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2023 Investment Outlook: Responsible Investing

By: EV Forward | December 14, 2022

New Framework for ESG Disclosure and Responsible Investing Underway

KEY POINTS

- 1 Major events in 2022 have caused a shakeout in the responsible investment industry that will bring meaningful change into 2023 and beyond.
- 2 Globally, the industry is moving toward more intensive ESG research that establishes clear connections between corporate behavior and financial outcomes.
- 3 Government ESG disclosure standards established in 2022 will help create a more transparent, consistent framework for security selection and corporate engagement.

The ESG and Responsible Investing markets have grown rapidly over the past decade because investors recognize that the world faces substantial environmental and social challenges, and that companies successfully addressing these challenges stand to benefit. Major events of 2022 have caused a shakeout in the industry and imply meaningful change today and into 2023.

To stay relevant as capital market participants in 2023 and beyond, we believe responsible investors must intensify research into how well companies are managing their specific exposures to financially material environmental and social factors, analyzing their near- and long-term financial impacts. Multidimensional research with clear connections between corporate behavior and corporate financial outcomes must inform both security selection and corporate engagement efforts, including ESG activism.

Greater Disclosure Required of ESG Asset Managers

For years, responsible investors have propelled companies to increase transparency and disclosure of their ESG performance across factors ranging from carbon emissions to workplace diversity. Now it is critical that responsible investment asset managers provide transparency into their own research methodology. Investors need clarity around the linkages between corporate ESG performance, financial outcomes, security selection and the results of corporate engagement and activism.

Understanding corporate governance will continue to be relevant for all types of investors, but the need for depth and granularity in responsible investment research and corporate engagement will dominate the ESG and responsible investing business in 2023 and beyond.

The responsible investing teams and firms that can succeed in doing this will continue to thrive and gain investor market share, becoming increasingly relevant participants in global capital markets.

New Responsible Investing Framework

We believe the events of 2022 will prove to have been seminal for responsible investing and ESG research, helping shape the framework for a rapidly changing investment landscape. The combination of powerful geopolitical events, along with ambitious government regulations aimed directly at responsible investing, are together creating a new reality for market participants.

The sum of geopolitics largely shows that individual entities — people, companies, countries — predominantly act in their own self-interests, as opposed to the long-term needs of global society. This makes solving issues that impact the global commons, such as climate change or COVID, very difficult for society to solve. Multiple situations today serve as proof points: the war in Ukraine, numerous conflicts between China and the West, divergent outcomes between rich and poor countries in the response to COVID, and inadequate progress among the world's large and rich countries to effectively deal with climate change.

Understanding this reality is critical to grasping the need for voluntary, market-led solutions to these massive challenges, and the need for stronger, deeper ESG research and engagement. We need corporations that can advance viable solutions do so while producing competitive financial returns for investors. Finding those winners and differentiating the rest requires exhaustive ESG research.

Government actions in 2022 — in terms of setting standards for ESG and responsible investing, as well as intervention in trade and industrial policy — underscore how a shift to deeper research and voluntary, market-led solutions are under way and will likely dominate in 2023. The United States Department of Labor new ESG rule, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," makes clear the need for in-depth ESG research focused on financially material factors. This rule will set the entry-level standard for

responsible investing going forward. In the EU, the Sustainable Finance Disclosure Regulation (SFDR) rules make clear the need for investment firms to define their approach to responsible investing. These rules, combined with ongoing enforcement actions in the UK, EU and U.S., make crystal clear that responsible investment firms and products must provide realistic expectations and real transparency into research and investment processes.

Stronger Capital Markets

The impact of deeper ESG investment research, clarity on ESG linkages to financial outcomes, and greater transparency into responsible investment processes has already created a narrower and more competitive field. Firms are adjusting their marketing claims and investors are conducting intensified due diligence. At the same time, corporations that are the subject of this research are adjusting their public-facing statements and strengthening the financial discipline of their sustainability-related capital investments.

We believe the outcome will be to strengthen capital deployment, create measurable differentials between corporations that can manage well and those that cannot, and enhance how capital markets function. Greater transparency, greater disclosure, greater focus on financial outcomes — these are the required underpinnings of successful, market-led solutions, consistent with the realities of the world we experienced in 2022. We have seen how individual entities behave in promoting their own self-interest, with minimal ability of governments to exert control, despite their efforts. Strong capital market function can counter this, advancing the needs of society while providing competitive returns to investors.

John Streur

Chief Executive Officer
Calvert Research and Management

In January 2023, John Streur will take on the role of Chairman, Calvert Research and Management, focusing on investment innovation, client engagement and thought leadership.

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EV Forward

"The need for depth and granularity in responsible investment research and corporate engagement will dominate the ESG and responsible investing business in 2023 and beyond."

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