# RESEARCH INSIGHTS

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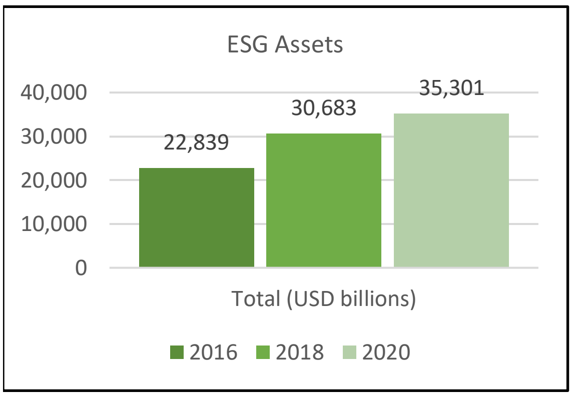
# Sustainable Investing

## *Fad or Future?*

**Sustainable investing may sound too good to be true. After all, who wouldn't want to do good while reaping returns? In this editorial, we explore if sustainable investing is the (profitable) way forward, or just another fad.**

## At a Glance

The sustainable investing industry grew to US$35.3 trillion at the start of 2020, a significant 15% increase from the previous two years (from 2018 to 2020) and 55% in 4 years (from 2016 to 2020). Sustainable Investing strategies, which include impact investing and ESG (environmental, social and governance) investing, were not recently developed, but have picked up in popularity in recent years as shareholders call for action and companies who fall short face repercussions.




## What is Sustainable Investing?

Sustainable investing challenges the way we view investing. Traditionally, individuals are attracted to invest through the expectation of returns with the input of capital. Of course, investors must also accept varying degrees of risks.
Sustainable investing retains the function of traditional investing: to generate profits, while incorporating environmental, social and governance-related (ESG) goals in order to spur positive change.

## How does Sustainable Investing work?

To invest sustainably, we first identify companies who build solutions to the world and society's issues while maintaining a profitable business model.
Usually, companies find ways to alleviate the problem through innovations in new technology, materials, or even viewing the world from a different angle. Through their work, problems are alleviated or even rectified, all while producing returns. These companies contribute positively to society through their operations and business activities.

## The Surge in ESG Investing

According to Credit Suisse, more than 85% of S&P 500 firms made their ESG information public in 2019, a great increase from 20% in 2013. You may wonder, why?
The key driver behind the rise of ESG investing would be investors' growing demand for transparency with regards to companies' stance on social issues and how they are acting for these causes. In response to this growing demand, companies have little to no choice but to adapt to consumers' changing preferences and expectations, or suffer negative financial consequences when they fail to respond to these signals. Potential and existing investors may decide to place their investments into other companies and funds that are better able to keep up with said trends.

## Moral vs. Economic Value of Sustainable Investing

Some investors see view sustainable investing as a source of economic worth, with opportunities as well as risks, just like other investment products. Others see beyond just the economic value of sustainable investments and recognise how such investments can align with their moral values.

Individuals may want their money to work for causes they deem 'good', while others do not wish to be complicit in or even encourage business activities which are seen to be damaging to society.

For example, an individual or a company may refrain from investing in the tobacco industry due to the ill effects of tobacco and would not want to be seen to be financing such activities. On the other hand, other investors would see no issue with such an investment as long as this investment in the tobacco industry reaps profits.

## Our Future with Sustainable Investing

With the Sustainable Investing movement gaining traction, the next decade will bring about a surge in investors demanding accountability and responsibility from companies.

This is very likely since the world's largest investors – pension funds, endowments, foundations, and labour unions – have begun to signal their keenness on ESG and sustainable investing considerations. These expectations will send a message to companies that they must begin to focus on such considerations to maintain the interest, support, and funding of these large investors.

Some examples of the world's largest institutional investors placing high importance on sustainability include Japan's GPIF (Government Pension Investment Fund) and the Netherland's ABP (National Civil Pension Fund). With $1.1 trillion in assets, Japan's GPIF is the biggest pension fund worldwide. In 2017, they selected three ESG indexes to aid in the integration of ESG considerations into their investments for their passive Japanese equities investments in 2017.

As for the Netherland's ABP (National Civil Pension Fund), the second largest pension fund in Europe, they declared two ESG-related goals in 2015, namely, to invest €5 billion in renewable energy by 2020 and to reduce its equity portfolio carbon emissions footprint by half, from 25 percent from 2015 to 2020.

These behaviours send strong signals to companies that sustainable investing and ESG considerations are becoming increasingly important and valued amongst investors, as such prompting them to align their business activities and practices to ESG and sustainability considerations.

It is unavoidable that huge companies capable of making waves will be called upon to do their part. To remain competitive, firms will have no choice but to keep up with changing expectations. Alongside this, ESG metrics will have to solidify in order for investors to better understand the impact of their investments and make informed decisions.

## Investing Sustainably to Achieve Global Goals

Employing sustainable investment strategies can help individuals, firms and even governments adapt to developments and changing global goals. For example, the Paris Agreement of 2015 is just one example of a global development which affected the sustainable investing and financial services industry. Entering into force in 2015, The Paris Agreement is a legally binding international treaty on climate change. Adopted by 196 Parties in Paris, the agreement holds the goal of maintaining global warning to below 2 degrees Celsius as compared to pre-industrial levels. The Paris Agreement was significant as it brought all nations together to share a common goal through actively adopting behaviours to combat climate change.

Another example would be the Sustainable Development Goals (SDGs), adopted by all member states of the United Nations in 2015, The SDG includes 17 globally set goals along with a total of 169 targets and 231 indicators which acknowledge that solving and alleviating issues such as poverty, among others, will come with implementing solutions which ameliorate standards of living, health, and education, abate inequality and encouraging economic growth. While the framework behind SDGs are state-based, investors as well as businesses have been strongly encouraged to work towards these goals. Companies across industries around the world, who are a part of the Global Compact LEAD initiative, have been leading businesses in aligning their business activity with the SDGs.

Sustainable investment products have different goals and areas of impact, where many share the same goals as those set out in the Paris Agreement as well as the Sustainable Development Goals, among others. Every time an investor chooses to invest sustainably, we get closer and closer to achieving these global goals.

## Sustainable Funds perform just as well as Traditional Funds

Sustainable investing can be lucrative while driving positive social and environmental change. According to Morgan Stanley, sustainable portfolios perform on par with traditional funds. Sometimes, even better. During market disruptions, they also experience less deviance.

One example of this would be the market crash which occurred in March 2020, amidst the COVID-19 pandemic. Sustainable funds fared better during the pandemic, where social and environmental issues garnered more attention. That year, in April and May, over 8.5 billion dollars went into sustainable investments. Difficult times like the COVID-19 pandemic forced companies to think about their long-term resilience, which often go hand in hand with sustainable business practices.

The favorable performance of sustainable funds during the pandemic shows us that prioritizing sustainability can be a financially advantageous move for corporations.

## Approaches to Sustainable Investments

According to the Global Sustainable Investment Alliance, there are seven core approaches to sustainable investments.

1. ESG integration

   The systematic inclusion of environmental, social and governance factors into financial analysis.
   ESG integration is the most reported sustainable investment approach in most regions and is the most subscribed strategy globally with USD25.2 trillion in assets as at 2020.

2. Corporate engagement & shareholder action

   Allowing shareholders to influence decisions regarding corporate behaviour.

3. Norms-based screening

   Holding investments to minimum standards of business and international norms set by the United Nations, the Organisation for Economic Co-operation and Development and Non-Governmental Organisations.

4. Negative/exclusionary screening

   Excluding particular companies, countries or sectors from a fund or portfolio based on exclusion criteria such as socially frowned upon products and activities such as weapons and tobacco, negative news, as well as socially or environmentally harmful business practices.

5. Best-in-class/positive screening

   Choosing to invest in sectors, companies or projects that have achieved a relatively good ESG or sustainability rating as compared to others in their respective industries.

6. Sustainability themed/thematic investing

   Specifically investing in themes such as sustainable agriculture in order to achieve positive environmental or social outcomes.

7. Impact investing and community investing

   Impact investing is investing with the goal of making worthwhile impact on society and the environment.

   Community investing occurs when capital is directed to individuals and communities who have been inadequately provided for. It also includes the financing of businesses that possess a clear social or environmental purpose.

## Criticisms surrounding Sustainable Investing

### Absolving governments of responsibility

Critics argue that sustainable investing may take responsibility away from governments to act against issues such as climate change. If we leave all the responsibility to firms and individuals to invest in and finance only socially and environmentally conscious products, are we absolving the government of their duty to enforce climate change fixes such as carbon tax and solutions such as cap and trade? Despite all the merits of ESG-focused strategies by firms, government intervention is still necessary to truly make an impact in the market.

That said, we can recognise that the best outcome can be generated through industry movement along with effective government policies.

### Accounting and reporting standards for ESG

The development of corporate reporting of ESG factors is still in its very early stages, especially when compared to traditional financial reporting. Furthermore, the lack of legal requirements for the disclosure of ESG reporting standards results in uneven and unstandardised ratings. In order to tackle this issue, the World Economic Forum is working towards the development of the new International Sustainability Standards Board.

### Greenwashing

According to Robeco, Greenwashing is the practice of misleading consumers to believe that a corporation is adopting more sustainable practices as compared to what is truly the case. Companies may attempt to greenwash for public relations reasons, and/or to attract more investors with this premise. For example, an asset manager may practice greenwashing through misleading consumers with false claims regarding the environmental or social merits of a product when the reality is much different. Socially and environmentally conscious consumers may choose to invest in a company or product based off these false claims.

Ultimately, investors are the ones who collectively possess the biggest influence and hold the power to pressure companies into being accountable. Investors must also make use of their voice and power to express their demands. At the same time, industries must encourage organisations to work towards a standardised ESG data reporting standard and encourage firms to uphold these standards.

## Writer's Opinions

### Long way to go, but here to stay.

Despite the challenges that come with sustainable investments, such as unstandardised accounting, reporting standards and greenwashing, these issues are highly likely to be attributed to the infancy of the field and relevant organisations have already taken steps towards refining processes and working towards eliminating such issues.

Given the rapid growth of the sustainable investing industry and the uptake of sustainable investments by some of the world's largest investors, it is safe to say that sustainable investing is not going anywhere. Rather, it will become a norm as the world continually becomes more socially and environmentally conscious.

Big names like Bloomberg, S&P and Moody's, among others, are providers of ESG ratings. Dun & Bradstreet, a global business intelligence company also provides ESG ratings alongside company details such as company address, revenue and phone number, allowing anyone who does a google search to get an idea of how each company fares in ESG rankings, as well as when compared to others in the same industry. The adoption and acceptance of sustainable investing by big industry players indicates that they believe sustainable investing is not going away any time soon.

In time to come, ESG integration and socially conscious business activities will become an expectation rather than a "bonus" for companies to have.

In this editorial, we established that engaging in sustainable practices can be financially advantageous for corporations. As for individuals, sustainable investing presents an opportunity for us to seek funds which align with our beliefs and personal values. Why not profit while contributing to a positive impact on the planet, as well as people in our community and beyond?

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