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Sustainable Investing Outlook: Strong Returns Amid Net Flow Pressures

Key Findings

- *Sustainable fund outflows in the first quarter of 2025 were minimal at 0.3% of assets, reflecting broader market volatility. Despite this, sustainable funds continue to outperform and attract interest amid uncertainty.*
- *Environmental, social, and governance (ESG) stocks have kept pace with the broader equity markets in the first half of 2025, while clean energy stocks outperformed fossil fuel and traditional energy sectors in terms of returns to stock market investors, despite the hype around the "end of ESG investing."*
- *Asia's sustainable fund inflows remain resilient, though modest in global terms. South Korea, Taiwan, and Thailand led gains, supported by policy incentives and rising retail demand for ESG-aligned investments.*
- *Sustainable bond issuance in Asia accelerated, with outstanding volumes tripling to USD918 billion by the end of 2024. The Association of Southeast Asian Nations (ASEAN) accounted for a double-digit share of ASEAN+3 issuance, while Asia-Pacific premiums remained above global averages.*

The politicization of environmental, social, and governance (ESG) investing in some regions, along with anti-renewable measures, has continued to influence both the discourse around ESG and the flow of funds into such investments in recent quarters. Despite persistent rhetoric to the contrary, the Institute for Energy Economics and Financial Analysis (IEEFA) found in 2024 that ESG investing demonstrated stronger performance, fund flows, asset owner sentiment, and regulatory momentum across much of the world. This briefing note revisits the subject and finds that, despite a more challenging backdrop, the broad conclusion remains largely valid.

Sustainable Investment Fund Flows

Global sustainable funds continued to draw strong investor interest in 2024, attracting USD31 billion in net inflows. However, in the first quarter of 2025, sentiment turned more cautious amid broader market volatility, resulting in modest net outflows of USD8.6 billion. This decline mirrors trends observed across the broader global fund market, where net inflows fell substantially to USD530 billion in the same period (4Q 2024: USD847 billion), reflecting investors' shift to more risk-averse positioning in an uncertain macroeconomic environment.

With global sustainable fund assets totaling USD3.2 trillion at the end of March 2025, net redemptions amounted to a meagre 0.3% of the asset base. As has been the case since early 2023, the U.S. continued to see outflows, with a 10th consecutive quarter of net redemptions. The quarter-over-quarter assets under management (AUM) decline for the U.S. was -4%, significantly more than the marginal decline seen of -0.4% in European flows. This trend reflects the increasingly hostile political climate (particularly from the U.S.), with state-level anti-ESG policies and corporate rollbacks of ESG commitments intensifying.

Meanwhile, the European Union (EU) experienced modest outflows amid heightened scrutiny and regulatory complexity. In recent months, debate has resurfaced around whether defence stocks should be included in socially responsible investing (SRI) and ESG portfolios. The EU is expected to address this issue in its upcoming review of the Sustainable Finance Disclosure Regulation (SFDR), providing clarity on the role of defence in sustainable investment strategies. At the same time, regulators are placing greater emphasis on the naming of funds and ensuring alignment between stated investment objectives and sustainable objectives.

Surveys by BNP Paribas Securities Services and Morgan Stanley also indicate that both institutional and retail investors remain firmly committed to sustainable investing, with a growing focus on themes that aim to deliver both financial returns and measurable impact. Almost half of the institutional investors surveyed in the BNP survey felt unaffected in their sustainability commitments by recent political changes. A majority expected sustainability to be *more* important over the next five years, and only 16% expected it to be less vital. Likewise, the Morgan Stanley survey showed an overwhelming majority of younger people remaining interested in sustainable investments.

Based on the above, and despite some headwinds, it is premature to draw conclusions from a single quarter's outflows. Investors appear to be exercising caution, awaiting greater clarity before committing capital.

Inflows in Asia Remain Healthy, Albeit from a Low Base

Europe remains the cornerstone of the sustainable funds market, accounting for 84% of global sustainable fund assets as of end-March 2025. In Asia, sustainable fund inflows continued in the first quarter of 2025, driven primarily by South Korea, Taiwan, and Thailand.

Taiwan's exchange-traded funds (ETF) market has expanded rapidly in recent years, reaching 272 ETFs with TWD6.4 trillion (approximately USD220 billion) in assets under management at the end of 2024, making it the third-largest in Asia. This growth has been driven by a retail investing boom and rising demand for low-cost, highly liquid investment instruments.

Reflecting this trend, Taiwan-domiciled sustainable funds have seen continuous net inflows since the fourth quarter of 2023.

Meanwhile, Thai government-led incentives for sustainability funds have spurred investor interest and inflows. Various schemes allow investors who subscribe to ESG mutual funds and the recently launched ESG Extra Funds to tax deductions of up to 30%. These funds are required to invest at least 80% of their net asset value in Thai assets with sustainability characteristics.

China, where sustainable funds had recorded consecutive outflows since 2Q 2022, finally saw a reversal in trend with a marginal inflow in 1Q 2025. This shift comes on the heels of a very strong year for China's broader ETF market, which recorded RMB1.1 trillion (around USD153.5 billion) in net capital inflows in 2024, marking a historic high and a 104% increase from 2023. While the recent inflow remains modest, it signals early signs of improving sentiment toward sustainable investing in China. This cautious optimism is supported by ongoing regulatory backing for green finance, a growing pipeline of ESG-themed products, and continued efforts to enhance market transparency and standardization.

Performance Remains Healthy and Attractive Even Compared to the Broader Market

Contrary to the prevailing cautious sentiment, global sustainable fund performance has remained highly resilient. Data from Morningstar shows that global large-cap sustainable funds (based on a screen of 1,382 funds) gained 2.09% in 1Q 2025, outperforming their conventional peers, which posted losses over the same period. Although year-to-date returns moderated to 1.32% as of 23 April 2025 amid tariff-related headwinds, sustainable funds continued to outperform conventional counterparts, which suffered further losses.

Table 1: The Performance of Global Large-Cap Sustainable Funds Fared Better than Conventional Counterparts

	YTD return (31 March 2025)
Global Large-Cap Sustainable Funds	2.09%
MSCI ACWI Large-Cap Net Return Index	-1.58%
Morningstar Global Target Market Exposure Net Return Index	-1.35%
	YTD Return (23 April 2025)
Global Large-Cap Sustainable Funds	1.32%
MSCI ACWI Large-Cap Net Return Index	-5.44%
Morningstar Global Target Market Exposure Net Return Index	-4.91%

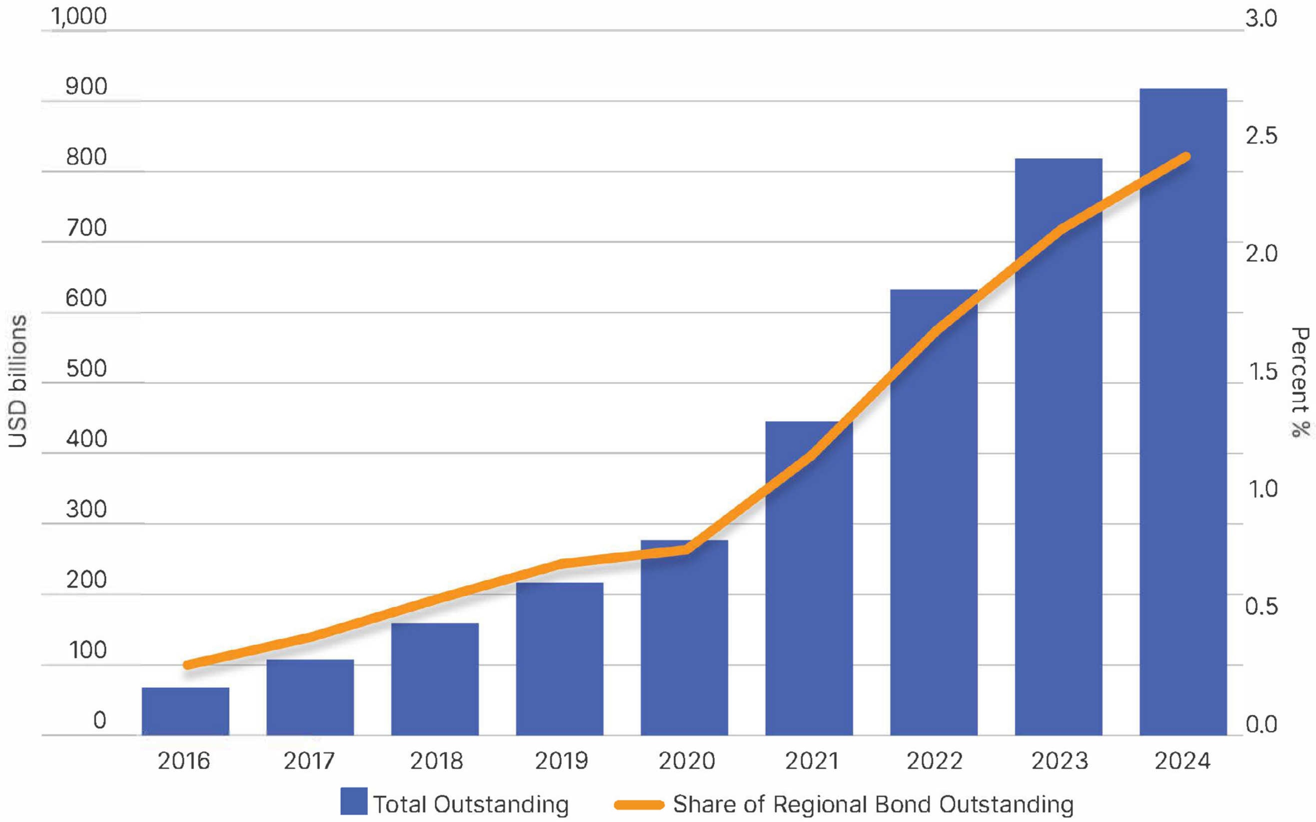
Source: Morningstar. IEEFA

The performance of ESG-positive stocks has remained solid, with environment-focused clean energy stocks outperforming their fossil fuel counterparts. The MSCI World Selection Index (formerly the MSCI World ESG Index, renamed in February 2025) has kept pace with the broader market, delivering gains in line with the broader MSCI World Index. Sectorally, clean energy has outperformed both the broader market and the fossil-fuel dominated energy sector. The iShares Global Clean Energy ETF (ICLN US) returned 15.6% gains to investors year-to-date as of 27 June 2025, compared to 5% for the S&P500 index, and just 1.2% for the Energy Select Sector SPDR ETF (XLE US).

Sustainable Bond Issuances Continue Strong Growth

While the region has historically lagged in ESG-related financing, momentum is building. In the sustainable bond market, outstanding sustainable bonds in ASEAN+3 (comprising the Association of Southeast Asian Nations (ASEAN), China, South Korea, and Japan) more than tripled from USD277 billion at the end of 2020 to USD918 billion by the end of 2024. Their share of the overall bond market also rose steadily, reaching 2.5% (Figure 1). Annual issuance has consistently surpassed USD200 billion over the past four years. Notably, ASEAN countries collectively accounted for 11% of ASEAN+3's total sustainable bond issuance in 2024—the first time the bloc reached a double-digit share of the region's sustainable debt market.

Figure 1: ASEAN+3's Sustainable Bonds Outstanding



Source: AsianBondsOnline.

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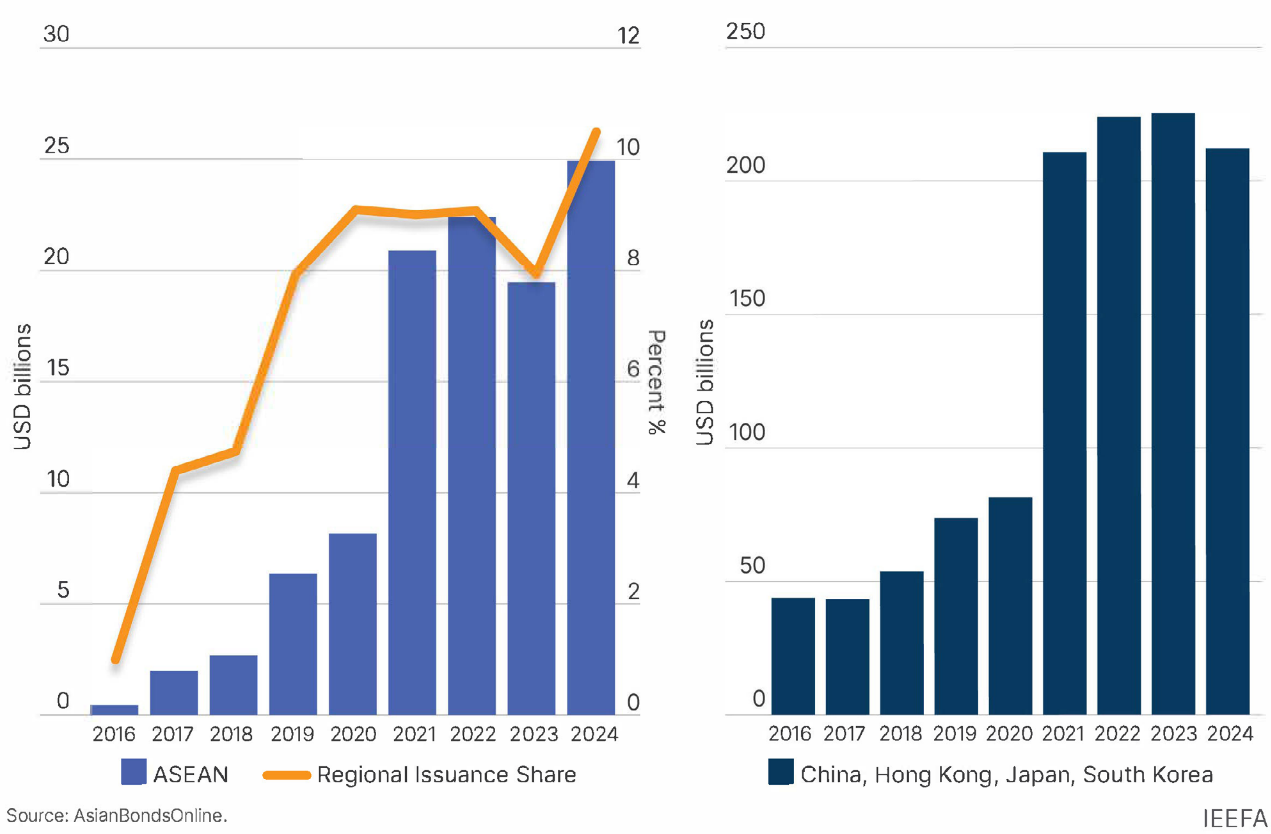
Figure 2: ASEAN+3's Sustainable Bond Issuance Amount



The "greenium"—the lower interest rate that issuers of green instruments pay relative to non-labelled counterparts—is currently hovering around zero, according to BNEF data. However, Asia-Pacific stands out as an exception, where green instruments still attract a healthy greenium averaging 8.5 basis points. In practical terms, this means entities issuing green bonds in the region pay 0.085% less on average in interest on those bonds compared to those issuing conventional bonds. This was particularly evident in China and Japan, two of the largest markets in the region, where bonds issued by domestic entities were priced at notable greeniums. Likewise, green bonds denominated in Japanese yen and Chinese yuan have also provided pricing advantages for issuers.

These trends suggest that sustainable financing remains an attractive option for governments, corporations, and other entities in Asia. However, as issuance volumes continue to grow, it would not be surprising to see the greenium in Asia narrow toward global averages. This would likely be a result of increasing supply, as well as the need to maintain competitive returns for investors over the long term. To support the continued development of the green bond market, regulators can play a key role by implementing measures to lower compliance and monitoring costs, and by investing in capacity-building for green instruments and markets. Lowering these barriers could reduce costs for both issuers and investors. Encouragingly, regulatory developments across Asia continue to advance sustainability reporting standards and promote broader sustainability-related activities.

Asian Economies Continue to Strengthen Sustainability Initiatives

Beyond the climate pledges, sustainability initiatives continue to progress, playing a vital role in bridging the funding gap. In stark contrast to U.S. revanchism, many Asian countries are advancing sustainability-related financial measures. A recent survey conducted by the Asian Development Bank Institute (ADBI) of 12 financial regulators across the region highlights this momentum in climate disclosure efforts under the International Sustainability Standards Board (ISSB) framework.

A majority (66%) of respondents surveyed had either mandated or planned to mandate the ISSB standards, while 60% had already established or intended to set an implementation timeline. Regarding greenhouse gas (GHG) emissions disclosure, over 40% reported plans to mandate or had already mandated reporting across all three scopes (Scopes 1, 2, and 3). An additional 25% had mandated disclosure of Scope 1 and Scope 2 emissions, according to the survey.

In terms of country-specific developments, Thailand recently launched Phase 2 of its sustainable finance taxonomy, expanding its scope to include high-emission sectors such as agriculture, construction and real estate, manufacturing, and waste management. Thailand is also the first ASEAN member to integrate key elements into a single framework—combining a transition finance methodology aligned with the Climate Bonds Initiative, practice-based agricultural guidance, and sector-specific thresholds with clear screening criteria and sunset provisions. Meanwhile, India—the world's third-largest emitter—has released a draft climate finance taxonomy aimed at mobilizing capital to support its target of reducing emissions by 45% by 2030 and achieving net zero by 2070.

At the regional level, the Multi-jurisdictional Common Ground Taxonomy (M-CGT)—a joint initiative by the EU, China, and Singapore—has mapped 110 activities across eight priority sectors. This initiative represents important progress toward the persistent challenge of taxonomy misalignment, which remains a key barrier for investors. Greater alignment can help facilitate cross-border green capital flows and serve as a valuable reference for countries developing or refining their own sustainable finance frameworks.

In parallel, robust sustainability reporting frameworks are emerging as a crucial foundation for attracting green capital. High-quality, consistent, and transparent disclosures allow investors to better assess climate-related risks and opportunities, supporting more informed capital allocation. The upcoming adoption of ISSB standards across the region—particularly International Financial Reporting Standards (IFRS) S1 and S2—is expected to further improve consistency and comparability. By strengthening sustainability disclosure practices, Asian markets not only build investor confidence but also pave the way for increased issuance of sustainable financial instruments.

Conclusion

Sustainable and ESG investing remains both relevant and essential—despite skepticism in some media narratives. Fund flows are periodically under pressure for all investment assets; it is a normal feature of broader market dynamics. Meanwhile, ESG indices have performed as well, if not better than, their conventional counterparts. As the urgency to decarbonize grows more paramount by the day, sustainable investing is well-positioned to benefit from long-term structural tailwinds regardless of near-term political obstacles. The evidence points to the growing institutional commitment, regulatory progress, and investor demand—all reinforcing ESG's continued role in shaping the future of finance.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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