ESG: What's really in the portfolio?

by Christian McCormick | 21/12/2018

Summary

Demand for ESG investing is rising. Yet for many, there is still a lack of clarity around what ESG is, what strategies are available and the potential implications for an investor's portfolio. Understanding how a fund approaches ESG investing and the types of factors they may prioritize can give investors more confidence about which funds align to their values.

Values-based investors can benefit from gaining a better understanding of the ESG investment process

Increasingly, investors are searching out investments that align with their values. Assets invested with money managers that incorporate ESG criteria—screening for environmental, social and governance issues—is estimated at over $20 trillion in AUM[1]. But while demand is rising for ESG investments, there is a lack of clarity around the criteria investors and portfolio managers use to evaluate these types of investments. How should ESG be defined? Should it be an overall evaluation of the company, or an evaluation of the product produced by the company?

This uncertainty makes it all the more important for investors to understand how to evaluate ESG investments and to better understand how the funds in which they invest select their holdings. After all, investors often look to ESG as a way to align their values with their investments. Gaining a clearer understanding of the ESG investment process can offer an instructive roadmap to investors hoping to become more knowledgeable about their own ESG investments.

Understanding the ESG universe

Among ESG funds, investors will find portfolios that have a broad mandate to invest in socially responsible companies. **Socially responsible investing** (SRI) often looks broadly at a company's impact on a range of environmental, social and governance issues. SRI funds make up the bulk of the ESG market.

Impact investing is a smaller piece of the ESG landscape. Impact funds often evaluate companies on a single issue. Some funds may only invest in companies in which women make up a meaningful number of the senior management team and the board of directors, or in companies directly involved in renewable energy sources such as wind or solar.

Due diligence

The variety of funds in the ESG universe gives investors more options to find investments that truly align with their values. It also means that not all ESG funds are alike.

It may surprise some that an electric car company might not have a high ESG rating. Although having an electric car as its main product would certainly give it a favorable environmental rating, it might not rate as highly on the social and governance scores. In other words, good ESG products are not necessarily produced by good ESG companies.

Firms such as MSCI, RobecoSAM, MSCI, and Sustainalytics provide ESG ratings that evaluate a company's adherence to environmental, social and governance criteria. All three of those firms, however, approach ESG differently. One rating system may put more weight on the environmental component of ESG, while another prioritizes governance or social issues.

Rarely do you see a company receive an equal weighting on all three areas. Different companies face different risk factors. A mining company may be more highly weighted on environmental factors because there are more risks from the company's carbon footprint than from, say, employee turnover. The materiality of ESG risks to a particular company and/or industry is a key component.

What's more, different stock market sectors often are rated differently because certain ESG risks are more material for certain types of companies. For instance, the overall rating for a financial services company likely places more emphasis on social and governance issues because those issues are most likely to be risk areas for that company.

Understanding how a fund approaches ESG investing requires more than simply checking the name of the fund. Investors interested in applying ESG criteria to their investment strategies should dig into available research, including fund prospectuses and third-party research on individual funds. Doing so can tell investors volumes about how managers approach ESG investing, and the types of factors they may prioritize in their portfolios. In the process, investors can feel more confident that the funds in which they invest align well with their own values.

1. Source: Forbes, "The Remarkable Rise of ESG", July 2018.

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by Karl Happe | 08/01/2019

Summary

There is no easy solution to the problem of rising economic inequality, but we may be able to address it with a more enlightened tax system – one that maintains incentives for work and investment while improving economic efficiency.

Key takeaways

- Making tax systems more progressive could create positive incentives for work, which could help reduce the wealth and income gap
- Fairer tax systems could combat rising inequality by incentivising companies to invest more in their businesses – including in their employees – rather than encouraging automation
- To help boost productivity and investment, we could reform the tax code to reward companies for generating operating earnings – not for financially engineering their results
- A more equitable tax system could help the wealthy – not just low- and middle-income earners – by potentially reducing political turmoil and increasing economic growth

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