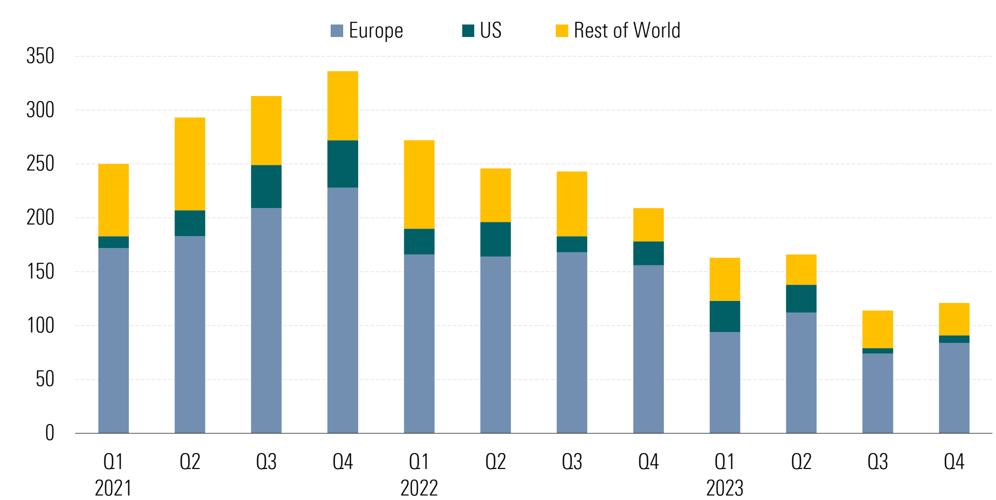


Source: Morningstar Direct. Data as of December 2023.

Global Fund Launches

An estimated 121 new sustainable funds hit the shelves globally in the fourth quarter, a minor uptick from the restated number of 114 launched in the third quarter of 2023. However, the number of 121 will likely also be restated upward in our next report as we identify more launches and as additional ones are reported to Morningstar.

Exhibit 4a Global Sustainable Fund Launches per Quarter



Source: Morningstar Direct. Data as of December 2023.

The cooldown in new sustainable product development was entirely driven by a significant reduction of new sustainable fund launches in Europe, which was almost half compared with one year ago. Product development in the U.S. also stayed at its historical low with only seven new launches, and the rest of the world was mixed.

BlackRock Tops the League Table Thanks to Its Passive Offering

Below we list the top asset managers that are marketing sustainable funds globally. BlackRock, the world's largest manager, is by far the leader in the sustainable investing space, with USD 318 billion of assets in ESG-focused open-ended assets and ETFs, at the end of 2023. It is followed by UBS, which with the acquisition of Credit Suisse last year pushed it to the second position, neck and neck with Amundi, the largest European manager.

Exhibit 4b Top Asset Managers by Global Sustainable Fund Assets

Overall

Firm	Net Assets (USD Billion)
BlackRock (incl. iShares)	318.1
UBS (incl. Credit Suisse)	164.7
Amundi (incl. Lyxor)	161.0
DWS (incl. Xtrackers)	93.1
BNP Paribas	85.8
Swisscanto	84.0
Natixis	74.5
Nordea	57.2
Pictet	49.7
Vanguard	47.2
Allianz Global Investors	46.6
Parnassus	39.3
Eaton Vance	34.7
Royal London	34.7
Eurizon	34.2
Goldman Sachs (incl. NNIP)	34.2
Handelsbanken	33.8
AXA	33.4
KBC	33.2
Union Investment	33.0

Actively Managed

Firm	Net Assets (USD Billion)
Amundi (incl. Lyxor)	84.1
Natixis	72.0
UBS (incl. Credit Suisse)	66.0
Nordea	57.2
DWS (incl. Xtrackers)	56.0
BNP Paribas	54.4
Swisscanto	52.3
Pictet	49.7
BlackRock (incl. iShares)	46.8
Allianz Global Investors	46.6
Parnassus	39.3
Eurizon	34.2
Goldman Sachs (incl. NNIP)	34.1
AXA	33.4
KBC	33.2
Union Investment	33.0
Royal London	28.6
Robeco	27.4
Vontobel	27.3
Schroders	26.2

Passively Managed

Firm	Net Assets (USD Billion)
BlackRock (incl. iShares)	271.3
UBS (incl. Credit Suisse)	98.7
Amundi (incl. Lyxor)	76.9
Vanguard	44.4
DWS (incl. Xtrackers)	37.2
Swisscanto	31.7
BNP Paribas	31.4
Handelsbanken	29.0
State Street	24.2
Northern Trust	22.6
Legal & General	18.2
Länsförsäkringar	16.7
Invesco	12.3
Storebrand Fonder	10.1
Eaton Vance	9.7
Cathay Securities Investmei	8.8
HSBC	8.3
Scottish Widows	6.5
Royal London	6.1
Nuveen	5.6

Source: Morningstar Direct. Data as of December 2023.

Global Regulatory Update

In December 2023, the Taskforce on Nature-related Financial Disclosures, or TNFD, launched the final set of disclosure recommendations and guidance, a comprehensive framework for organizations to report and address their ever-evolving dependencies, impacts, risks, and opportunities related to nature. It was built on the Financial Stability Board's Task Force on Climate-related Financial Disclosures', or

TCFD's, recommendations to provide a similar approach and enable integrated climate and nature reporting.

More regulatory updates can be found in each regional section in this report.

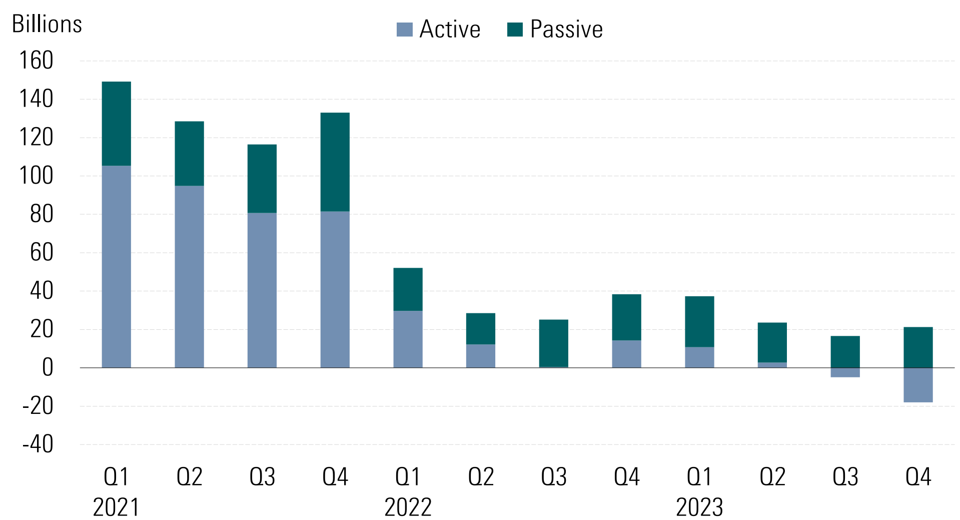
Quarterly Statistics per Domicile

Europe

Active Funds Register Second-Consecutive Quarter of Outflows, While Passive Funds Rebound

Weak inflows extended into the last quarter of 2023, as net new investments into European sustainable funds reached an estimated new low of just over USD 3.3 billion, down significantly from the revised USD 11.8 billion reported in the previous quarter. The decline in subscriptions was entirely attributable to actively managed sustainable strategies, which bled close to USD 18 billion in the fourth quarter, following net outflows of USD 4.8 billion in the third quarter. On the other hand, passive investment strategies demonstrated noteworthy performance, attracting net new money of USD 21.3 billion in the last three months of the year.

Exhibit 5 European Sustainable Fund Flows (USD Billion)



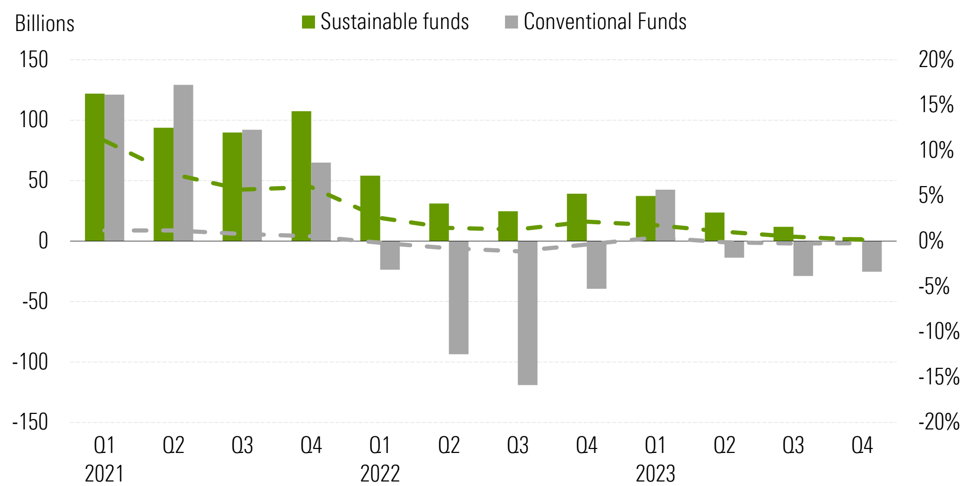
Source: Morningstar Direct. Data as of December 2023.

The lower quarterly net inflows were echoed by a declining organic growth rate. Calculated as net flows relative to total assets at the start of a period, the organic growth rate for the European sustainable fund universe in the fourth quarter fell to 0.14%, compared with 0.5% in the previous quarter.

However, sustainable funds fared better than the European conventional funds, which bled USD 25.4 billion in the past three months. In a similar vein, the outflows among the conventional peers were driven by the active strategies whose outflows accelerated to over USD 70 billion from USD 58 billion in the previous quarter, as disappointing performance of the active funds compelled investors to shift to passive low-cost investing.

Over 2023, European sustainable funds fetched over USD 76 billion, almost halved from the annual net flows of USD 149 billion for 2022. But in comparison, European conventional funds suffered annual outflows of USD 50 billion.

Exhibit 6 European Sustainable Fund Flows Compared With Conventional Fund Flows



Source: Morningstar Direct. Data as of December 2023.

A few factors contributed to the lower inflows into sustainable funds in Europe last year: the challenging macroenvironment, including high interest rates, inflation, and fears of recession in some parts of the world. Among other implications, this has led investors to favor government bonds, an area that has limited ESG products because ESG integration remains challenging in that corner of the fixed-income market—in fact, it is not feasible in the case of single-country government funds like U.S Treasuries or U.K. gilts. Also, it is fair to assume that some investors took a more cautious approach to ESG investing last year in the wake of the underperformance of ESG and sustainable strategies in 2022 partly due to their typical underweight in traditional energy companies and overweight in technology and other growth sectors. While the technology sector rebounded in 2023, other popular sectors in sustainable strategies continued to underperform. Renewable energy companies, for example, have been particularly affected by soaring financing costs, materials inflation, and supply chain disruptions, among other issues.

Additional factors weighing on investor demand for sustainable funds include greenwashing concerns and the ever-evolving regulatory environment. The wave of fund reclassifications to Article 8 from 9 in late 2022,[3] and other issues related to the implementation of SFDR, have caused confusion among investors and other market participants.

3 SFDR Article 8 and Article 9 Funds: Q4 2022 in Review

Exhibit 6a European Sustainable Fund Flows Compared With Conventional Fund Flows by Asset Class

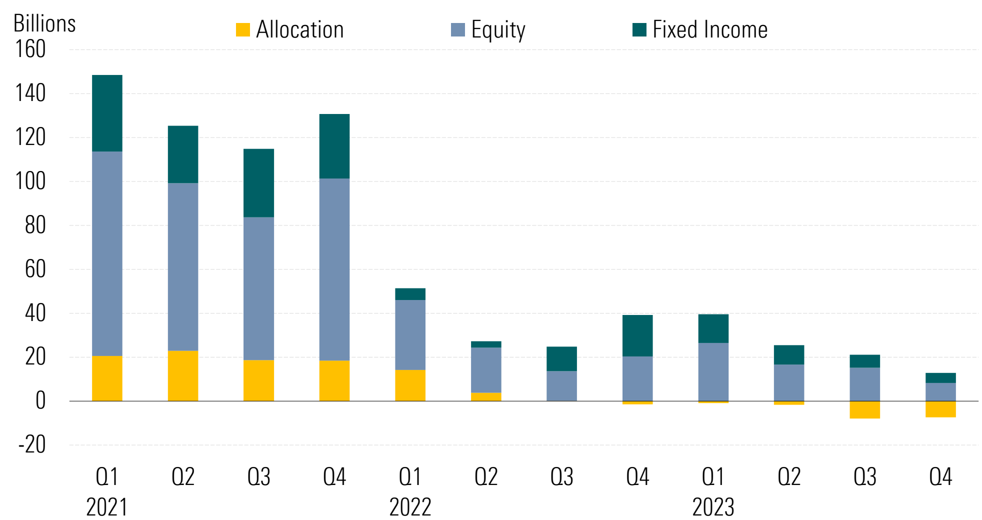
USD Billion	Sustainable Funds		Conventional Funds		Overall Fund Universe	
	Q3 2023	Q4 2023	Q3 2023	Q4 2023	Q3 2023	Q4 2023
Allocation	-7.9	-7.4	-12.0	-23.8	-19.9	-31.1
Alternative	-0.1	-0.1	-6.8	-8.6	-6.9	-8.7
Commodities	0.0	-0.1	-4.7	-5.1	-4.7	-5.2
Convertibles	-0.3	-0.5	-1.4	-2.1	-1.7	-2.6
Equity	15.2	8.2	-17.9	-13.4	-2.7	-5.2
Fixed Income	5.8	4.6	15.7	29.7	21.5	34.3
Miscellaneous	-0.2	-0.1	-0.4	0.0	-0.6	-0.1
Property	-0.6	-1.4	-1.4	-2.1	-2.0	-3.5
Total	**11.8**	**3.3**	**-28.8**	**-25.3**	**-17.0**	**-22.0**

Source: Morningstar Direct. Data as of December 2023.

In the fourth quarter, equity remained the most favored asset class, and equity sustainable funds gathered almost USD 8.2 billion. While these net inflows are almost 50% less than those of the previous quarter, they compare positively to the USD 13.4 billion outflows from conventional equity funds.

Meanwhile, flows into sustainable bond funds decelerated to USD 4.6 billion, reduced by almost one fifth compared with the USD 5.8 billion restated for the third quarter. In contrast, conventional bond fund flows demonstrated a strong rebound to USD 29.7 billion. The recent dovish signals from the major central banks and weakening of the U.S. dollar have helped to reduce stress in bond markets, especially at the long end of the yield curve, but also across maturities as inflation expectations continue to ease. Outflows from sustainable allocation funds extended into the sixth-consecutive quarter, at USD 7.4 billion.

Exhibit 7 European Sustainable Fund Flows by Asset Class



Source: Morningstar Direct. Data as of December 2023.

Leaders and Laggards

Among the bestselling sustainable products in the third quarter of 2023, is the continued strong presence of passive products netting altogether almost USD 4.5 billion of net new money. **iShares MSCI USA ESG Enhanced ETF** and **Amundi MSCI World ESG Climate Net Zero Ambition CTB ETF** rose to the top two places of the bestselling leaderboard, with combined inflows of USD 2.2 billion. In third place we find activity-managed best-in-class strategy **Credit Suisse Equity Switzerland Total Market ESG Blue**.

Exhibit 8a Top 10 European Sustainable Fund Flows in Fourth-Quarter 2023

Fund Name	Net Flows (USD, Million)
iShares MSCI USA ESG Enhanced ETF	1,292
Amundi MSCI World ESG Climate Net Zero Ambition CTB ETF	1,013
Credit Suisse Equity Switzerland Total Market ESG Blue	980
JPMorgan US Research Enhanced Index Equity (ESG) ETF	911
iShares MSCI Europe ESG Enhanced ETF	909
AMUNDI EURO GOVERNMENT TILTED GREEN BOND ETF Acc	866
iShares MSCI EMU ESG Enhanced ETF	839
Handelsbanken Global Index Criteria	831
Allianz Floating Rate Notes Plus	813
Xtrackers MSCI World ESG ETF	787

Source: Morningstar Direct. Data as of December 2023.

At the other end of the spectrum, **Amundi MSCI World Climate Transition CTB** registered the largest outflows over the period, followed by **BNP Paribas Easy MSCI USA SRI S-Series PAB 5% Capped**. The latter focuses on companies with robust sustainability profiles, while aligning with the requirements of EU Paris-Aligned Benchmarks and applying a 5% cap on issuer weights. The third-largest withdrawals in the fourth quarter were recorded by **iShares MSCI USA SRI ETF**. In fourth place, **Mercer Passive Global High Yield Bond Fund**, which experienced outflows of almost USD 790 million, tracks an index that favors issuers with higher ESG rankings and green-bond issues while reducing exposure to or excluding issuers with lower rankings.

Exhibit 8b Bottom 10 European Sustainable Fund Flows in Fourth-Quarter 2023

Fund Name	Net Flows (USD, Million)
Amundi MSCI World Climate Transition CTB	-1,004
BNP Paribas MSCI USA SRI S-Series PAB 5% Capped	-955
iShares MSCI USA SRI ETF	-942
Mercer Passive Global High Yield Bond Fund	-789
Nordea Global Climate and Environment Fund	-622
BNPPF S-Fund - Equity Europe	-618
iShares € Corp Bond 0-3yr ESG ETF	-586
Cardano ESG Transition Enhanced Index Equity North America (I)	-566
Fidelity Funds - Sustainable Water & Waste Fund	-534
abrdn SICAV I - China A Share Sustainable Equity Fund	-527

Source: Morningstar Direct. Data as of December 2023.

The aggregate inflows among the top 10 bestselling firms netted almost USD 18 billion in the last quarter of 2023, which is almost an identical figure to the previous quarter. While BlackRock continues to lead, Credit Suisse secured the second position, a notable ascent from its absence in the top 20 in the previous quarter. JPMorgan and Swisscanto maintained their previous positions in the top five.

Exhibit 9a Top 10 European Sustainable Fund Providers by Flows in Fourth-Quarter 2023

Firm	Net Flows (USD Million)
BlackRock (incl. iShares)	5,778
JPMorgan	1,925
Swisscanto	1,533
Northern Trust	1,300
UBS (incl. Credit Suisse)	1,260
DWS (incl. Xtrackers)	1,214
Amundi (incl. Lyxor)	1,171
Legal & General	1,091
Nordea	1,042
State Street	950

Source: Morningstar Direct. Data as of December 2023.

At the opposite end of the spectrum, BNP Paribas topped the chart of the largest withdrawals in the fourth quarter, with five products accounting for the firm's almost entire outflow. These products are **BNP Paribas MSCI USA SRI S-Series PAB 5% Capped**, **BNPPF S-Fund - Equity Europe**, **BNP Paribas**

Sustainable Enhanced Bond 12M, **BNP Paribas MSCI Japan SRI S-Series PAB 5% Capped**, and **BNP Paribas Corp Bond SRI PAB 1-3Y**.

Exhibit 9b Bottom 10 European Sustainable Fund Providers by Flows in Fourth-Quarter 2023

Firm	Net Flows (USD Million)
BNP Paribas	-3,414
Eurizon	-1,697
AXA	-1,516
Pictet	-1,415
Cardano Asset	-1,065
Fidelity International	-981
abrdn	-878
Mercer Global Investments	-758
Carmignac	-723
Liontrust	-672

Source: Morningstar Direct. Data as of December 2023.

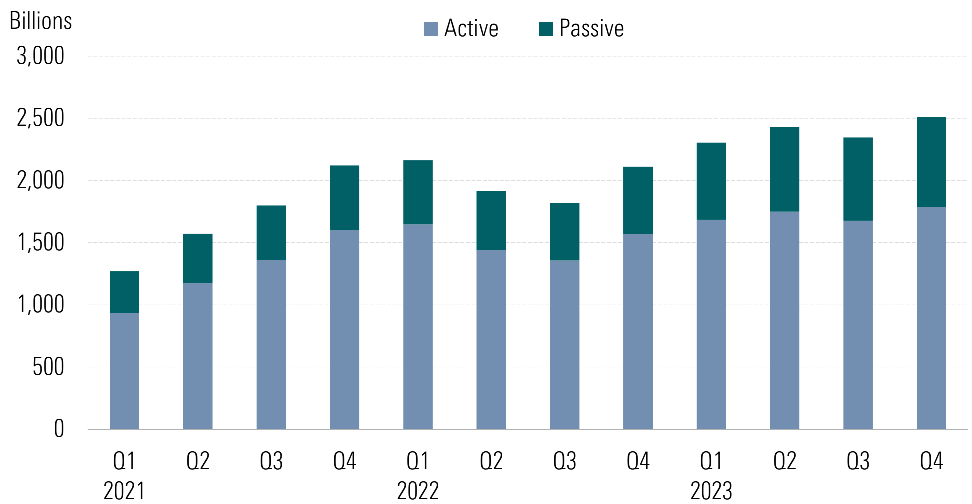
European Sustainable Fund Assets Rebound

Supported by price appreciation across most equity and bond markets, assets in European sustainable funds rebounded to USD 2.5 trillion, a 7% increase from the previous quarter. For context, the Morningstar Europe Index[4] gained 11.4% and 20.3% through the last quarter and over the full 2023, respectively. Fixed-income markets, represented by the Morningstar Eurozone Core Bond Index, also inched up by 11.3% in the last quarter, extending the year-to-date gain to 10.5%.

The market share of sustainable funds in Europe stood close to 22% at the end of December.

4 Meanwhile, the Morningstar Global Market Index achieved an 11.2% gain in the last quarter and a 22.1% gain throughout the entirety of 2023. Fixed-income markets, represented by the Morningstar Global Core Bond Index, also inched up by 8% in the last quarter, extending year-to-date gain to 5.2%.

Exhibit 10a European Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct. Data as of December 2023.

BlackRock Tops the League Table Thanks to Its Passive Offering

Below we list the top asset managers marketing sustainable funds in Europe. BlackRock, the world's largest manager, is by far the leader in the sustainable-investing space, with USD 257 billion of assets in ESG-focused open-ended assets and ETFs, at the end of 2023. It is followed by UBS, which with the acquisition of Credit Suisse last year pushed it to the second position, neck and neck with Amundi, the largest European manager.

Exhibit 10b Top Asset Managers by Sustainable Fund Assets in Europe

Overall

Firm	Net Assets (USD Billion)
BlackRock (incl. iShares)	256.8
UBS (incl. Credit Suisse)	164.2
Amundi (incl. Lyxor)	164.0
DWS (incl. Xtrackers)	89.7
BNP Paribas	85.8
Swisscanto	84.0
Natixis	73.8
Nordea	57.2
Pictet	49.7
Allianz Global Investors	46.7
Union Investment	37.7
Handelsbanken	36.2
Royal London	34.7
Eurizon	34.3
KBC	33.2
AXA	32.9
Deka	30.7
Goldman Sachs (incl. NNIP)	30.7
Robeco	27.3
Vontobel	27.2

Actively Managed

Firm	Net Assets (USD Billion)
Amundi (incl. Lyxor)	76.3
Natixis	71.3
UBS (incl. Credit Suisse)	65.6
DWS (incl. Xtrackers)	57.4
Nordea	57.2
BNP Paribas	54.4
Swisscanto	52.3
Pictet	49.7
Allianz Global Investors	46.7
BlackRock (incl. iShares)	41.5
Union Investment	37.7
Eurizon	34.3
KBC	33.2
AXA	32.9
Goldman Sachs (incl. NNIP)	30.6
Royal London	28.6
Robeco	27.3
Vontobel	27.2
Deka	26.9
Candriam	26.1

Passively Managed

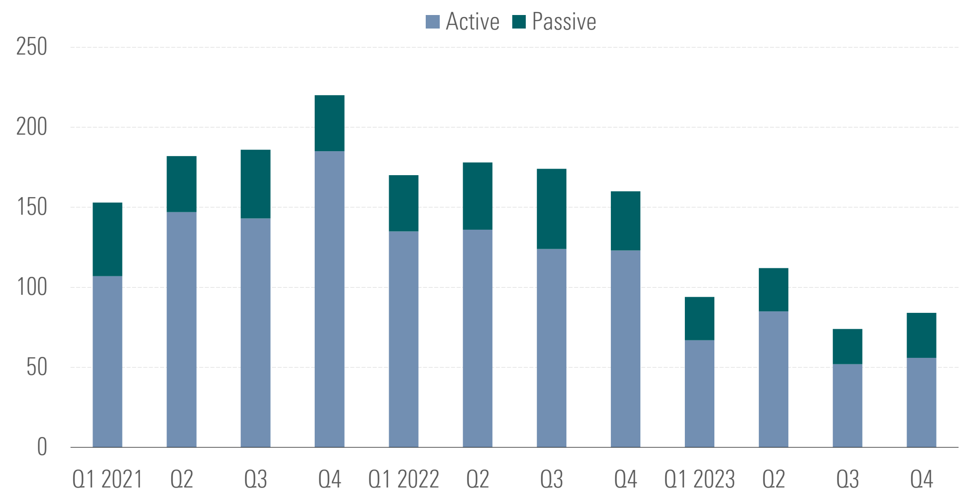
Firm	Net Assets (USD Billion)
BlackRock (incl. iShares)	215.3
UBS (incl. Credit Suisse)	98.5
Amundi (incl. Lyxor)	87.7
DWS (incl. Xtrackers)	32.2
Swisscanto	31.7
BNP Paribas	31.4
Handelsbanken	30.7
State Street	21.5
Northern Trust	20.6
Legal & General	18.1
Länsförsäkringar	16.7
Vanguard	13.1
Storebrand Fonder	10.1
HSBC	8.3
Invesco	7.4
Mercer Global Investments	7.4
Scottish Widows	6.5
Royal London	6.1
Swedbank	5.1
Cardano Asset	5.0

Source: Morningstar Direct. Data as of December 2023.

Fund Launches Rebound a Bit in Q4

Product development showed a minor pick up in the fourth quarter, as newly launched sustainable funds totaled 84, up from the revised 74 in the third quarter. This number is likely to be restated upward in future reports as we identify more launches and as additional numbers are reported to Morningstar.

Exhibit 11a European Sustainable Fund Launches



Source: Morningstar Direct. Data as of December 2023.

The continued slowdown in new products can be attributed partly to the overall market sentiment dampened by the challenging macro backdrop. This is also reflected in the number of new conventional strategy launches, which remain low. But asset managers have also been more cautious in their development of new ESG and sustainable strategies because of greenwashing accusations and the uncertainties of the regulatory environment.

Sustainable fund launches in Europe totaled 364 during 2023, significantly lower than the 682 seen one year earlier. Product development reached its zenith in 2021. Overall, it is fair to say ESG product development is at the lowest level in its recent history.

For more details on SFDR: Read SFDR Article 8 and Article 9 Funds: Q4 2023 in Review

The table below shows the 10 largest new fund launches in the fourth quarter, with passive equity strategies dominating the list. However, among the wider sample of new ESG launches in Europe, active strategies remained dominant, accounting for over two thirds (56) of the new offerings. The overwhelming majority of newly incepted funds distributed in Europe were classified as Article 8 under the Sustainable Finance Disclosure Regulation, or SFDR.

Exhibit 11b Top 10 European Sustainable Fund Launches

Fund Name	SFDR Fund Type	Size (USD Million)
Amundi MSCI USA SRI Climate Net Zero Ambition PAB ETF	Article 8	6,050
Amundi S&P 500 Climate Net Zero Ambition PAB ETF	Article 8	2,729
UBS Global Equity Climate Transition Fund	Article 6	2,079
Amundi MSCI USA ESG Climate Net Zero Ambition CTB ETF	Article 8	1,841
Raiffeisen Futura Pension Invest Growth	Article 6	1,400
BlackRock Sustainable Advantage US Equity Fund	Article 8	1,138
Amundi MSCI World ESG Climate Net Zero Ambition CTB ETF	Article 8	1,130
Amundi MSCI USA ESG Leaders Extra ETF	Article 8	804
State Street World ESG Screened Index Equity Fund	Article 8	679
Amundi MSCI World Climate Net Zero Ambition PAB ETF	Article 8	411

Source: Morningstar Direct. Data as of December 2023.

While broad sustainable and ESG offerings continued to account for most of the product development in the last three months, climate remained by far the most popular theme, taking up over almost one third (25 products) of new product launches.

These new climate fund launches were mostly climate transition as per Morningstar's own classification.[5] Examples include **Amundi MSCI USA SRI Climate Net Zero Ambition PAB ETF** and **Fidelity Sustainable EUR Corporate Bond Paris-Aligned Multifactor ETF**. The latter tracks an index that ensures at least 50% reduction for both carbon emissions (based on Scope 1, 2, and 3 emissions) and carbon intensity (based on Scope 1, 2, and 3 emissions and book values of equity and debt) compared with the parent benchmark. The index also targets 7% annual reductions for both indicators, in line with the decarbonization trajectory of the Paris Agreement's 1.5°C scenario.

Among the three new launches by USB, **UBS Global Equity Climate Transition Fund** aims to mitigate the socioeconomic impacts of climate change and transition by tilting toward emerging-markets equities that align with five UN sustainable development goals, including good health and well-being, affordable clean energy, decent work and economic growth, responsible production and consumption, as well as climate action. The active strategy also applies a quantitative model that compares a company's carbon footprint trend with the required emission reduction implied by net zero and allows for the estimation of the probability that the company will achieve the target.

Another index strategy, **BNP Paribas ECPI Global ESG Infrastructure ETF**, focuses on companies involved in the development and maintenance of sustainable infrastructure under the predefined themes of communication, energy, transportation, waste management, water, and social infrastructure.

5 https://www.morningstar.com/en-uk/lp/investing-in-times-of-climate-change

Regulatory Update

In December 2023, the European Securities and Markets Authority announced it will postpone the publication of its final guidelines on the use of ESG-related terms in funds' names to the second quarter of 2024 (initially planned for the third quarter of 2023). However, ESMA already gave away some important information in its updated document, including that it intends to drop the 50% minimum sustainable investment requirement for funds using sustainable-related terms in their names. The new likely criteria across categories of terms are summarized in the table below.

Exhibit 11c ESMA's Proposed Criteria for ESG Fund Names

	Criteria		
Words Used in Fund Name	**Min 80% of investments meet characteristics or objectives**	**Exclusions**	**Invest meaningfully in sustainable investments as per SFDR**
Sustainability	Yes	EU PAB	Yes but no min. prescribed
Transition	Yes	EU CTB	No
Environment	Yes	EU PAB	No
Social or Governance	Yes	Undecided	No
ESG	Yes	EU PAB	No
Impact	Yes	Unclear	No

Source: ESMA updated document. PAB: Paris-aligned benchmark. CTB: Climate transition benchmark.

It's interesting to note that while the first criteria (minimum 80% of investments must meet the extra-financial characteristics) is consistent with the recent SEC's amendment to the "names rule" (80% as well) and the U.K. SDR (70%). The confirmation of mandatory exclusions across most terms is unprecedented and constitutes a serious step up for most Article 8 and Article 9 funds using ESG-related terms. The guidelines would apply three months after the date of their publication on ESMA's website in all EU official languages. Managers of new funds would be expected to comply with the guidelines in respect to those funds from the date of application of the guidelines. Managers of funds existing before the date of application of the guidelines should become compliant six months after the application date.

In November, the European Securities and Markets Authority published three explanatory notes clarifying the definition of sustainable investments, the application of the "Do No Significant Harm", or DNSH, principle, and the use of estimates. These documents may be used as guidance to support the implementation of the sustainable finance framework, which includes both SFDR and the Taxonomy Regulation.

On Dec. 4, 2023, the European Supervisory Authorities published their proposal to amend the Regulatory Technical Standards, or RTS, of SFDR, suggesting, among other things, to add new social Key

Performance Indicators to the list of Principal Adverse Impact indicators I, greenhouse gas disclosures in precontractual documents and DNSH transparency.

For more details on EU regulation and SFDR: Read SFDR Article 8 and Article 9 Funds: Q4 2023 in Review

In the U.K., on Nov. 28, 2023, the Financial Conduct Authority unveiled its long-awaited Sustainability Disclosure Requirements and investment labels regime for investment products. The SDR policy statement includes a substantial package of measures aimed at improving the trust in, and transparency of, sustainable investment products and at minimizing greenwashing. As part of the raft of new measures, the FCA created four sustainability labels to help consumers differentiate between products with different sustainability objectives and investment approaches. The labels are "Sustainability Focus," "Sustainability Improvers," "Sustainability Impact," and "Sustainability Mixed Goals." A brief description of each label is provided in the table below.

Exhibit 11d U.K. Sustainability Labels—for Use From July 31, 2024

Sustainability Focus™	Invests mainly in assets that **focus on sustainability** for people or the planet
Sustainability Improvers™	Invests mainly in assets that may **not be sustainable now**, with an aim **to improve** their sustainability for people or the planet over time
Sustainability Impact™	Invests mainly in **solutions** to sustainability problems, with an aim **to achieve a positive impact** for people or the planet
Sustainability Mixed Goals™	Invests mainly in a **mix of assets** that either focus on sustainability problems, aim to improve their sustainability over time, or aim to achieve a positive impact for people or the planet

Source: SDR policy statement. Morningstar Research.

Use of labels is voluntary and asset managers will be allowed to use them from July 31. Within the next few months, asset managers will be reviewing their product lines to consider which funds would qualify for a label.

For more details on SDR: Read Through the Looking Glass: An early analysis of what the U.K. sustainability-labeled funds market may look like.

Meanwhile, the French ISR label was revamped. Among other criteria, from 2025, ISR-labeled funds will be banned from investing in companies involved in new projects related to the exploration, exploitation, and refining of fossil fuels, whether conventional or unconventional. In addition, high-carbon-emitting companies will be required to gradually adopt transition plans that align with the Paris Agreement. The stricter eligibility criteria aim at combating global warming and will make it easier for sustainability-oriented investors to know what they're really getting.

For more details on SDR: Read French ISR Label Revamp Report

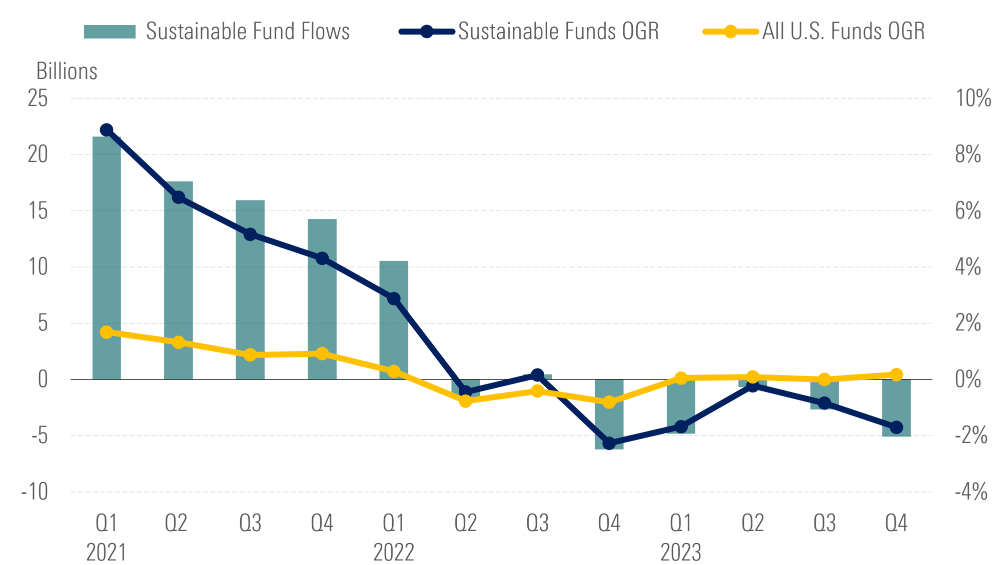
United States

Sustainable Funds Register First Annual Outflows on Record

Investors pulled USD 5 billion from U.S. sustainable funds in 2023’s fourth quarter, for a total of USD 13 billion over the past year.

Sustainable equity funds generally underperformed their conventional peers in 2023, though by a smaller margin than in 2022. Some of the macroeconomic pressures that contributed to their underperformance—such as high interest rates and supply chain disruptions—continue to feature in market outlooks for 2024. In addition to middling returns, greenwashing concerns persisted in the absence of clear regulation for ESG and sustainable investing. Finally, the continued politization of ESG investing contributed to a chilling effect on demand for sustainable funds.

Exhibit 12 U.S. Fund Flows: Sustainable Vs. All U.S. Funds (USD Billion)



Source: Morningstar Direct. Data as of December 2023.

While sustainable funds lost money in 2023’s fourth quarter, the overall universe of U.S. long-term open-end and exchange-traded funds, encompassing conventional funds as well as sustainable funds, collected more than USD 40 billion over the period. Net inflows of USD 40 billion hardly move the needle for U.S. funds overall, where assets totaled more than USD 26 trillion at the end of the year.

Nevertheless, this marked the fifth-consecutive quarter where investor appetite for U.S. sustainable funds was weaker than for their conventional counterparts.

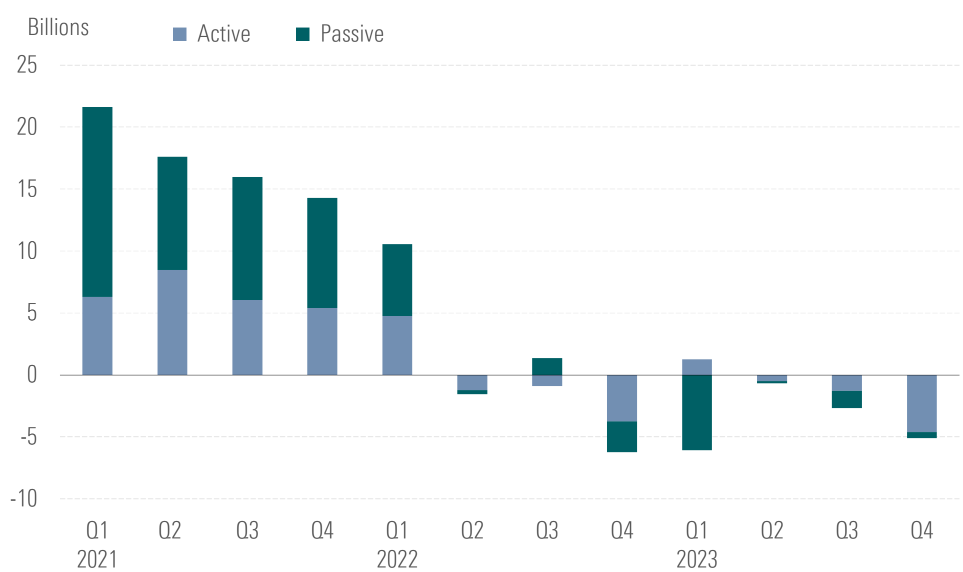
The organic growth rate of sustainable funds, which is calculated as net flows as a percentage of total assets at the start of a period, puts the magnitude of net flows and redemptions into perspective. During the fourth quarter, sustainable funds contracted by 1.7%. By comparison, overall U.S. funds grew by a modest 0.2% during the period.

One iShares Fund Takes the Cake for Outflows in 2023

Actively managed sustainable funds shed USD 4.6 billion during the fourth quarter, which accounted for roughly 90% of net withdrawals from sustainable funds.

Parnassus bore the brunt of the outflows, with two funds—Parnassus Core Equity PRBLX and Parnassus Mid Cap PARMX—ranking among the worst for fourth-quarter withdrawals. Long known as the largest U.S. sustainable fund, Parnassus Core Equity has been one of the 10 biggest losers in terms of outflows for more than two years straight, shedding more than USD 4.5 billion over that period. Parnassus attributes a portion of the fund's outflows to the launch of a less-expensive collective investment trust and the subsequent conversion of investors from one vehicle to the other. Our data includes only open-end and exchange-traded funds.

Exhibit 13 U.S. Sustainable Fund Flows (USD Billion)



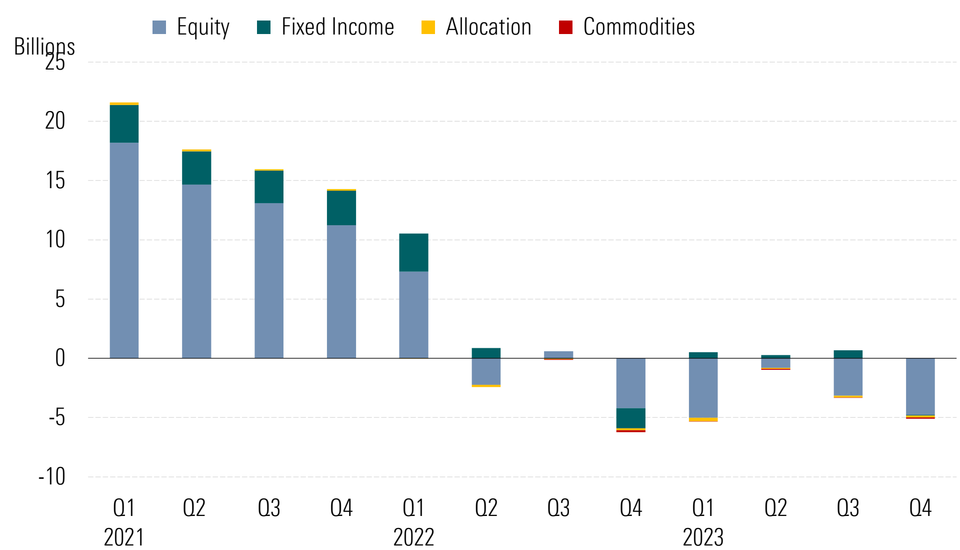
Source: Morningstar Direct. Data as of December 2023.

Over the full year, active sustainable funds bled USD 5.1 billion, while their passive peers recorded USD 8.1 billion of outflows. One passive fund accounted for a substantial portion of 2023's outflows. Investors pulled more than USD 9 billion from iShares ESG Aware MSCI USA ETF ESGU during the year, nearly 4 times as much as the runner-up, Xtrackers MSCI USA ESG Leaders Equity ETF USSG. Roughly two thirds of the outflows occurred in 2023's first quarter (matching a change in BlackRock's flagship target allocation ETF model portfolios, which mostly replaced iShares ESG Aware MSCI USA ETF with iShares MSCI USA Quality Factor ETF QUAL). Without this fund, sustainable passive funds would have netted more than USD 1 billion over the year.

Investors Pulled Money From All Major Asset Classes

Sustainable bond funds shed a modest USD 55 million during the fourth quarter, reversing a trend of resilience seen in previous periods. These outflows weren't enough to erase the gains seen in previous quarters, however, and sustainable fixed-income offerings collected USD 1.4 billion over the year as investors sought to lock in attractive yields.

Exhibit 14 U.S. Sustainable Fund Flows by Asset Class (USD Billion)



Source: Morningstar Direct. Data as of December 2023.

On the other hand, sustainable equity funds extended their streak of losses with a USD 4.8 billion redemption in the fourth quarter. This marks the fifth-consecutive quarter of withdrawals from sustainable equity funds. Over the full year, these funds shed USD 13.8 billion in net flows.
ETFs that offered Xtrackers and iShares, especially iShares ESG Aware MSCI USA ETF, were the hardest hit.

Barely visible in the exhibit above, sustainable commodity funds debuted in 2022's third quarter and have suffered outflows in every quarter since. These funds lost nearly USD 84 million in the fourth quarter, bringing annual net outflows to a total of USD 204 million. Harbor Energy Transition ETF RENW stood apart from the crowd by collecting USD 8.7 million over the course of the year. This fund repurposed to adopt an ESG mandate in the third quarter of 2022, and it tracks an index composed of futures contracts on commodities expected to benefit from the transition to low-carbon energy sources, namely wind power and solar power.

Leaders and Laggards

The fourth quarter's biggest winner, iShares MSCI USA ESG Select ETF SUSA, collected USD 942 million during the period. This boosted the fund's annual net inflows to USD 1.3 billion, which secured its place among the top 10 flow recipients for the year.

Exhibit 15 Top 10 U.S. Sustainable Fund Flows

Fund Name	Net Flows (USD Million)
iShares MSCI USA ESG Select ETF	943
Xtrackers Emerging Markets Carbon Reduction and Climate Improvers ETF	291
Vanguard FTSE Social Index	226
Invesco Solar ETF	218
Fidelity U.S. Sustainability Index	195
Vanguard ESG U.S. Stock ETF	189
iShares ESG U.S. Aggregate Bond ETF	147
Northern Global Sustainability Index	125
Calvert Core Bond	112
Dimensional US Sustainability Core 1 ETF	93

Source: Morningstar Direct. Data as of December 2023.

The roster of top 10 flow recipients also includes climate-focused offerings such as Xtrackers Emerging Markets Carbon Reduction and Climate Improvers ETF EMCR and Invesco Solar ETF TAN. In the case of Invesco Solar ETF, fourth-quarter inflows weren't enough to offset outflows earlier in the year, and the fund ended the year in negative territory. Renewable energy stocks have been pummeled in recent years, and in 2023, the Morningstar North America Renewable Energy Index rose just 1.6%, compared with the Morningstar US Large-Mid Cap Index's 26.9% gain.

The Largest Sustainable Funds Extend Their Outflows

With USD 27.8 billion and USD 13.4 billion in assets, respectively, Parnassus Core Equity and iShares ESG Aware MSCI USA ETF are two of the largest funds in the U.S. sustainable funds landscape. These two funds have also suffered outflows in each of the past four quarters.

Exhibit 16 Bottom 10 U.S. Sustainable Fund Flows

Fund Name	Net Flows (USD Million)
Parnassus Core Equity	-644
Ishares Climate Conscious & Transition MSCI USA ETF	-606
Parnassus Mid Cap	-586
Xtrackers MSCI USA Climate Action Equity ETF	-528
Xtrackers MSCI USA ESG Leaders Equity ETF	-359
American Century Sustainable Equity	-350
First Trust NASDAQ Clean Edge Smart Grid Infrastructure Index	-275
GMO Resource Transition	-261
Calvert Equity	-258
iShares ESG Aware MSCI EM ETF	-245

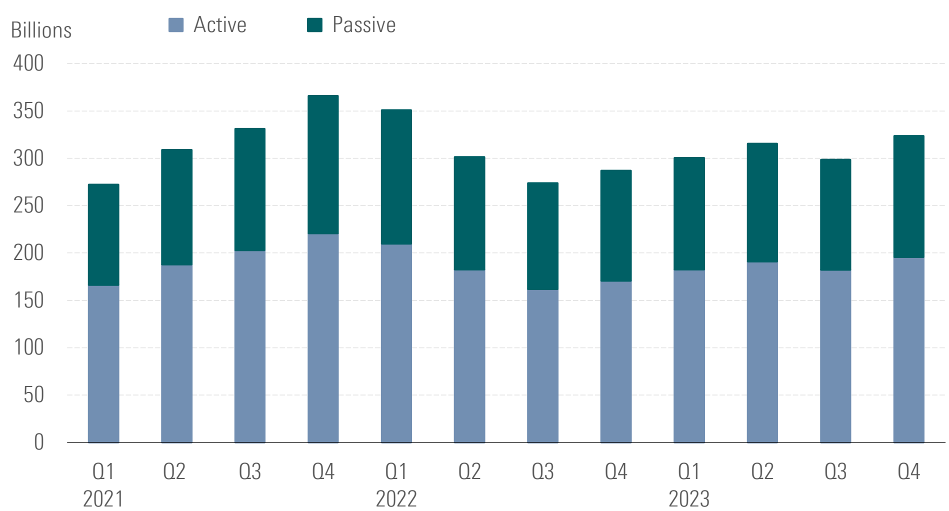
Source: Morningstar Direct. Data as of December 2023.

On a quarterly basis, iShares Climate Conscious & Transition MSCI USA ETF USCL fell to second place in terms of the worst net withdrawals, shedding almost USD 606 million during the period. This fund made headlines when it launched in 2023's second quarter and immediately skyrocketed to become the largest-flow recipient during the period. A strong second quarter also contributed to this fund becoming the largest-flow recipient for 2023, collecting net inflows of USD 1.6 billion during the year.

Rising Markets Lift All (Asset) Boats

Despite outflows, and although sustainable equity funds tended to lag their conventional peers in terms of 2023 returns, market appreciation carried sustainable fund assets higher to close out the year.

Exhibit 17a U.S. Sustainable Fund Assets



Source: Morningstar Direct. Data as of December 2023.

Assets in sustainable funds climbed to USD 323 billion at the end of 2023. This represents a nearly 12% decline from the all-time high record at the end of 2021 but an 18% increase from the recent low in 2022's third quarter. By comparison, assets in the broader U.S. funds landscape also peaked at the end of 2021 and slid by 5% through to the end of 2023.

BlackRock, Parnassus, and Calvert Are the Top Managers in the Space

Below we list the top asset managers that are marketing sustainable funds in the U.S. BlackRock, the world's largest manager, tops the list, with close to USD 60 billion of assets in ESG-focused open-ended assets and ETFs, at the end of 2023. It is followed by Parnassus and Calvert.

Exhibit 17b Top Asset Managers by Sustainable Fund Assets in the U.S.

Overall

Firm	Net Assets (USD Billion)
BlackRock (incl. iShares)	59.2
Parnassus	39.3
Calvert	34.7
Vanguard	30.5
TIAA (incl. Nuveen)	21.7
Dimensional	13.1
Brown Advisory	9.8
Impax	8.5
Amundi (incl. Lyxor)	8.5
Invesco	7.8
Putnam	7.7
Eventide	6.9
American Century	5.9
DWS (incl. Xtrackers)	5.2
Fidelity	5.1
Boston Trust Walden	4.0
First Trust	3.7
Community Capital	3.4
PIMCO	2.7
Praxis Mutual Funds	2.5

Actively Managed

Firm	Net Assets (USD Billion)
Parnassus	39.3
Calvert	25.0
TIAA (incl. Nuveen)	16.2
Dimensional	13.1
Brown Advisory	9.8
Impax	8.5
Amundi (incl. Lyxor)	8.5
Putnam	7.7
Eventide	6.9
American Century	5.9
BlackRock (incl. iShares)	5.5
Boston Trust Walden	4.0
Community Capital	3.4
Invesco	2.8
PIMCO	2.7
Neuberger Berman	2.3
Domini	2.1
Victory Capital	1.6
RBC	1.6
Vanguard	1.4

Passively Managed

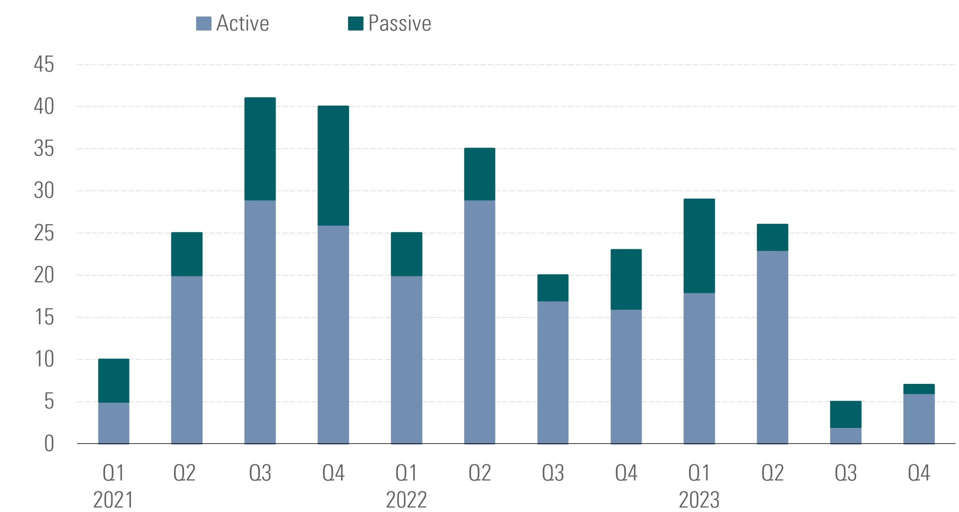
Firm	Net Assets (USD Billion)
BlackRock (incl. iShares)	53.7
Vanguard	29.0
Calvert	9.7
TIAA (incl. Nuveen)	5.6
DWS (incl. Xtrackers)	4.9
Invesco	4.9
Fidelity	3.8
First Trust	3.7
Northern Trust	2.0
State Street	2.0
Praxis Mutual Funds	1.6
Global X	1.5
Kraneshares	0.9
New York Life	0.8
Green Century	0.8
TCW	0.6
Flexshares	0.5
VanEck	0.4
Jackson	0.3
ALPS	0.3

Source: Morningstar Direct. Data as of December 2023.

New Sustainable Fund Launches Slow Amid Weakening Demand

In the U.S., sustainability-focused product development stayed muted in 2023's fourth quarter. Fewer sustainable funds (including both new launches and repurposed funds) came to market than at any other point in the past three years. Just seven new sustainable funds launched during the period, up from three in the third quarter but down compared with 27 in the second quarter. This brings the annual total of new sustainable fund launches to 67, well below the 100-plus new offerings seen in 2021 and 2022.

Exhibit 18a U.S. Sustainable Fund Launches



Source: Morningstar Direct. Data as of December 2023.

Of the six new offerings, four focus on climate-related themes such as renewable energy providers and climate solution providers. The largest new fund is Vontobel Global Environmental Change ENVRX, which opened in October and closed the year with USD 11.5 million in assets. The fund seeks to only invest in companies contributing to positive social or environmental impact, such as clean energy infrastructure, clean water, and low-emission transportation.

Exhibit 18b U.S. Largest New Sustainable Funds

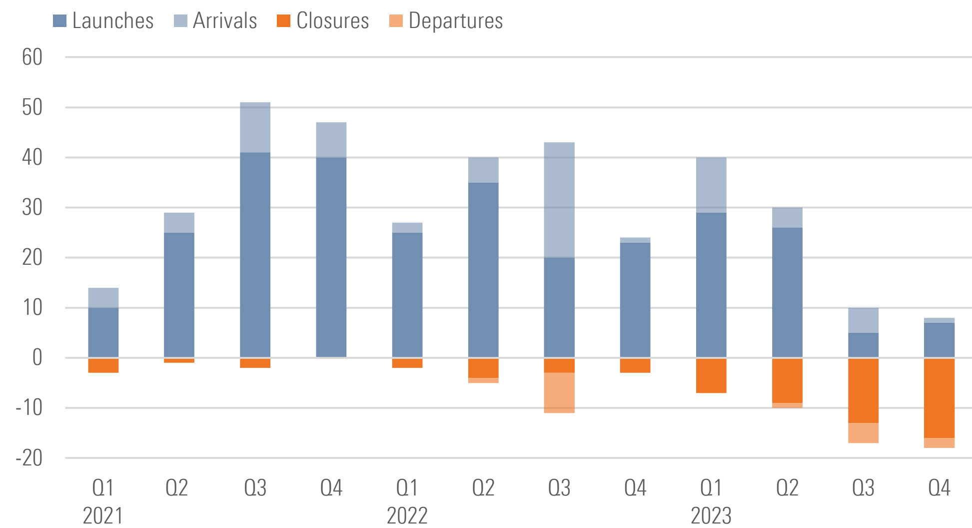
Fund Name	Fund AUM (USD Million)
Vontobel Global Environmental Change	11
PGIM Jennison Better Future ETF	11
Macquarie Energy Transition ETF	6
JHancock Global Climate Action	5
Mast Global Battery Recycling & Production ETF	3
Impax Global Social Leaders	2
Cromwell Sustainable Balanced	0

Source: Morningstar Direct. Data as of December 2023.

Sustainable Fund Closures Continue

For the second-consecutive quarter in recent history, sustainable fund departures outpaced arrivals. In the fourth quarter of 2023, seven new sustainable funds launched, and one existing fund, was added to the sustainable funds landscape (labeled "Arrivals" in the exhibit below). During the same period, 16 sustainable funds liquidated.

Exhibit 18c U.S. Sustainable Funds: New Arrivals and Departures



Source: Morningstar Direct. Data as of December 2023.

Out of the 16 sustainable funds liquidated during the fourth quarter, some of the largest (in terms of assets) were emerging-markets debt strategies from BlackRock. BlackRock Sustainable Emerging Markets Flexible Bond Fund had amassed nearly USD 35 million in its two years on the market before the firm closed it in December.

The new offerings and repurposed funds brought the total number of sustainable open-end and exchange-traded funds in the United States to 647 at the end of the year.

Sustainable Funds Deliver Mediocre Returns in 2023

When it comes to performance, sustainable funds held up much better in 2023 compared with 2022. Sustainable fixed-income funds performed roughly in line with peers, although sustainable equity funds tended to lag the competition.

The exhibit below shows how sustainable funds' total and risk-adjusted returns (as measured by the Sharpe ratio) compared with their respective Morningstar Category peers. On the whole, sustainable funds lagged their conventional peers by a small margin, with 53% of sustainable funds landing in the bottom half of their respective Morningstar Categories.

Exhibit 19 U.S. Sustainable Funds: Performance Vs. Category Peers

Total Return

	All Funds		Equity		Fixed Income	
Quartile	#	%	#	%	#	%
Top	139	24%	84	21%	27	22%
Second	132	23%	85	22%	35	29%
Third	159	27%	99	25%	42	34%
Bottom	151	26%	125	32%	18	15%

Sharpe Ratio

	All Funds		Equity		Fixed Income	
Quartile	#	%	#	%	#	%
Top	127	22%	83	21%	26	21%
Second	128	22%	77	20%	35	29%
Third	166	29%	104	26%	37	30%
Bottom	160	28%	129	33%	24	20%

Source: Morningstar Direct. Data as of December 2023.

Equity funds suffered the worst of the underperformance, and 32% of sustainable equity funds dropped to the bottom quartile relative to peers. Among large-blend equity funds (the largest grouping within the U.S. sustainable funds landscape), the median return for sustainable funds was 20.8% in 2023. This trailed the 23.9% median gain for the overall category (encompassing both sustainable and conventional funds) as well as the 26.9% gain for the Morningstar US Large-Mid Cap Index.

Regulatory Update

On Sept. 20, 2023, the SEC amended the Investment Company Act Names Rule to expand the types of names that could be considered materially deceptive or misleading if a fund does not adopt a policy to invest, under normal circumstances, at least 80% of the value of its assets in the investment focus that the name suggests. The amendments apply to financial and extra-financial terms such as "growth" and "value" or certain terms that reference a thematic investment focus, such as the incorporation of one or more environmental, social, or governance factors. This rule went into effect before the end of the year, but fund companies technically have around two years to come into compliance with the rule. Some fund companies may revise fund names or strategies to ensure strict compliance with the updated rule.

While federal guidance on climate-related disclosures remains in limbo, one state is forging ahead. On Oct. 7, 2023, California signed into law a bill requiring large businesses with more than USD 1 billion in annual revenue that operate in California to disclose their scope 1, 2, and 3 greenhouse gas emissions to an emissions-reporting entity. This bill is largely viewed as a test case for the SEC, as market reactions will shed light on which parts of the SEC's proposal may be disputed.

In December 2023, a federal judge sided with the U.S. Department of Labor in a lawsuit concerning "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," the rule finalized by the DOL in November 2022. The rule states that the duty of prudence (a retirement plan fiduciary's responsibility to make investment decisions based on financially material factors) could include the consideration of climate change and other ESG issues, and it allows for collateral benefits (such as positive impact on people and planet) to act as tiebreakers in plan selection. The rule also lifted prior guidance that made it difficult and risky for employers who wanted to use ESG-focused investment options as default investments for workers automatically enrolling in qualified plans.

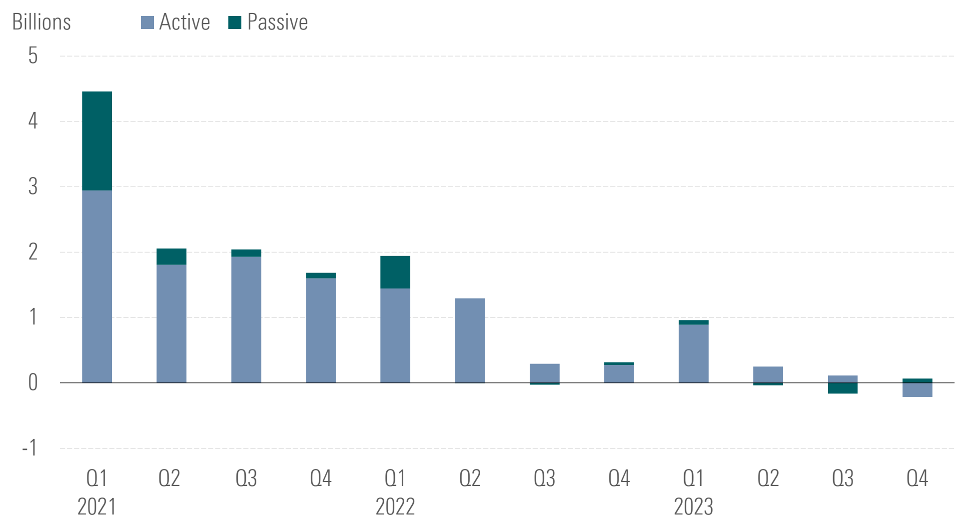
Canada

Flows Stay Negative

In the fourth quarter of 2023, the Canadian sustainable funds market saw its second-consecutive quarter of net outflows, with net withdrawals amounting to USD 151 million. This is significantly larger than the third-quarter net outflows of USD 52 million, which aligns with the broader trend of weakening demand seen across markets.

Active funds bled nearly USD 217 million, while passive funds registered net inflows of USD 65 million. This marked the first time since 2021 that active funds experienced outflows.

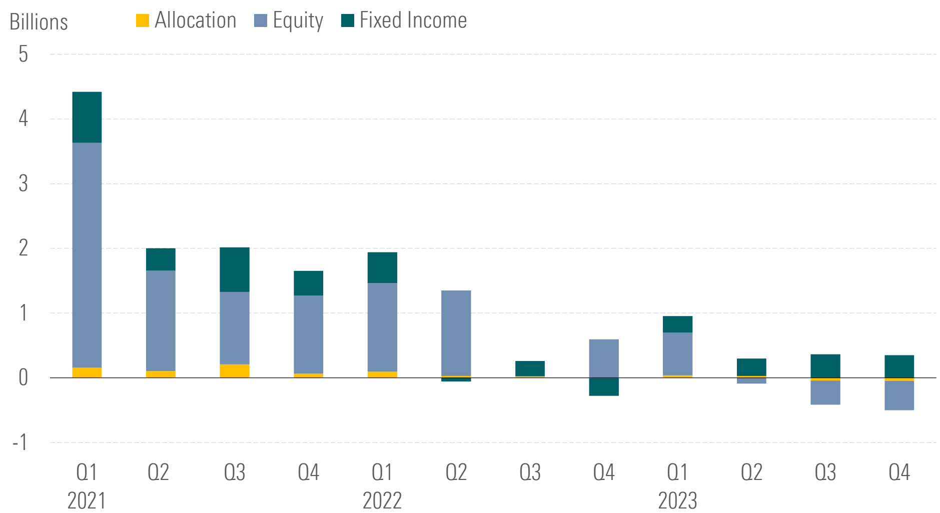
Exhibit 20 Canada Sustainable Fund Flows



Source: Morningstar Direct. Data as of December 2023.

However, Canadian sustainable funds held up better than their conventional peers. While both traditional and sustainable funds experienced outflows, the outflows experienced by conventional peers were more significant. Calculated as net flows relative to total assets at the start of a period, the organic growth rate puts the magnitude of flows into perspective. The sustainable funds landscape contracted by a modest 0.4% in the fourth quarter, while the overall landscape (encompassing both traditional and sustainable funds) shrank by 0.8% during the period.

Exhibit 21 Canada Sustainable Flows by Asset Class



Source: Morningstar Direct. Data as of December 2023.

When looking at the breakdown of asset classes, fixed income registered net inflows for a second-consecutive quarter at USD 349 million, while equity and allocation experienced outflows. This is consistent with last quarter as investors try to lock in attractive yields.

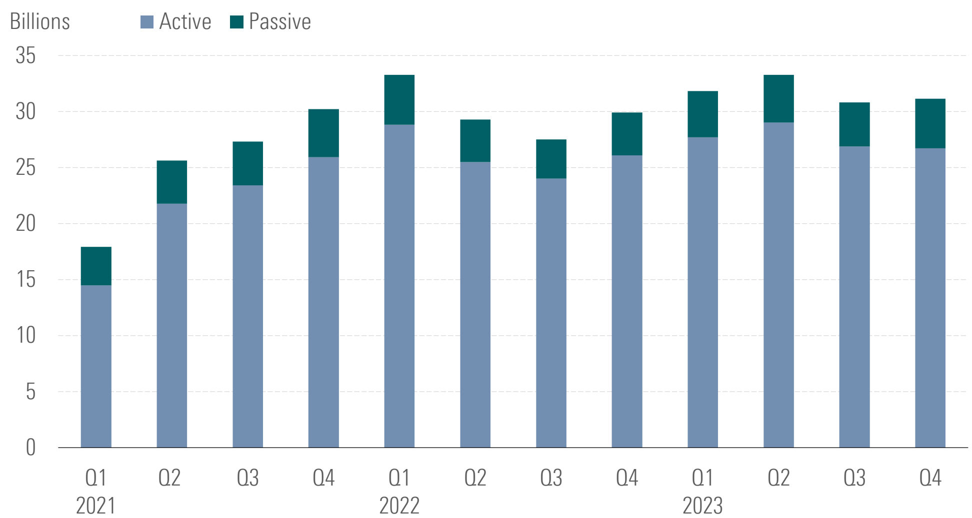
RBC Vision Balanced Fund and some of the Desjardins SocieTerra funds experienced the largest outflows for a third-consecutive quarter. The former lost USD 90 million in the fourth quarter compared with USD 50 million in the second quarter.

On the other hand, National Bank Investments, Northwest Ethical Investments, and Invesco are the firms that attracted the largest portion of net new money. Collecting USD 469 million during the period, NBI Sustainable Canadian Bond ETF received the most flows for a second-consecutive quarter.

Assets Continue to Decline

Assets in Canadian sustainable funds stayed more or less constant over the fourth quarter, at roughly USD 31 billion. Active strategies experienced a marginal decline in assets whereas passive strategies experienced some growth over the fourth quarter. This, however, is better than the performance of the overall Canadian funds market, which witnessed a drop in assets of 16.5% to USD 1.08 trillion at the end of December from USD 1.30 trillion three months earlier.

Exhibit 22 Canada Sustainable Fund Assets



Source: Morningstar Direct. Data as of December 2023.

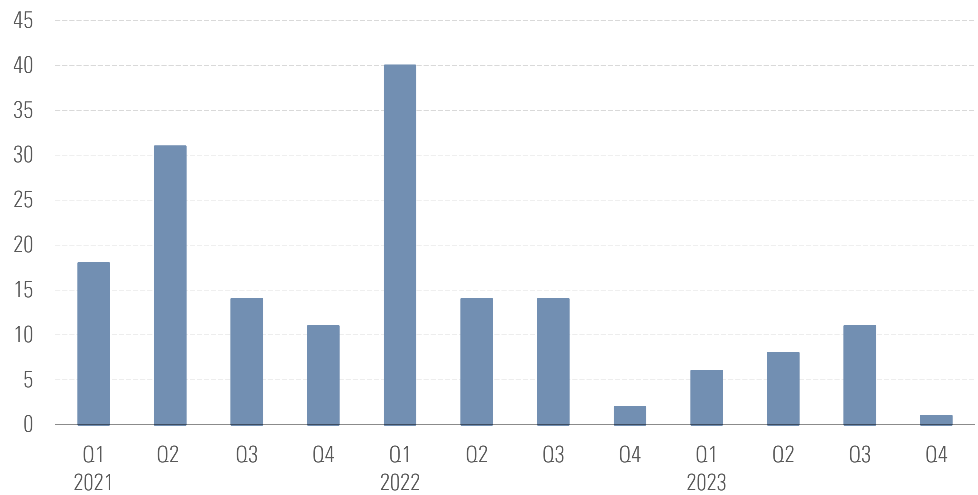
The distribution of funds across asset classes remained unchanged, with a greater percentage of assets allocated to equities (72%), followed by fixed income (24%), and the remainder to allocation funds. No asset class showed any significant changes in market share compared with the previous quarter.

New Launches Slow Down and Closures Pick Up a Bit

Product development slowed down in the fourth quarter, with only one new product launched, namely Mackenzie Greenchip Global Environmental All Cap Fund. The fund invests in equity-issuers that operate in the environmental economy.

ESG funds in Canada did witness 10 closures in the fourth quarter of 2023, including five Emerge ETFs from the EMPWR lineup and three iShares ESG MSCI Leaders ETFs.

Exhibit 23 Canada Sustainable Fund Launches



Source: Morningstar Direct. Data as of December 2023.

Regulatory Update

In November 2023, the CFA Institute, Global Sustainable Investment Alliance, and PRI partnered to develop definitions for responsible investment approaches meant to better align the industry. In total, five approaches were defined with the goal of enabling institutional investors, regulators, and other industry participants to communicate with precision and better align investors' responsible investing values with their investments. The Canadian Investment Funds Standard Committee, or CIFSC, is in the process of reviewing its Responsible Investment Framework in January 2023, to ensure alignment with this guidance.

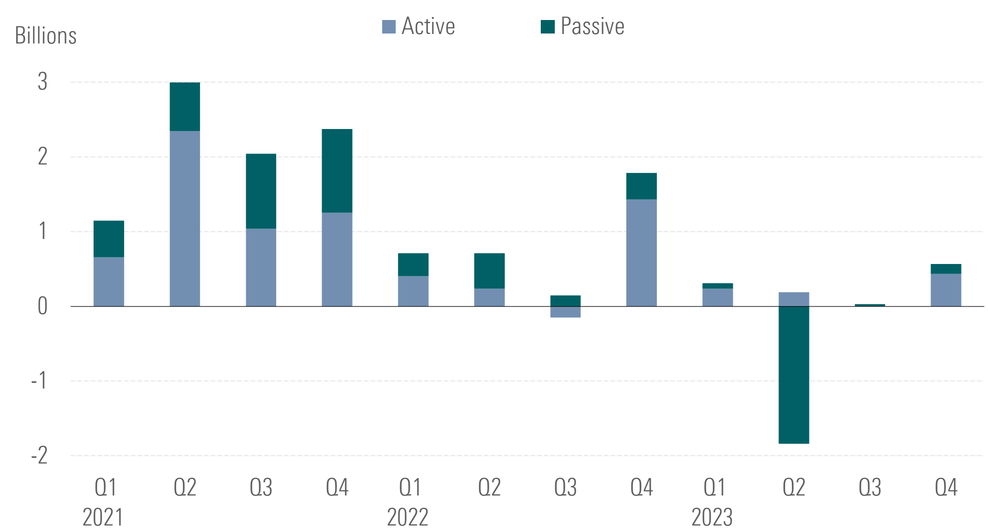
Australia and New Zealand

Flows

For the final quarter of 2023, preliminary data shows that the Australasian (Australia and New Zealand) sustainable funds universe attracted USD 567 million of subscriptions (based on available data as of Jan. 18). These positive flows were predominantly driven by active strategies, which saw net inflows of USD 434 million.

Dimensional was a key recipient of the inflows and gained an estimated USD 330 million over the fourth quarter of 2023. Meanwhile, flows into Australasian passive sustainable funds were reasonable with USD 133 million in net new money over the final quarter of 2023.

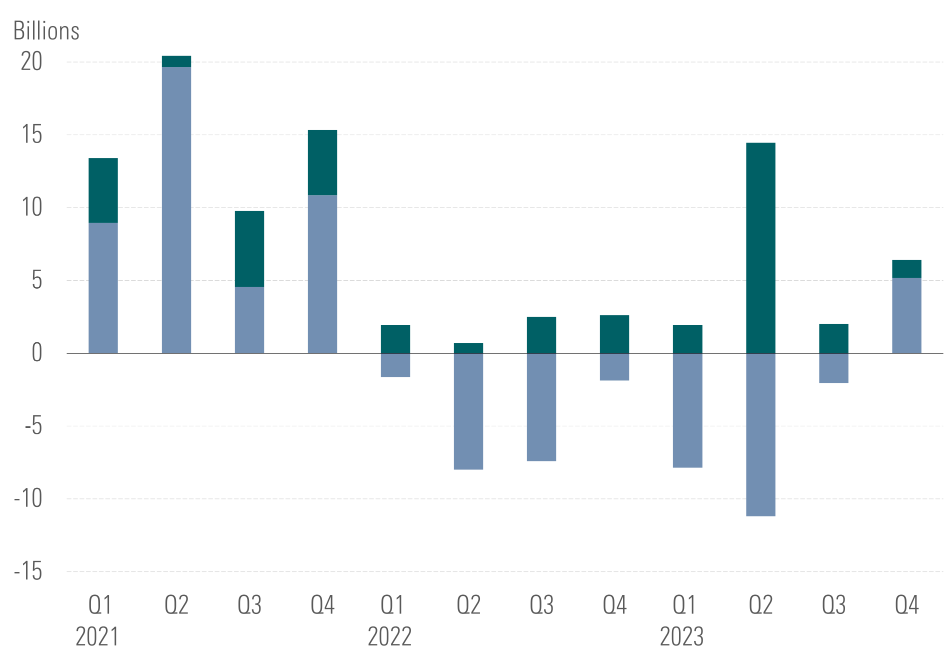
Exhibit 24 Australia and New Zealand Sustainable Fund Flows (USD Billions)



Source: Morningstar Direct. Data as of December 2023.

Meanwhile, the broader market also experienced strong net inflows of USD 6.4 billion in the last quarter of 2023, driven by active strategies, which received flows of over USD 5.2 billion, while passive strategies saw net inflows of USD 1.2 billion.

Exhibit 25 Australian and New Zealand Sustainable Fund Flows Compared With the Broader Market (USD Billions)

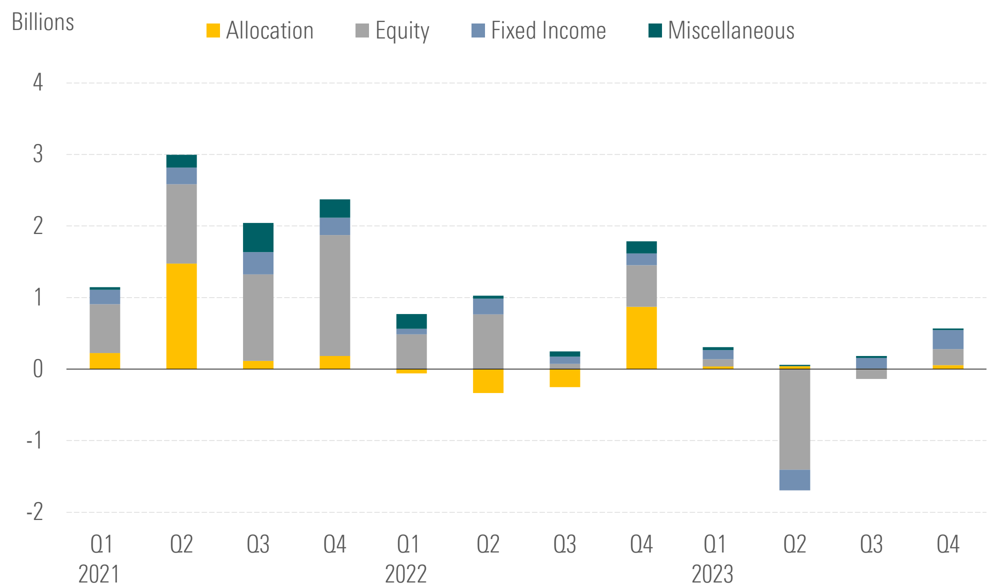


Source: Morningstar Direct. Data as of December 2023.

Flows by Category

In the Australasia region for the final quarter of 2023, fixed-income strategies saw USD 268 million in net inflows, followed by inflows in equity of around USD 222 million. Allocation funds and miscellaneous funds (infrastructure, property, alternatives, and so on) collected about USD 55 million and USD 22 million of net new money, respectively.

Exhibit 26 Australia and New Zealand Sustainable Flows by Asset Class

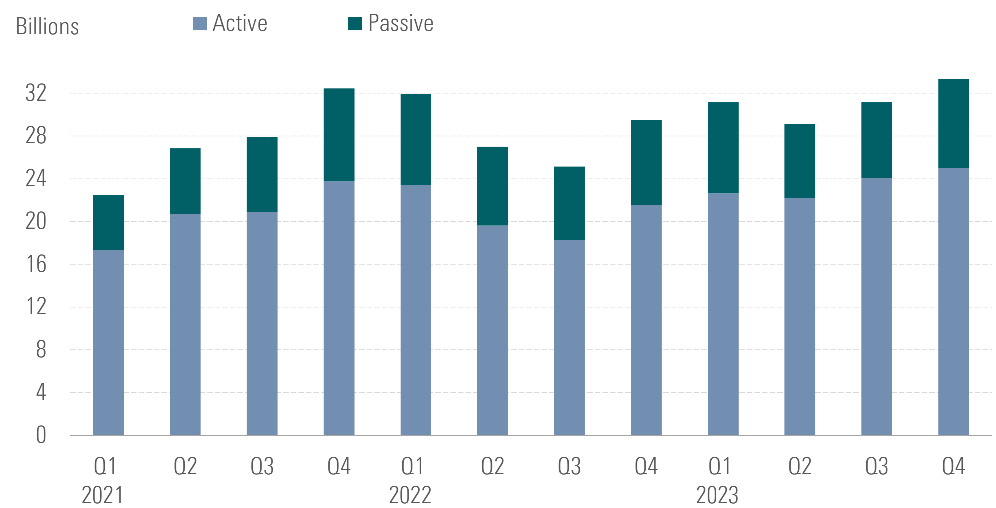


Source: Morningstar Direct. Data as of December 2023.

Assets

The total size of Australasian sustainable investments was estimated at USD 31.2 billion as of Nov. 30, 2023, which is USD 100 million higher compared with the assets as of Sept. 30, 2023.

Exhibit 27 Australia and New Zealand Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct. Data as of December 2023.

The Australian sustainable funds market remains quite concentrated, with the top 10 firms accounting for more than two thirds of total assets in sustainable funds, which has been stable since the end of the third quarter of 2023.

The top 10 fund houses by sustainable fund assets are listed below. Australian Ethical has seen a marginal decline of its market share compared with the previous quarter. DFA continues to steadily grow its market share and now sits in second place, replacing index giant Vanguard, which, after its huge second-quarter outflows, fell by two ranks and landed behind Betashares.

Exhibit 28 Top Five Australian and New Zealand Fund Houses

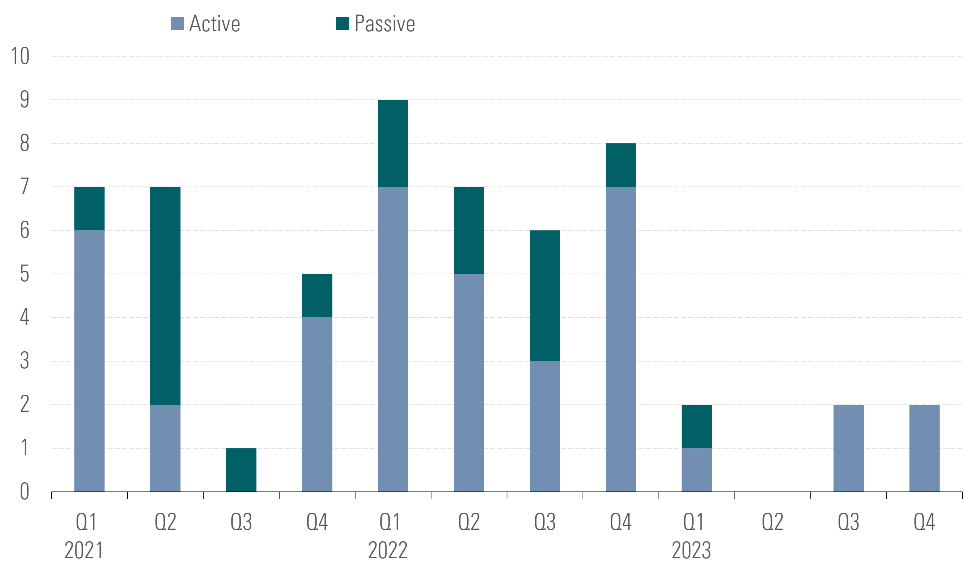
Sustainable FUM Market Share	**% Market Share**
Australian Ethical Investment Ltd	16.3%
DFA Australia Limited	11.3%
Betashares Capital Ltd	10.6%
Vanguard Investments Australia Ltd	6.5%
Mercer Investments (Australia) Limited	5.4%
Pendal Institutional Limited	4.7%
Russell Investment Management Limited	4.0%
BlackRock Investment Mgmt (AUS) Ltd	3.8%
State Street Global Advisors (Aus) Ltd	2.8%
U Ethical	2.6%

Source: Morningstar Direct. Data as of December 2023.

Launches

There were two new sustainable funds launched in the fourth quarter of 2023. Launches last year were significantly lower than the previous year. This can be partly attributable to the challenging market conditions. As of the end of December 2023, we counted 263 strategies in our Australasian sustainable fund universe.

Exhibit 29 Australia and New Zealand Sustainable Fund Launches



Source: Morningstar Direct. Data as of December 2023.

Regulatory Update

In a key development toward sustainability reporting, the Australian Accounting Standards Board, or AASB, released ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information, which is the Exposure Draft publication for public input by March 1, 2024.

The Australian government made a commitment to introduce internationally aligned climate-related financial reporting, which led to three decisions:

- Having a separate suite of standards to the accounting standards that are focused on Australian sustainability-related reporting requirements;
- Using the ISSB work as a foundation, modified for Australian requirements and stakeholders; and
- Allowing for Australia to independently apply its own disclosure requirements independent of any broader sustainability-reporting frameworks, thus giving additional time to consider the development for Australian sustainability-related matters.

The sustainability-related reporting requirements leverages off the foundations set by the International Sustainability Standards Board in June 2023, which issued IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures.

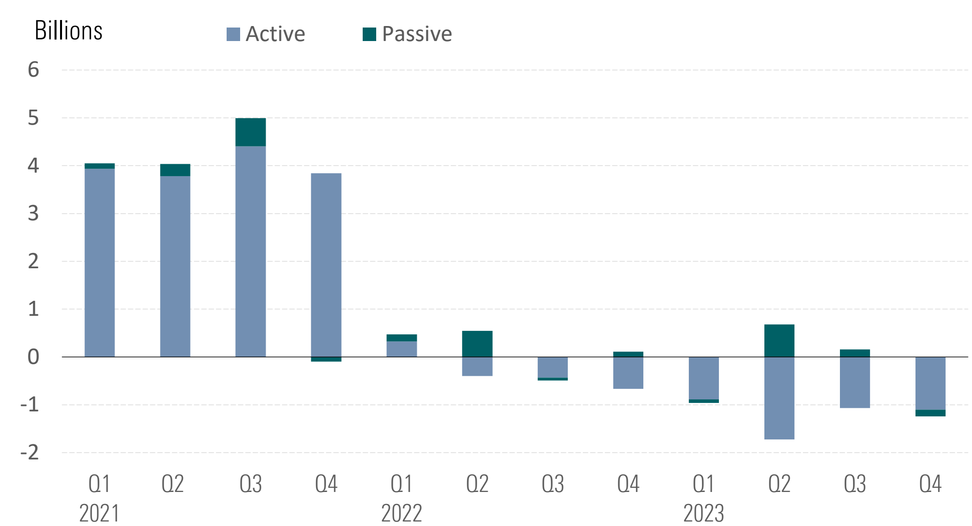
Japan

Flows

In the fourth quarter of 2023, the Japanese sustainable funds landscape saw its seventh-consecutive quarter of outflows, with net withdrawals amounting to USD 2.4 billion. These outflows contrast with the performance of the broader Japanese funds market, which witnessed inflows of USD 14 billion. Over the full 2023, sustainable funds in Japan bled USD 8.3 billion, while the whole Japanese fund market collected an annual aggregate of USD 65 billion.

In the last quarter, actively managed funds constituted 88% of the outflows, while passively managed funds made up 12%, reflecting a pattern reminiscent of the previous quarter. However, in contrast to the prior period, passive funds experienced outflows instead of inflows. Two funds emerged as major contributors to the outflows—**AMOne Global Warming Prevention Related Equity Fund Dividend 3 Month** and **iShares MSCI Japan Climate Action ETF**—which shed USD 368 million and USD 230 million, respectively.

Exhibit 30 Japan Sustainable Fund Flows (USD Billion)

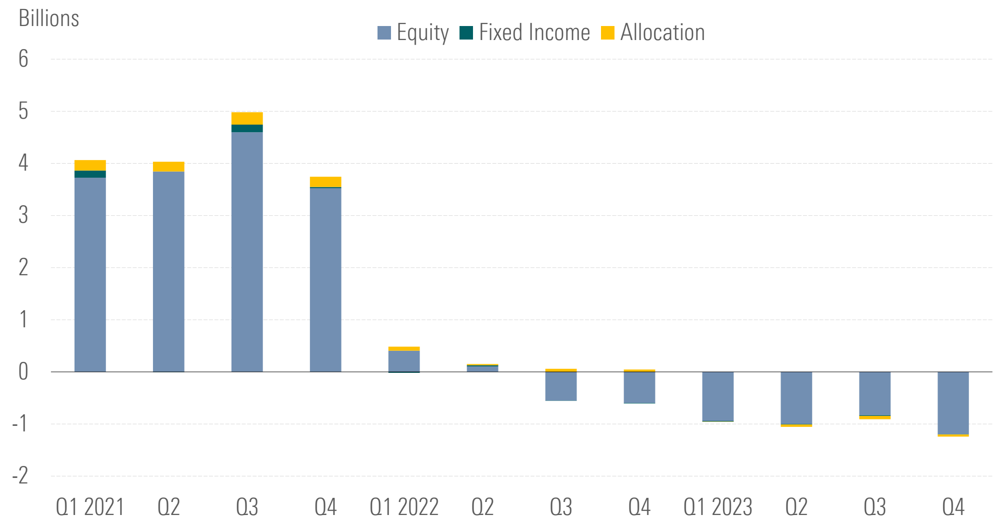


Source: Morningstar Direct. Data as of December 2023.

It should be noted that there is a possibility of double counting at the global level. We include Japan-domiciled funds of funds and feeder funds in this review to better reflect the actual flow situation in the Japanese fund market, as many Japanese funds of funds are invested in European funds.

Equity funds lost USD 1.17 billion during the fourth quarter of 2023, representing 94% of the quarter's outflows.

Exhibit 31 Japan Sustainable Fund Flows by Asset Class (USD Billion)

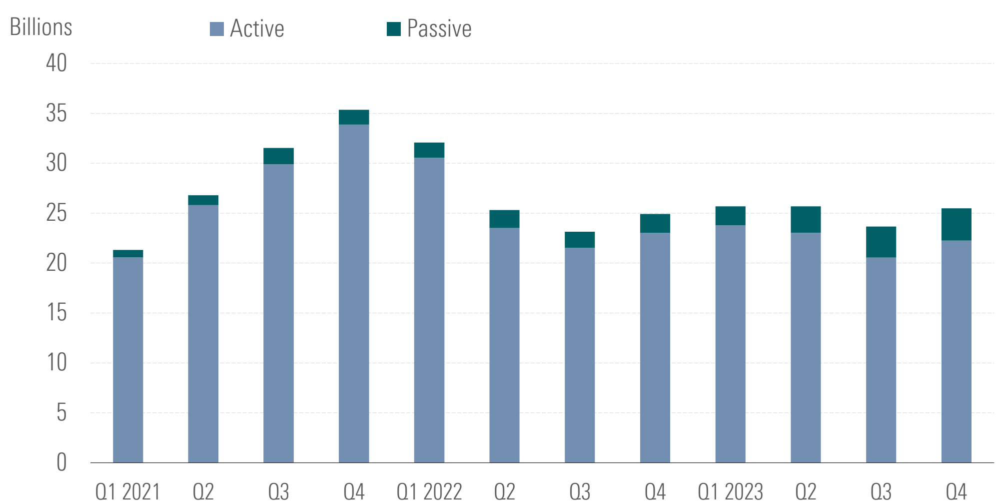


Source: Morningstar Direct. Data as of December 2023.

Assets

Total assets in Japan-domiciled sustainable funds rose to USD 25.4 billion in the fourth quarter. The 7.2% increase in assets from the end of September was driven by market appreciation (the Nikkei rose by 5% over the period). Actively managed funds and equity funds dominate the Japanese sustainable fund landscape, accounting for 87% and 85% of total assets, respectively.

Exhibit 32 Japan Sustainable Fund Assets (USD Billion)

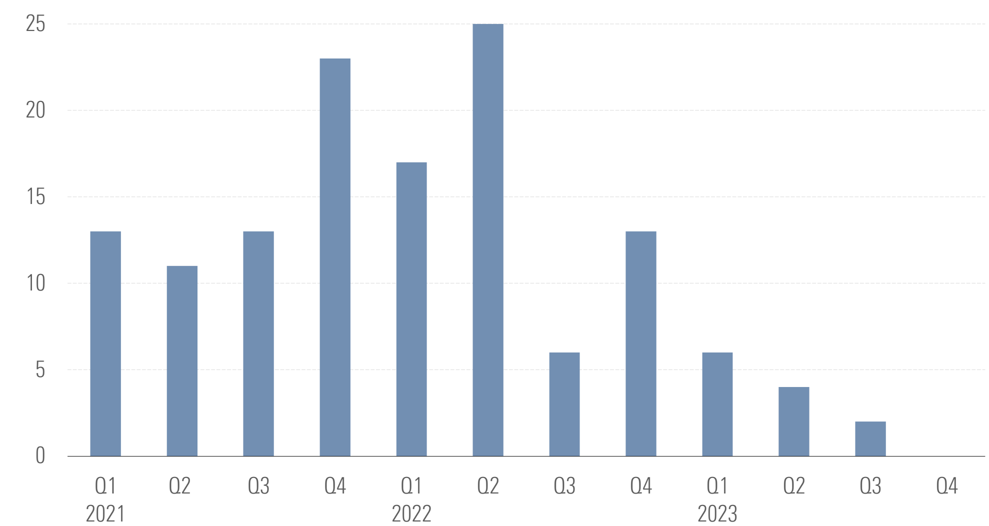


Source: Morningstar Direct. Data as of December 2023.

Launches

In the fourth quarter of 2023, the Japanese market did not witness the introduction of any new sustainable funds, reflecting a relatively quiet year in terms of product development compared with the past couple of years.

Exhibit 33 Japan Sustainable Fund Launches



Source: Morningstar Direct. Data as of December 2023.

Asia ex-Japan

We used the most recent data available within the past quarter for funds whose full quarterly data was unavailable at the time of publication. Because China's data was not available at the time of publication, we used second-quarter 2023 data as a proxy for fourth-quarter 2023 data in every exhibit of this section.

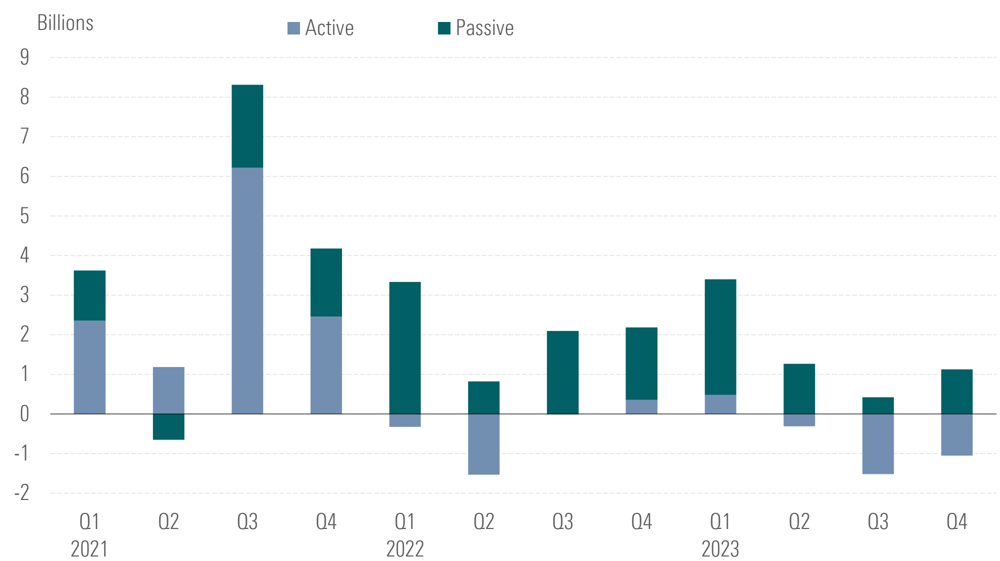
Flows—Active Funds Continue to Bleed Money

In the third quarter of 2023, China-domiciled sustainable funds experienced withdrawals of USD 1.33 billion. The outflows were dominated by actively managed funds such as E Fund Environmental Protection Theme Flexible Allocation and Orient New Energy Automobile Theme, which bled USD 156 million and USD 143 million, respectively, over the quarter.

Excluding China, the Asia ex-Japan region recorded net inflows of roughly USD 1.4 billion over the fourth quarter. The highest inflows came from Taiwan-domiciled sustainable funds. Cathay Sustainability High Dividend ETF, the largest passive fund in the region with USD 7.6 billion in assets, led the subscriptions at USD 580 million, while three Taiwan-domiciled fund launches—Capital ICE ESG 20+ Year BBB US Corporate ETF, FSITC Global Sustainable Investment Multi-Asset, and Taishin TIP Customized Taiwan ESG High Dividend Small/Mid-Cap ETF—accounted for another USD 725 million in inflows over the period.

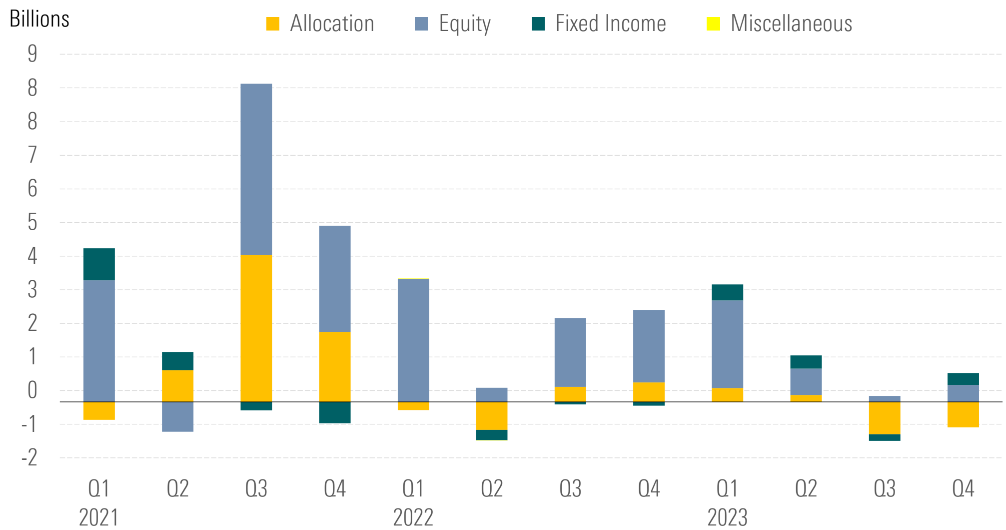
India- and Malaysia-domiciled sustainable funds saw USD 44 million and USD 20 million in net outflows over the quarter, respectively, with the former ending 2023 with four-consecutive quarters of outflows totaling USD 226 million.

Exhibit 34 Asia ex-Japan Sustainable Fund Flows (USD Billion)



Source: Morningstar Direct. Data as of December 2023.

Exhibit 35 Asia ex-Japan Sustainable Fund Flows by Asset Class (USD Billion)



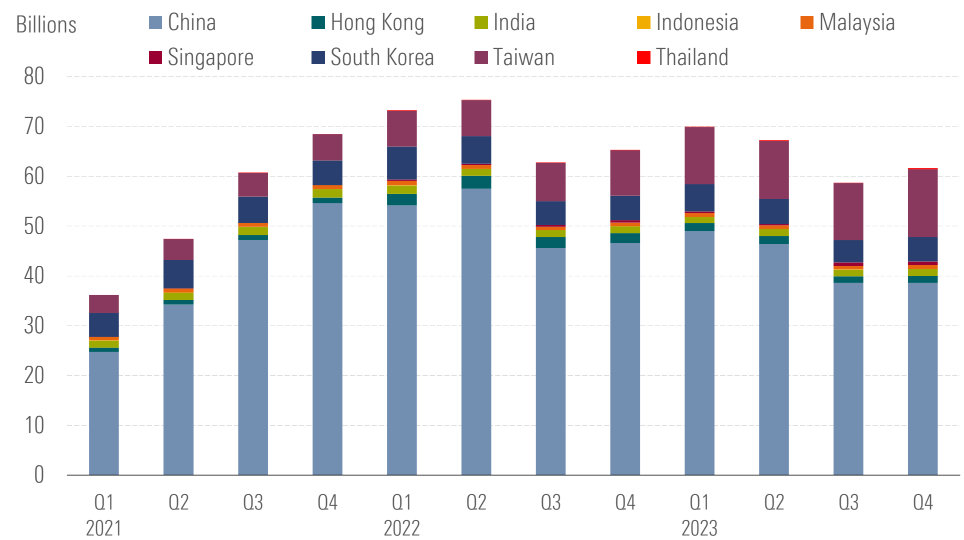
Source: Morningstar Direct. Data as of December 2023.

Assets

Total assets in sustainable funds across Asia ex-Japan climbed 5% quarter over quarter to USD 61 billion. Outside of China (for which data was not available at the time of publication), Taiwan continued to lead, housing 22% of the region's assets. Sustainable fund assets in Taiwan grew by nearly 50% over the year to reach USD 13.6 billion at the end of 2023, helped by the great performance of the local market (the MSCI Taiwan Index was one of the best-performing indexes in the region in the fourth quarter of 2023, returning 17.5%, while the MSCI ESG Leaders Index gained 18.4%).

Assets in Thailand-domiciled sustainable funds, meanwhile, experienced a sharp increase in the fourth quarter of 2023, from USD 75 million at the end of August 2023 to USD 236 million at the end of December 2023 thanks to a series of fund launches discussed below. Despite experiencing outflows, India's sustainable fund assets, which are exclusively held in equity funds, increased by 5.3% to USD 1.4 billion. Positive market performance across the region helped support the growth in sustainable fund assets.

Exhibit 36 Asia ex-Japan Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct. Data as of December 2023.

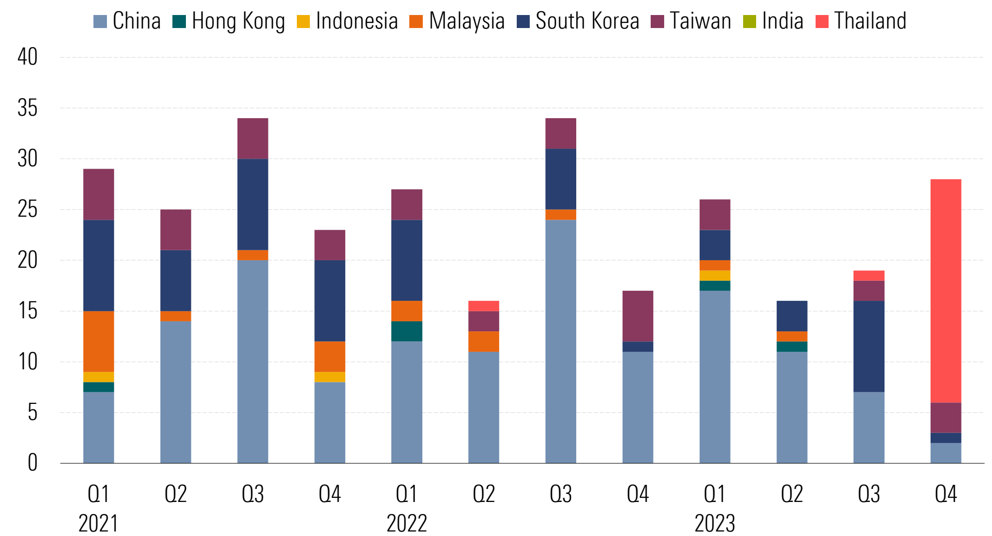
Equity funds remained the dominant asset class in the region, representing two thirds of Asia ex-Japan sustainable fund assets at the end of December, while allocation and fixed-income funds comprised 23% and 6%, respectively. The gap between passive and active strategies continued to narrow. Assets in passive sustainable funds saw inflows of USD 1.13 billion in the fourth quarter of 2023 and accounted for 46% of total flows into the region's sustainable funds from 38% a year earlier.

Launches

During the fourth quarter of 2023, 29 new sustainable funds were launched across the region, the largest amount since the third quarter of 2022. Twenty-two of the new launches were Thailand-domiciled products. These funds were all launched with the support of the Thailand SEC and aim to help stimulate awareness of long-term savings and drive Thailand toward sustainability. With these launches, the SEC is targeting Thailand's younger generation and has included tax incentives subject to a holding period for investing in the funds.

Elsewhere, there were three launches in Taiwan, mentioned above: two in China, and one each in Singapore and South Korea. Of those with asset data available at the time of this publication, the largest fund launch as of the end of December 2023, was of the Taiwan-domiciled Taishin TIP Customized Taiwan ESG High Dividend Small/Mid-Cap ETF. The ETF was launched in November 2023 and tracks the TIP Customized Taiwan ESG High Dividend Small/Mid-Cap Index, which invests in 30 small and medium-size stocks that exhibit high ESG performance and high dividend yields as informed by sustainability ratings and dividend indicators.

Exhibit 37 Asia ex-Japan Sustainable Fund Launches



Source: Morningstar Direct. Data as of December 2023.

Regulatory Update

The Asia ex-Japan regulatory landscape continued to evolve in the fourth quarter of 2023. In November, the Hong Kong Monetary Authority issued new guidelines for the sale and distribution of green and sustainable investment products, including funds, that registered institutions must comply with within the next 12 months. These standards include requirements of ongoing product due diligence, management supervision on issues and risks such as greenwashing, and ESG-related training for staff. The same month, the Hong Kong Exchanges and Clearing signed a Memorandum of Understanding with the China Beijing Green Exchange that includes plans to build an ESG ecosystem and promote green and sustainable finance.

Elsewhere, the Bursa Malaysia and UN Global Compact Network Malaysia & Brunei also announced a strategic partnership to develop sustainability-focused programs that, among other goals, aim to support the upskilling of sustainability practitioners at Malaysian companies.

In Singapore, the Monetary Authority of Singapore published a Code of Conduct for ESG rating and Data Product Providers. The code was released with a checklist to self-attest compliance with the goal of creating industry standards for transparency in methodologies and data sources, governance, and conflict of interest management. The MAS also announced the launch of Gprnt, which offers a solution for digital reporting of ESG information and is expected to be rolled out in February 2024.

Appendix—Defining the Global Sustainable Fund Universe

The global sustainable fund universe encompasses open-end funds and ETFs that, by prospectus or other regulatory filings, claim to focus on sustainability; impact; or environmental, social, and governance factors.

Our universe of sustainable funds is based on intentionality rather than holdings. For example, a portfolio can score well on ESG metrics such as the Morningstar Sustainability Rating, but if ESG issues are not the focus of the fund's investment strategy, it will not be included in our universe. To identify intentionality, we relied on a combination of fund names (a strong indicator of intentionality) and information found in fund documents. The fund's documents should contain enough details to leave no doubt that ESG concerns figure prominently in the security-selection and portfolio construction process.

The global sustainable fund universe does not contain the growing number of funds often referred to as "ESG integrated funds," which formally consider ESG criteria in the investment process and engage with portfolio holdings but do not make ESG considerations the focus of the investment process.

Furthermore, the global sustainable fund universe doesn't include funds that employ limited exclusionary screens such as controversial weapons, tobacco, and thermal coal (combined with an ESG integration approach or not). We however include ESG-screened passive funds in our universe as, typically for these, the exclusions are the sole purpose of the strategy.

Finally, the global sustainable fund universe excludes money market funds, feeder funds, and funds of funds to avoid double counting and inflating flows and assets. We make an exception for Japan and South Korea to better reflect the actual flow situation there as many Japanese funds of funds are invested in European funds.

To identify sustainable funds in their respective regions analysts use the "Sustainable Investment–Overall" data point in Morningstar Direct. We also use the "Sustainable Investment Overall Start Date" data point to account for repurposed funds, where relevant.

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