

# Bringing ESG Considerations to Australian Strategies

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This paper will demonstrate the potential improvements in environmental, social and governance (ESG) characteristics that are reflected in sustainability benchmarks versus traditional market-capitalization-weighted benchmarks in a hypothetical group of Australian equities. We explore how our indices seek to maintain overall industry group weights and country compositions that are similar to their benchmarks while incorporating sustainability values. The alternatives to market-cap-weighted equity indices we considered include: a broad-based domestic sustainability index, international carbon control indices, a global ESG real estate index, and a global net zero infrastructure index.

## An Overview of Sustainability- Focused Indices

The [S&P/ASX 200 ESG Index](#) draws on the intelligence of the S&P DJI ESG Scores, which robustly measure companies' sustainability risk and performance factors to measure the performance of securities from the benchmark index that meet sustainability criteria. It seeks to maintain industry group weights that are similar to its benchmark, while providing an improved sustainability profile as a result of an improved ESG score. It excludes companies with activities in specific areas, such as the extraction and consumption of thermal coal, production of tobacco and controversial weapons, as well as companies with poor alignment with UN Global Compact (UNGC) principles, involvement in relevant ESG controversies, and those identified as sustainability laggards.

The [S&P Developed Ex-Australia LargeMidCap Carbon Control Index](#) and the [S&P Emerging LargeMidCap Carbon Control Index](#) focus on carbon intensity reduction and employ the carbon emissions intensity figures published by S&P Global Trucost. The index design aims to minimize average carbon intensity of the underlying benchmark, while offering diversification across a range of companies in the underlying index. The indices also apply exclusions based on companies' involvement in specific business activities including fossil fuel, tobacco, controversial weapons, alcohol, gambling and adult entertainment, as well as companies with poor alignment with UNGC principles, low S&P DJI ESG Scores, and involvement in relevant ESG controversies.

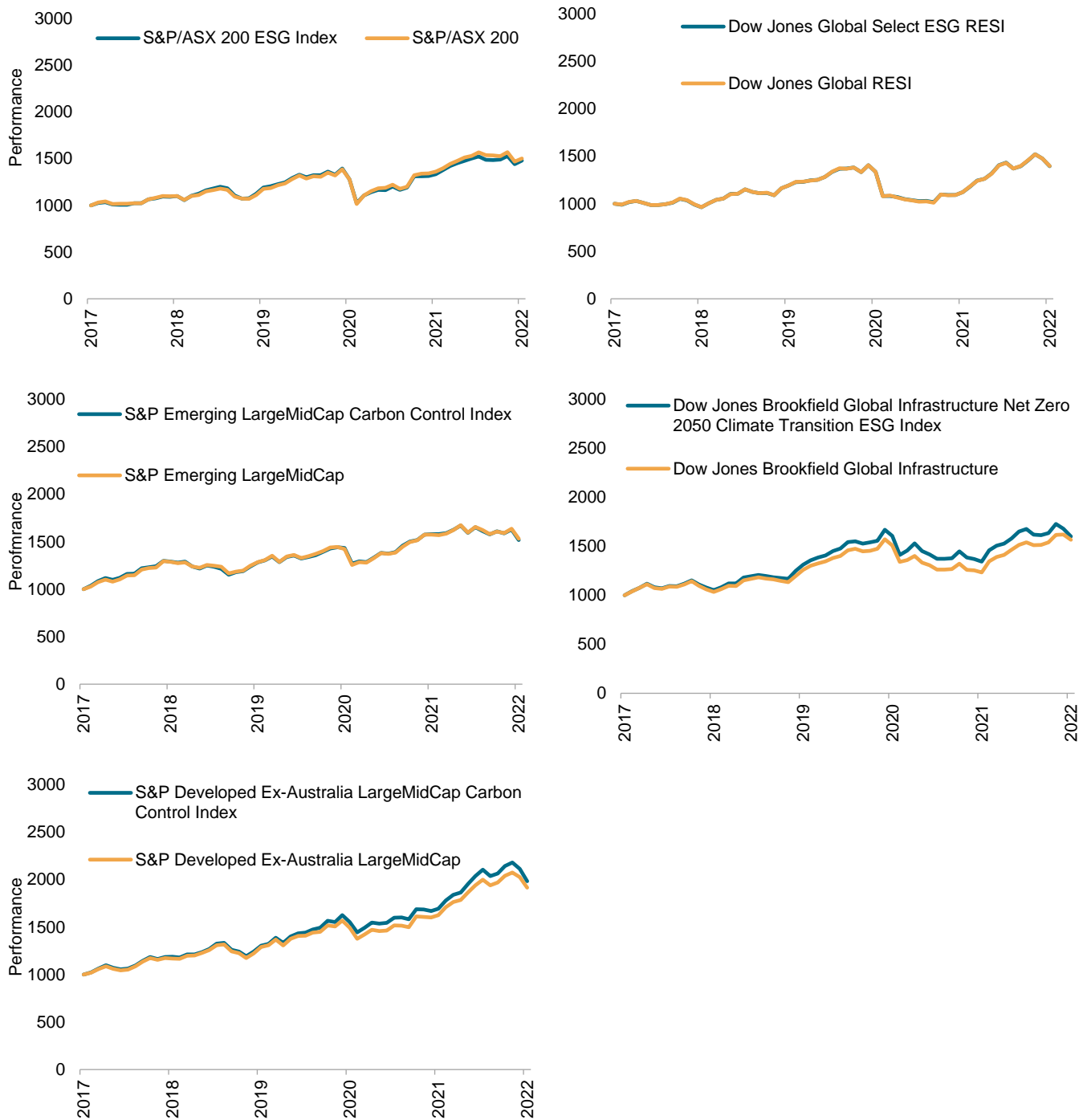
The [Dow Jones Global Select ESG Real Estate Securities Index \(RESI\)](#) uses data from GRESB and is designed to be representative of the investment characteristics of the Dow Jones Global Select Real Estate Securities Index, a conventional real estate benchmark, but with an improved sustainability profile through the use of GRESB scores. As a leader in evaluating ESG characteristics of real estate companies, GRESB uses a framework that is specifically tailored to real estate companies and seeks to embrace industry best practices on the full range of ESG issues that can be material to shareholders. The indices also apply exclusions based on companies' involvement in specific business activities including fossil fuel, tobacco, controversial weapons, alcohol, gambling and adult entertainment, as well as companies with poor alignment with UNGC principles and involvement in relevant ESG controversies.

Finally, the [Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index](#) relies on innovative environmental datasets published by S&P Global Trucost to select and weight companies from the listed infrastructure universe to be collectively compatible with a 1.5°C global warming climate scenario at the index level. The index design also aims to be in line with the EU Climate Transition Benchmark requirements and the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), including but not limited to a 30% carbon intensity reduction relative to the underlying benchmark, a baseline 7% average year-over-year self-decarbonization, activity exclusions and a reduction in index exposure to physical climate risks.

## Performance of Sustainability-Focused Indices

We analyzed the risk/return profiles of five sustainability equity indices compared with their traditional benchmarks, without sustainability considerations. As illustrated in Exhibits 1 and 2, based on back-tested data, all five sustainability-focused indices closely tracked their respective benchmarks over the period studied, with annual tracking error ranging from 1.0% to 2.6%.

### Exhibit 1: Back-Tested Historical Performance of Sustainability-Focused Indices versus Benchmarks



Source: S&P Dow Jones Indices LLC. Data from Feb. 28, 2017, to Feb. 28, 2022. The S&P/ASX 200 ESG Index was launched July 6, 2020. The Emerging LargeMidCap Carbon Control Index and Developed Ex-Australia LargeMidCap Carbon Control Index were launched Aug. 30, 2021. The Dow Jones Global Select ESG RESI was launched April 26, 2021. The Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index was launched Nov. 29, 2021. All data prior to index launch date is back-tested hypothetical data. Index performance based on gross total return in AUD. Past performance is no guarantee of future results. Charts are provided for illustrative purposes and reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

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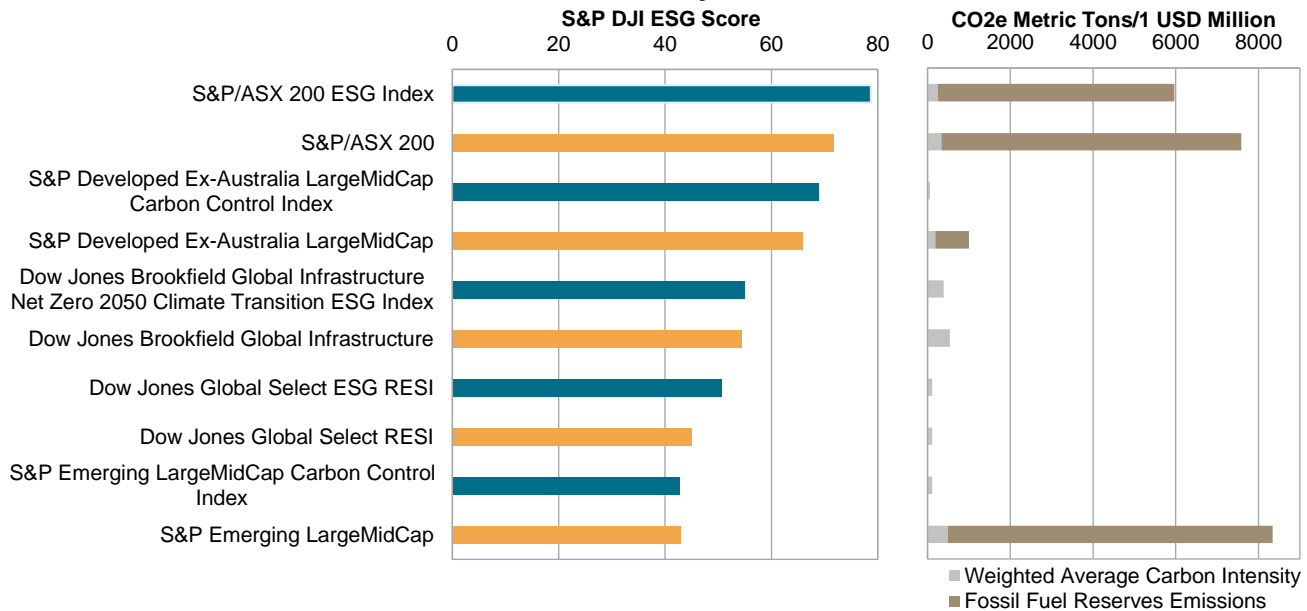
## Exhibit 2: Back-Tested Historical Risk/Return Profile of Sustainability-Focused Indices versus Benchmarks

Index	Annual Return (%)	Annual Volatility (%)	Risk-Adjusted Return	Excess Return (%)	Annual Tracking Error (%)
S&P/ASX 200	8.48	14.5	0.58	-	-
S&P/ASX 200 ESG Index	8.18	14.3	0.57	-0.30	1.75
S&P Developed Ex-Australia LargeMidCap	13.88	10.9	1.27	-	-
S&P Developed Ex-Australia LargeMidCap Carbon Control Index	14.66	10.9	1.35	0.79	1.12
S&P Emerging LargeMidCap	8.90	10.9	0.82	-	-
S&P Emerging LargeMidCap Carbon Control Index	8.72	10.8	0.81	-0.18	1.27
Dow Jones Brookfield Global Infrastructure	9.40	11.7	0.81	-	-
Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index	9.86	12.6	0.79	0.45	2.58
Dow Jones Global RESI	6.93	14.1	0.49	-	-
Dow Jones Global Select ESG RESI Index	6.91	13.9	0.50	-0.02	0.79

Source: S&P Dow Jones Indices LLC. Data from Feb. 28, 2017, to Feb. 28, 2022. The S&P/ASX 200 ESG Index was launched July 6, 2020. The Emerging LargeMidCap Carbon Control Index and Developed Ex-Australia LargeMidCap Carbon Control Index were launched Aug. 30, 2021. The Dow Jones Global Select ESG RESI was launched April 26, 2021. The Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index was launched Nov. 29, 2021. All data prior to index launch date is back-tested hypothetical data. Index performance based on gross total return in AUD. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

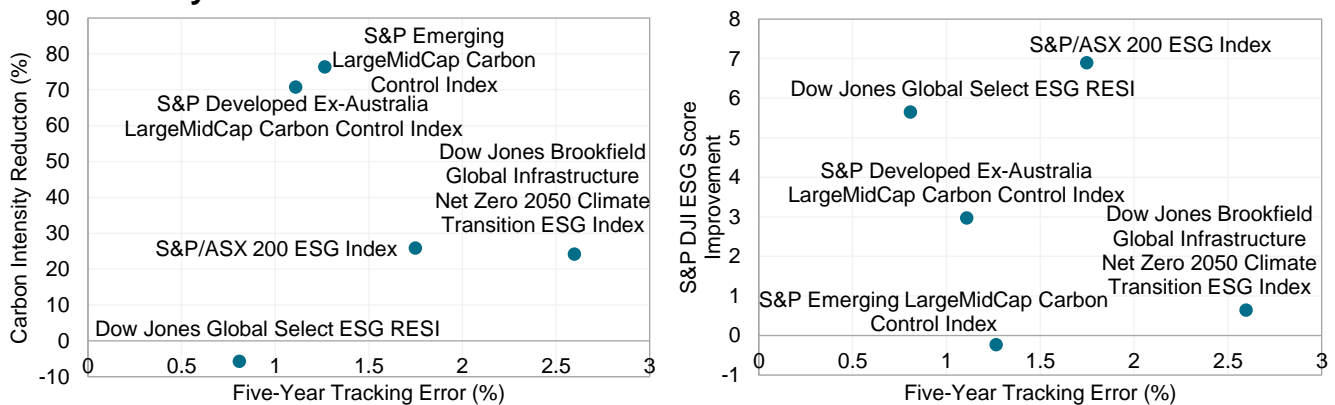
As seen in Exhibit 3, most sustainability-focused indices showed an S&P DJI ESG Score improvement relative to their underlying indices, with the S&P ASX 200 ESG Index and Dow Jones Global Select ESG RESI leading for highest ESG score improvement. Likewise, most sustainable index variants reflected lower carbon intensity and a significant fossil fuel reserve emissions reduction relative to the benchmark. Particularly, the S&P Carbon Control Indices demonstrated the highest carbon intensity reductions, with the lowest level of tracking error (see Exhibit 4). The S&P ASX 200 ESG Index reflected a 21% reduction in fossil fuel reserve emissions relative to its underlying index, mainly due to the thermal coal exclusion and, to a smaller extent, the removal of companies with low S&P DJI ESG Scores. See Appendix 1 for the sector allocations of the analyzed indices.

### Exhibit 3: ESG Characteristics of Sustainability-Focused Indices versus Benchmarks



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2022. Charts are provided for illustrative purposes. For more information on index carbon metrics, please see [here](#).

### Exhibit 4: ESG Characteristics versus Back-Tested Five-Year Tracking Error of Sustainability-Focused Indices



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2022. The S&P/ASX 200 ESG Index was launched July 6, 2020. The Emerging LargeMidCap Carbon Control Index and Developed Ex-Australia LargeMidCap Carbon Control Index were launched Aug. 30, 2021. The Dow Jones Global Select ESG RESI was launched April 26, 2021. The Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index was launched Nov. 29, 2021. All data prior to index launch date is back-tested hypothetical data. Index performance based on total return in USD. Past performance is no guarantee of future results. Charts are provided for illustrative purposes and reflect hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

## Potential Sustainability Profile Improvements within a Hypothetical Index of Indices

To demonstrate the potential improvement in sustainability profile versus traditional market-cap-weighted benchmarks in a typical Australian equity strategy, we constructed two

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hypothetical indices of indices based on the latest asset mix of the overall superannuation industry, sourced from the Australian Prudential Regulation Authority (APRA).

### Exhibit 5: Superannuation Industry Asset Allocation

Asset Class	Proportion of Investments (%)
Cash	9
Fixed Income	18
Australian Fixed Income	10
International Fixed Income	8
Equity	56
Australian-Listed Equity	23
International-Listed Equity	29
Unlisted Equity	5
Property	8
Listed Property	3
Unlisted Property	5
Infrastructure	6
Listed Infrastructure	1
Australian-Unlisted Infrastructure	3
International-Unlisted Infrastructure	2
Commodities	0
Other	2
<b>Total Investments</b>	<b>100</b>

Source: APRA. Available at: <https://www.apra.gov.au/quarterly-superannuation-statistics>. Accessed on March 1, 2022. Table is provided for illustrative purposes.

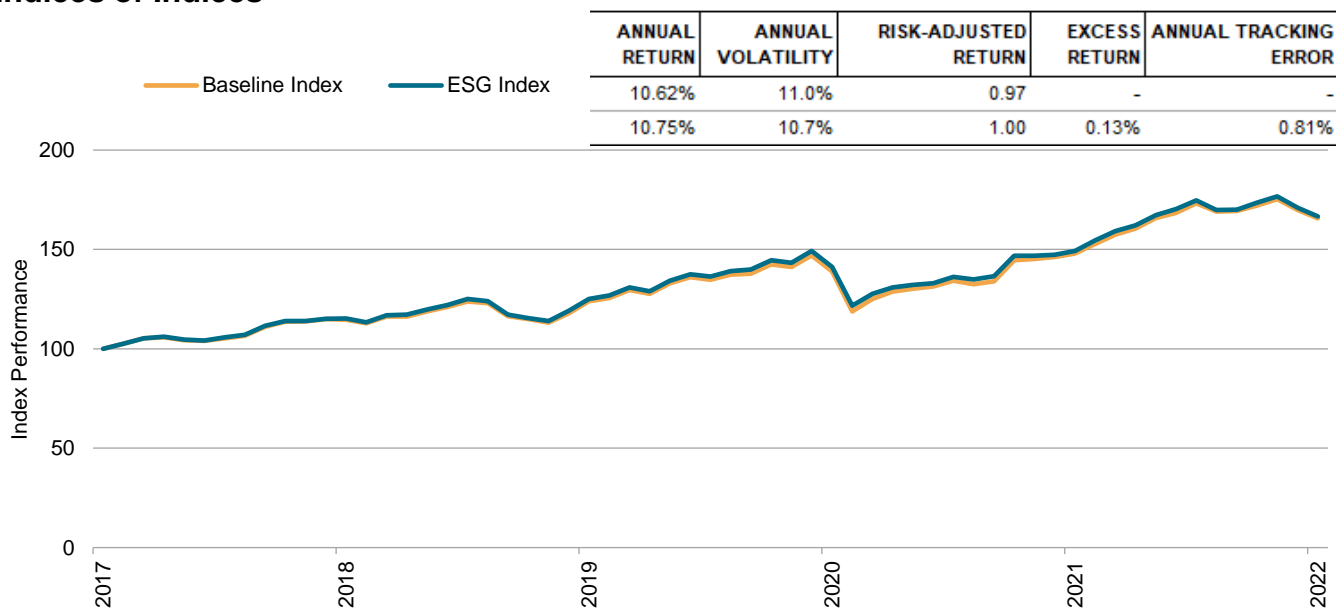
To construct the hypothetical baseline index of indices, we use traditional indices to represent the various investment types that are listed equity. The weight assigned to each index corresponds to its weight in Exhibit 5, rescaled to sum 100% among listed equity. For simplicity, the index of indices is rebalanced on a monthly basis. The hypothetical ESG index of indices is constructed in a similar way by swapping traditional indices with their ESG counterparts. Exhibit 6 presents the allocation of the two hypothetical indices of indices, and Exhibits 7 and 8 present the results of this analysis.

### Exhibit 6: Listed Equity Portion of Asset Allocation in Hypothetical Baseline and ESG Indices of Indices

Hypothetical Baseline Index	Hypothetical ESG Index	Weight (%)
Australian-Listed Equity		23
S&P/ASX 200	S&P/ASX 200 ESG Index	23
International-Listed Equity		29
S&P Developed Ex-Australia LargeMidCap	S&P Developed Ex-Australia LargeMidCap Carbon Control Index	20
S&P Emerging LargeMidCap	S&P Emerging LargeMidCap Carbon Control Index	9
Listed Property		3
Dow Jones Global Select RESI	Dow Jones Global Select ESG RESI	3
Listed Infrastructure		1
Dow Jones Brookfield Global Infrastructure	Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index	1
<b>Total Listed Equity</b>		<b>56</b>

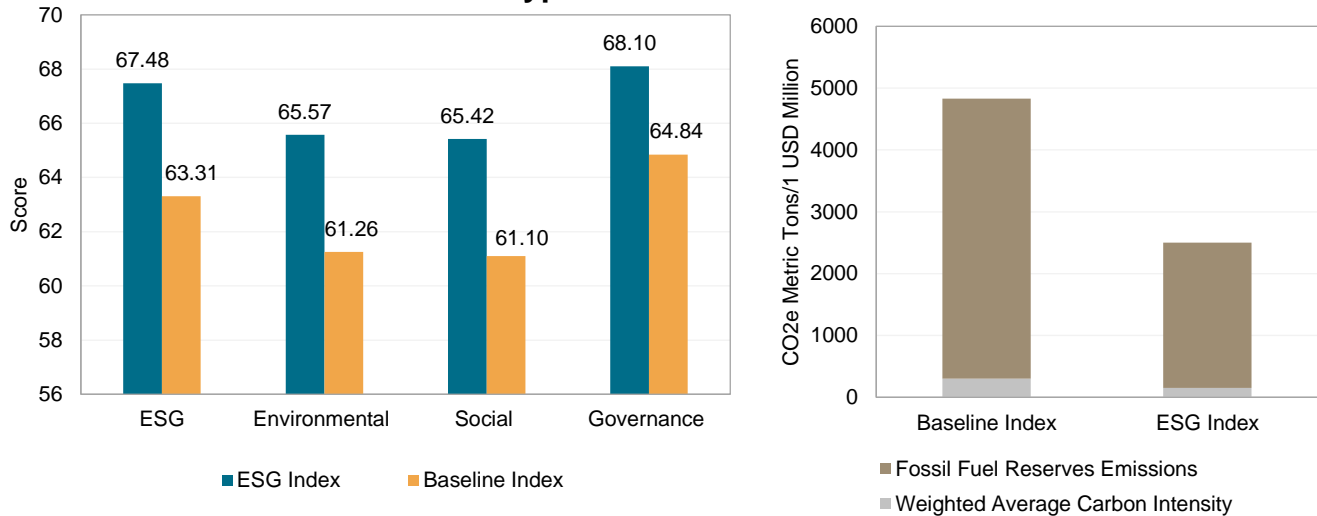
All information above is hypothetical.  
 Source: S&P Dow Jones Indices LLC. Table is provided for illustrative purposes.

### Exhibit 7: Back-Tested Historical Performance of Hypothetical Baseline versus ESG Indices of Indices



All indices of indices are hypothetical.  
 Source: S&P Dow Jones Indices LLC. Data from Feb. 28, 2017, to Feb. 28, 2022. The S&P/ASX 200 ESG Index was launched July 6, 2020. The Emerging LargeMidCap Carbon Control Index and Developed Ex-Australia LargeMidCap Carbon Control Index were launched Aug. 30, 2021. The Dow Jones Global Select ESG RESI was launched April 26, 2021. The Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index was launched Nov. 29, 2021. All data prior to index launch date is back-tested hypothetical data. Index performance based on gross total return in AUD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

**Exhibit 8: ESG Characteristics of Hypothetical Baseline versus ESG Indices of Indices**



All indices of indices are hypothetical.  
 Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2022. Charts are provided for illustrative purposes. For more information on index carbon metrics, please see [here](#).

Looking at an ESG-based index of indices versus a typical equity index of indices reflects potential sustainability benefits, with a low annualized tracking error level of 0.81% (see Exhibit 7) to the baseline index of indices. The hypothetical ESG index of indices showed an improvement of 4.17% for the S&P DJI ESG Score relative to the hypothetical baseline index of indices, as well as enhanced dimensional environmental, social and governance scores. Furthermore, the ESG index of indices demonstrated carbon intensity and fossil fuel reserve reductions close to 50%, helping align with lower carbon targets. The hypothetical ESG index of indices exhibited an underweight to the Energy and Materials sectors, while overweighting Health Care and Communication Services (see Appendix 2).

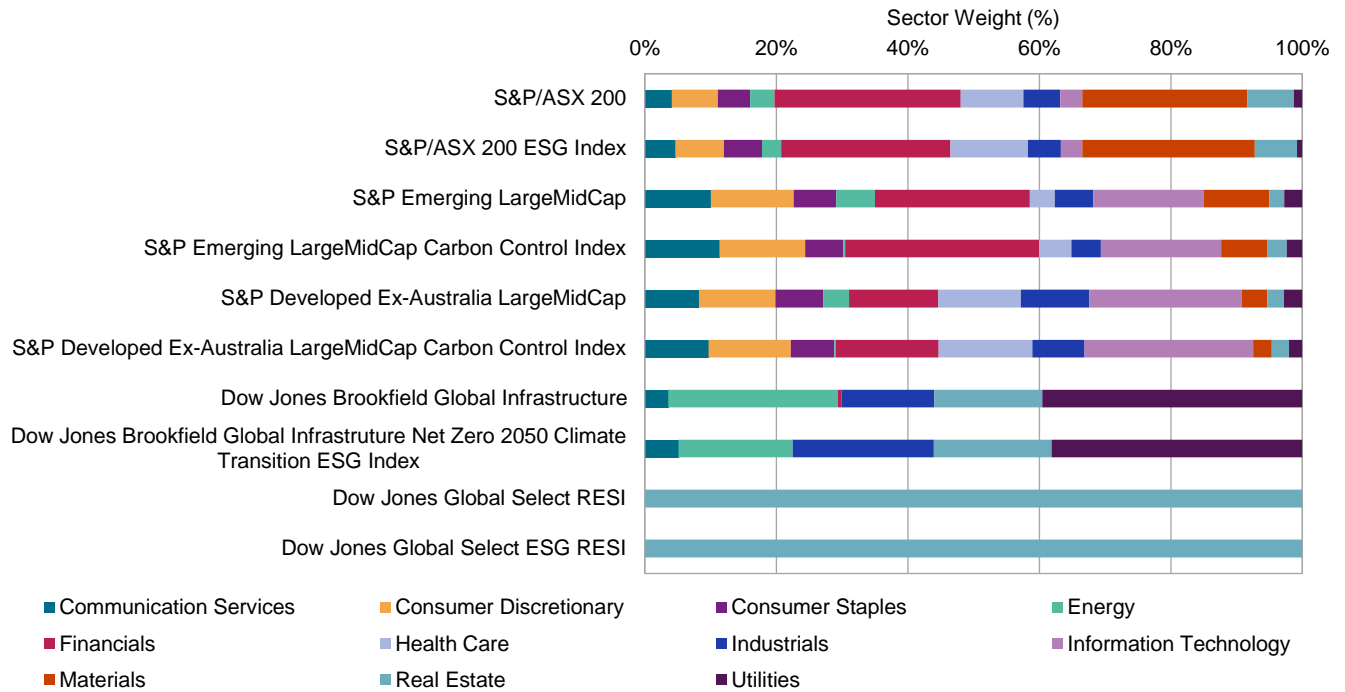
## Conclusion

Market participants are increasingly integrating sustainability considerations into their investment decision-making. For Australia, that’s no exception. We highlighted how various S&P ESG Indices could potentially offer an improved sustainability profile versus a traditional market-cap-weighted index of indices, including S&P DJI ESG Score improvement and lower carbon intensity—with low levels of tracking error to the benchmark index. Importantly, each series of S&P ESG Indices has different design features that could appeal to different investment and sustainability needs. When combined with a holistic strategy, these indices may represent efficient tools to help align investments with principles and move toward more sustainable business activities.



# Appendix 1

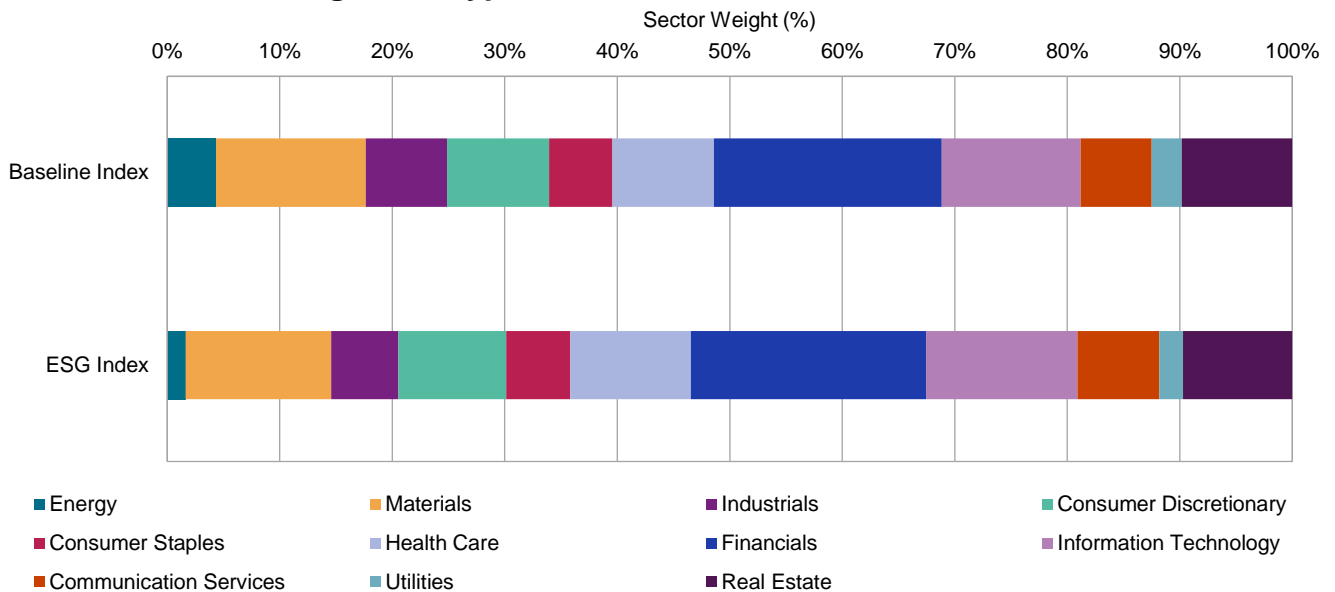
**Exhibit 9: Sector Weights of Sustainability-Focused Indices versus their Benchmarks**



Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2022. Chart is provided for illustrative purposes.

# Appendix 2

**Exhibit 10: Sector Weights of Hypothetical Baseline versus ESG Indices of Indices**



All indices of indices are hypothetical.

Source: S&P Dow Jones Indices LLC. Data as of Feb. 28, 2022. Chart is provided for illustrative purposes.

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## Performance Disclosure/Back-Tested Data

The S&P/ASX 200 ESG Index was launched July 6, 2020. The Emerging LargeMidCap Carbon Control Index and Developed Ex-Australia LargeMidCap Carbon Control Index were launched August 30, 2021. The Dow Jones Global Select ESG RESI was launched April 26, 2021. The Dow Jones Brookfield Global Infrastructure Net Zero 2050 Climate Transition ESG Index was launched November 29, 2021. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance, and is based on the index methodology in effect on the index launch date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. In addition, forks have not been factored into the back-tested data with respect to the S&P Cryptocurrency Indices. For the S&P Cryptocurrency Top 5 & 10 Equal Weight Indices, the custody element of the methodology was not considered; the back-test history is based on the index constituents that meet the custody element as of the Launch Date. Complete index methodology details are available at [www.spglobal.com/spdji](http://www.spglobal.com/spdji). Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results.

Please refer to the methodology for the Index for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations. Back-tested performance is for use with institutions only; not for use with retail investors.

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