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Equities | Responsible Investing

A look at ESG and international equity investing

Picture of Ian

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London - In perusing an article over the weekend, I was reminded of the myriad approaches to environmental, social and governance (ESG) investing and the confusion this acronym creates across every part of the investment chain — from clients to advisors to portfolio managers. The different frameworks for ESG — with varying definitions, scoring methodologies and ideologies — all contribute to this confusion.

While I believe there is room in this debate for all manner of viewpoints, most importantly, I want to discuss how Chris Dyer and I approach ESG in the international equity strategies we manage.

"We think of each of these letters 'E - S - G' as another source of information that helps us better understand the risks and rewards impacting a business today or in the future."

A lens on corporate business models

While we welcome the attention ESG is generating, we have already been using this approach for a number of years. To some, ESG means chasing popular investment themes, such as renewable energy. That is not what we do. We simply try to distill everything down to what really matters for any investor: risk and reward. Essentially, we use ESG as another lens to evaluate the sustainability of a company's business model and financially material issues. We think of each of these letters "E - S - G" as a source of information that helps us better understand the risks and rewards impacting a business today or in the future.

Consumer influence and regulation

A number of factors are forcing companies to implement more progressive ESG practices. For example, in consumer-related sectors, we have watched with interest at how changing consumer preferences have directly influenced business strategies and product lines. Here, an evolving customer base and generational shifts have moved environmental and social issues from side stage to main stage. At other times, regulation dictates the need for change. Parts of Europe were early in adopting renewable energy, with government policies promoting this change. Companies that got ahead of this curve, such as certain Spanish utilities, could adapt and position their business models for the future.

Other industries face more complex scenarios in looking at ESG risks. One Irish fossil-fuel distributor, for example, recently held an investor symposium titled, "Enabling the Energy Transition." The company hosted the event to address investor concerns about the company's ability to adapt quickly enough to a shifting energy landscape. Chris and I were fortunate to meet one-on-one with the CEO and discuss the topic ahead of the event, and it's an area we intend to monitor closely.

We have spoken before about governance reform being an important catalyst for financial improvement and alpha generation in Japan. We are seeing clear signs of change in Japan, driven by both regulation and a greater demand for accountability in how corporations manage themselves and interact with shareholders. We expect this to drive an increasing opportunity set of investment ideas.

A new dominant paradigm

ESG are three letters that will continue to dominate and divide opinion in the investment world. We analyze them in exactly the same way we evaluate any other important piece of financial or strategic information about a business. We believe the proprietary insights from our close collaboration with the Calvert ESG research team places us in an advantageous position relative to other investment managers that don't have this expertise.

The COVID-19 crisis we find ourselves in today is shining a light on new ESG topics, such as human capital management and the increasingly digital world we live in. For us, though, ESG is just another lens to evaluate the sustainability of a company's business model. We believe that if we start and end with this premise, we don't really have to worry about what others are saying.

Bottom line: For us, ESG is another lens we use to evaluate financially material factors and the sustainability of a company's business model in international equity markets. We rely on our close collaboration with Calvert's ESG research team to provide useful, proprietary insights on companies and industries.

About risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. The value of equity securities is sensitive to stock market volatility. Investments in foreign instruments or currencies can involve greater risk and volatility than US investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions. Investing primarily in responsible investments carries the risk that, under certain market conditions, a strategy may underperform those that do not utilize a responsible investment strategy.