ESG, millennials, local market opportunities

Let's get mainstream and make a difference

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Mounting interest in Environmental, Social and Governance (ESG) investing is helping build momentum for impact investing – and in particular support for the United Nations' sustainable development goals.

That is positive for the world's emerging economies. But they still need to build robust processes if they want to win the trust of investors.

What is behind this upsurge in ESG investing?

I believe two factors are at work.

One is the general finding that funds incorporating ESG metrics perform at least as well as, and sometimes better than, those that pick their holdings from the broader market.

This runs counter to investing theory, which maintains that returns increase with the size of the investable universe. The more choice you have, the better your returns should be. Strict screening for ESG factors radically reduces that choice.

But several studies have shown there is no downside to ESG investing. Some, including a notable one from Harvard Business School, have demonstrated clear upside. Similarly, indices based on shares that score high on ESG have generally outperformed their more general peers by a small margin over the longer term.

Fund managers now engage with companies to understand their ESG performance, their values and the sustainability of their business model, integrating these insights into their standard analysis to highlight not just risk but also opportunity.

The moral of all this is that by adding ESG metrics to the tools you use as a fund manager can actually enhance returns.

So why not do just that?

Changing investor demographics

The other big factor, I believe, is shifting investor demographics – and in particular the increasing influence of women and millennials.

Women are now a powerful force in the investment world. At an event organised by InvestmentNews in London late last year, one panellist said women now control up to half of Britain's wealth and most have an avid interest in ESG strategies.

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Several studies have shown that a large proportion of millennials also look to combine investing their money with 'doing good'. The latest global investment study from Schroders showed the 18 to 35-year old group was likely to stay invested in a positive ESG investment for longer than older investors.

Growing awareness of the effects of man-made environmental impact, concern over ethical sourcing, and a variety of social and governance factors – all combine with the search for sustainable long-term returns to suggest ESG investing is rapidly going mainstream.

Going beyond ESG: impact investing

The same cannot be said of impact investing, which is the younger and smaller cousin of ESG investing. However, like ESG, it is firmly on the rise.
Read more on impact investing on wikipedia.org

Impact investing is defined as 'investing to generate a measurable, beneficial social or environmental impact alongside a financial return'. It is the bridge between philanthropy and market-rate capital.

The Global Impact Investing Network (GIIN), a non-profit in this area, tracked almost 8,000 related deals in 2016, involving USD 22 billion.

In its latest annual survey it said fund managers "see significant interest from most investor types, especially foundations, family offices and banks, and growing interest from sovereign wealth funds, pension funds and insurance companies."

Need for robust processes

The survey also found that around 60% of impact investors studied were either tracking the UN's Sustainable Development Goals (SDGs) in their investments or were planning to in the near future.

This brings me back to my last article, which looked at the impact international investors are increasingly having on emerging economies by targeting the SDGs.

All the numbers point in one direction: there is a mounting pool of long-term capital waiting for the right opportunities in the developing world. But markets that are potential recipients must have the right processes in place to manage the investment flows and the investor actions that follow.

As a key conduit within the investment ecosystem, Euroclear continues to work with many of these countries to help them structure their tax and regulatory systems to meet the needs of international investors. And that is an important part of making the UN's development goals a reality.

It's a brave new world for sure.