Global Matters Weekly

9 October 2023

Responsible investment: here for good

by Jade Coysh

A few years ago, the world of sustainable investment exploded; I couldn't open a newspaper without seeing an article referencing the importance of ESG (Environmental, Social and Governance) and every fund manager's presentation suddenly included slides on how they consider ESG factors in their investment decisions.
Roll forward to today and the narrative looks quite different. Suddenly the media coverage surrounding responsible investment has taken an unfavourable stance (a quick search for ESG news and the first headline I come across is 'ESG exodus') and 'ESG funds' have experienced outflows in the billions over the past two years.

So, what has caused this shift in sentiment in a relatively short space of time? Perhaps the stellar performance of the (traditional) energy sector in 2022 was enough to convince investors that oil trumps renewable energy. Perhaps the anti-ESG regulation in the United States is scaring investors. Perhaps investors are feeling overwhelmed by the amount of information out there and the ever-increasing reporting burden. It's difficult to know, but one thing is certain: the issues that responsible investment seeks to solve are certainly still prominent – it's hard to ignore climate change when you're sunbathing in the UK in early October!

Putting morality and 'feel good' aspects aside, responsible investment can be alpha generative. A strong investment process considers the full spectrum of strengths and the potential risks of an investment, and ESG factor analysis is simply another lens through which one can analyse an investment. For example, an ESG-integrated process will identify that a company is not disposing of waste efficiently (environmental risk that could lead to reputational damage) or has a strong culture that leads to happier employees (social opportunity).

Companies are increasingly redirecting capital expenditure (CapEx) into pro-ESG areas like renewable energy, electric vehicles (EV), employee mental health etc. Taking the example of EV's, it is expected that automakers will spend around $1.2 trillion through to 2030 switching their product lines towards EVs[1]. Taking a backwards looking example, in 2022, global investment in the low-carbon energy transition equalled $1.1 trillion[2] – a significant amount of capital in a single year. In turn, companies that have successfully reduced emissions faster than peers over the last five years have outperformed those in the worst quintile of emissions management by c.3% per annum[3], demonstrating that this CapEx spending is additive to returns. When selecting the long-term winners, it's difficult to ignore these trends.

'Long term' is a phrase that is misrepresented a lot in the investment world. There is no hard definition for the phrase and every fund manager I've met has told me that they are a 'long-term investor'. Responsible investing is genuinely a long-term game because it's going to take years for many of these themes to play out, such as the renewable energy transition or addressing the male-to-female ratio on Boards. It is likely that there will be some short-term volatility and the gains will not be linear, but over the longer term these themes will likely be beneficial. The recent rise in the oil price saw some investors dampening their focus on environmental factors and increasing the carbon footprint of their portfolios in order to chase short term performance. Now it's worth noting that as a firm, MGIM is not opposed to owning carbon-intense portfolios but it's important that fund managers stick to their convictions, consistently follow a robust process, and our preference is that firms are engaging with companies to improve.

The final point that I will make to demonstrate why responsible investment is additive to returns is regulation. Yes, there are 'red states' in the United States (US) that are pushing anti-ESG policies, and the UK has backtracked on various green policies recently, but there is global regulation coming and even in the US we are seeing pro-ESG policies such as the SEC's sustainable disclosure regulation, rolled out in 2022. More broadly we are seeing an increasing number of guidelines, regulation and best practice initiatives being introduced in the UK, Europe, Asia and even in some Emerging Markets. When these policies are brought in, investors will want to own companies on the 'right' side of this change because there is a risk in holding those that have to spend huge amounts in a short time period in order to catch up.

All in all, investors do not have to give up returns in order to invest responsibly and in fact there is evidence that investing responsibly and integrating ESG factors is additive to returns. However, not all responsible investment strategies are created equal and alongside many other factors, one has to assess a fund manager's ability to implement a responsible investment strategy effectively.

Sources

1 https://www.reuters.com/technology/exclusive-automakers-double-spending-evs-batteries-12-trillion-by-2030-2022-10-21/

2 https://about.bnef.com/blog/global-low-carbon-energy-technology-investment-surges-past-1-trillion-for-the-first-time/

3 https://mybrand.schroders.com/m/8645ae373488e2e/original/Schroders_TCFD_2022.pdf

Belvest 研富

9 October 2023

For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited
研富投資服務有限公司
9th Floor, Centre Mark II
305-313 Queen's Road Central
Sheung Wan, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
belvest@bis.hk
www.bis.hk

Important notes

This communication is issued by Belvest Investment Services Limited and/or Belvest related companies (collectively, and individually Belvest) solely to its clients, qualified prospective clients or institutional and professional investors. Unless stated otherwise, any opinions or views expressed in this communication do not represent those of Belvest. Opinions or views of any Belvest company expressed in this communication may differ from those of other departments or companies within Belvest, including any opinions or views expressed in any research issued by Belvest. Belvest may deal as Distributor or Agent, or have interests, in any financial product referred to in this email. Belvest has policies designed to negate conflicts of interest. Unless otherwise stated, this e-mail is solely for information purposes.

This message may contain confidential information. Any use, dissemination, distribution or reproduction of this information outside the original recipients of this message is strictly prohibited. If you receive this message by mistake, please notify the sender by reply email immediately.

Unless specifically stated, neither the information nor any opinion contained herein constitutes as an advertisement, an invitation, a solicitation, a recommendation or advise to buy or sell any products, services, securities, futures, options, other financial instruments or provide any investment advice or service by Belvest.

No representation or warranty is given as to the accuracy, likelihood of achievement or reasonableness of any figures, forecasts, prospects or return (if any) contained in the message. Such figures, forecasts, prospects or returns are by their nature subject to significant uncertainties and contingencies. The assumptions and parameters used by Belvest are not the only ones that might reasonably have been selected and therefor Belvest does not guarantee the sequence, accuracy, completeness or timeliness of the information provided herein. None of Belvest, its group members or any of their employees or directors shall be held liable, in any way, for any claims, mistakes, errors or otherwise arising out of or in connection with the content of this e-mail.

This e-mail and any accompanying attachments are not encrypted and cannot be guaranteed to be secure, complete or error-free as electronic communications may be intercepted, corrupted, lost, destroyed, delayed or incomplete, and/or may contain viruses. Belvest therefore does not accept any liability for any interception, corruption, loss, destruction, incompleteness, viruses, errors, omissions or delays in relation to this electronic communication. If verification is required please request a hard-copy version. Electronic communication carried within the Belvest system may be monitored.

Belvest 研富