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VALUE OR "VALUES"?

The trend towards environmentally and socially conscious decisions has become more of a mainstream focus opposed to the ideals of a few. With this shift in focus, more investors have shown an increased interest in ESG investing, or the practice of considering environmental, social and governance issues in their investments. ESG investors assess a company's ability to manage these issues while creating value for shareholders. For example, the "E" can include a company's water use system and its impact on the ecosystem, the "S" can include a company's supply chain transparency to promote fair labor and the "G" can include a corporate board's commitment to diversity. Key drivers in ESG investing gaining traction are found in both individual and institutional investment management. The demand is common in the largest intergenerational wealth transfer in history, with the Boomer generation passing investments to their heirs, as well as endowment and pension funds aiming to align investments with their socially conscious missions.

Previously viewed as a "niche" segment of investment management, investing in ESG focused companies was previously thought to involve a trade-off between value and "values", or sacrificing one's investment value potential for values one believes in. ESG factors are quantitively measured to determine if risk-adjusted returns are created. Many institutions, such as Thomson Retuers, Morningstar and MSCI, have developed a "scoring" system to quantify a company's ESG score. These off-balance sheet factors, which are oftentimes qualitative in nature, represent both risk and opportunity for companies and investors. Acknowledging the increased interest in these factors, several large asset managers have used these ESG scores to back test the performance of higher versus lower ESG rated companies. The BlackRock Investment Institute issued a report on its findings, stating risk-adjusted returns may not have to be sacrificed as "sustainable equity portfolios feature companies that offer some buffer against ESG-related risks and the potential of outperforming the broader market over longer time periods". While ESG Scores are relatively new to investment management, the study notes that firms with good corporate governance, environmental risk management practices and strong employee relations have been known to have lower corporate risk with a more likely chance to outperform. [i]

With the rising demand from firms' employees and investors for a greater emphasis on the ESG aspects of their businesses, companies are facing challenges both internally and in the market. Many firms have resisted or opted out of disclosing how specific ESG issues are addressed. Larger companies have greater resources to dedicate to sustainable causes or environmental studies, while smaller companies do not have the same ability. Some firms will resist because they don't believe they can keep up with investor demand for progress once initial disclosures are made. Other firms state its environmental impacts do not affect their bottom line, for example, and others state they simply are not able to collect useful information to disclose.

In the market, there is a lack of standardization across different institutions' scoring systems, lack of transparency in ESG funds, and an inconsistent understanding of what implies a weak or strong ESG score. A strong social score, for example, is based on a collection of different factors (i.e. daycare services, no anti-competition controversies, new women employees) but the factors that are meaningful for a financial services firm are not the same for a medical device company. A common misunderstanding is the inclusion of oil and gas companies in an ESG fund, which is a typical sector that sustainably conscious investors seek to avoid. Despite a lower environmental score, an oil company could score very well regarding social and governance issues, leading to a high enough rating to be included into the fund.

As a firm, RMC has acknowledged the increased investor interest in ESG standards, and has incorporated this in our investment process. ESG analysis is considered another component of fundamental research, and carries the same risk or opportunity as traditional financial indicators. While the evolution of considering these standards, specifically by a quantitative scoring system, currently poses challenges for investors, future progress in comparability and transparency should provide value to the research process. Performing a qualitative assessment of ESG factors has always been a practice at RMC. Positive employee relations or a strong corporate board structure, as examples, have long been considered qualities of companies that lead to increased shareholder value. As such, it is consistent with our fiduciary duty to have this analysis as part of our investment process. Incorporating ESG strategies could seem to require a large shift in holdings, however, that portfolio may already be creating value while aligned with one's "values".

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[i] BlackRock Investment Institute: Sustainable Investing: a 'why not' moment – May 2018

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