



## ESG Considerations in Frontier Markets

November 21, 2022

ESG factors can be hard to quantify in frontier markets, but a quantitative approach with a qualitative overlay may help uncover attractive opportunities.

Watch the video or read the recap below.

**Mike:** Hi, everyone. Mike Corcoran with *Institutional Investor*. Thanks for joining us again as we continue our conversation with Yvette Babb (listen to Yvette discuss the higher return potential of frontier markets debt). Yvette is a hard and local currency portfolio manager on William Blair's Emerging Markets Debt team. And we've been talking with her about frontier markets and some of the opportunities that they present for investors.

Certainly, Yvette, one interesting topic around frontier markets is environmental, social, and governance (ESG). There's a sort of perception that emerging markets in general, and frontier markets maybe in particular, sort of tend to lag a little bit in that regard. And that's good equal opportunity, of course, too. So, I wonder if you could talk a little bit about how ESG plays into your process and the impact that has when you're looking into frontier markets.

**Yvette:** Great. Thanks, Mike. Yeah. So, ESG is an integral part of our process. We have a two-pronged approach. We have a quantitative approach and a qualitative overlay.

We've quantified ESG as part of our sovereign risk model, trying to express the degree to which ESG factors have a significant bearing on credit spreads. And that quantitative relation is most certainly very evident for governance

scores.

There are environmental and social aspects that are less well-quantified. And so, we find that the qualitative overlay is very helpful in understanding that.

But I think in terms of overall metrics that are available for ESG, it's important to note that there is a higher correlation between the level of development of a country and the ESG scores. And so, the fact that ESG scores are low for low-income countries, which generally, frontier markets are at the lower end of the income scale, that is purely a reflection of the sovereign development.

And Teal Emery and I reference this income bias, as we refer to it, in [a recent podcast](#) that we recorded on The Active Share. And so, we are trying to find auxiliary information that will give us additional information that will uncover creditworthiness i.e., information that on the environmental and social side will speak to the willingness and the ability of a country to repay its debt.

**Mike:** I wonder if you could tell us a little bit about, once you take everything that you told us about there, and sort of slot it into the more holistic decision-making and sort of assessment of opportunities in frontier markets.

**Yvette:** Sure. So, as I mentioned, we have a two-pronged approach for the way in which we view ESG in our portfolios. We use this on risk models to assess whether or not an individual issuer or the whole universe is cheap relative to its fundamentals.

And part of that is indeed embedding the ESG scores in our quantitative assessment. And so, that allows us to uncover whether individual issuers are cheap relative to their own history, but also relative to their fundamentals.

We also, as I mentioned, like to use ESG in a qualitative framework because not all of it is very well calculated in figures, which can be delayed in their release or not timely to capture recent developments.

And so, we are able to assess the degree to which we feel markets are mispriced and uncover those alpha-generating opportunities where risks can be perceived to be too high due to social issues, perhaps even due to environmental issues, and where we feel that most certainly won't result in the worst-case scenario of a country unable to or unwilling to meet its social obligations.

And secondly, we think that there are a number of thematic events that are unfolding related to ESG, such as the demand for the metals of the future. And this is something my colleagues Luis and Alexandra alluded to in [a white paper](#) they released last year focused on the demand for electric vehicles. So, a number of metals of the future, as they coined them, that we feel are likely to drive investments as well as export flows in a number of frontier markets moving forward.

And so, we feel that that is one of the structural themes that is emerging on the back of ESG, that is uncovering some attractive frontier market opportunities.

**Mike:** All right. That wraps up our conversation with Yvette Babb. Yvette is a hard and local currency portfolio manager on William Blair's Emerging Markets Debt team. We've been chatting with her about opportunities in frontier markets and Yvette, thanks for joining us today.

**Yvette:** Thanks so much, Mike.

*Yvette Babb is a hard and local currency portfolio manager on William Blair's emerging markets debt (EMD) team.*

**Disclosure:**

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

Information and opinions expressed are those of the authors and may not reflect the opinions of other investment teams within William Blair Investment Management, LLC, or affiliates. Factual information has been taken from sources we believe to be reliable, but its accuracy, completeness or interpretation cannot be guaranteed. Information is current as of the date appearing in this material only and subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. This material may include estimates, outlooks, projections, and other forward-looking statements. Due to a variety of factors, actual events may differ significantly from those presented.

Investing involves risks, including the possible loss of principal. Equity securities may decline in value due to both real and perceived general market, economic, and industry conditions. The securities of smaller companies may be more volatile and less liquid than securities of larger companies. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks. These risks may be enhanced in emerging markets. Different investment styles may shift in and out of favor depending on market conditions. Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result.

Investing in the bond market is subject to certain risks including market, interest rate, issuer, credit, and inflation risk. Rising interest rates generally cause bond prices to fall. High-yield, lower-rated, securities involve greater risk than higher-rated securities. Sovereign debt securities are subject to the risk that an entity may delay or refuse to pay interest or principal on its sovereign debt because of cash flow problems, insufficient foreign reserves, or political or other considerations. Derivatives may involve certain risks such as counterparty, liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Currency transactions are affected by fluctuations in exchange rates; currency exchange rates may fluctuate significantly over short periods of time. Diversification does not ensure against loss.

There can be no assurance that investment objectives will be met. Any investment or strategy mentioned herein may not be appropriate for every investor. References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security. Past performance is not indicative of future returns.

Copyright © 2020 William Blair & Company, L.L.C. "William Blair" is a registered trademark of William Blair & Company, L.L.C. No part of this material may be reproduced in any form, or referred to in any other publication, without express written consent.