Prescient
INVESTMENT MANAGEMENT

Why ESG naysayers are wrong, and this powerful risk management tool is here to stay.

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ESG's role in investment management is being increasingly criticised and minimised globally. Some US asset managers are reportedly rethinking the usefulness of integrating ESG and sustainability measures into their decision-making process.

However, the evidence shows that, if taken seriously, integrating Environmental, Social, and Governance (ESG) into investment processes offers enduring value for clients. It is not just a hallmark of responsible investing but also a strategic imperative for delivering superior, risk-adjusted returns.

Two studies, in particular, highlight ESG's contribution to investment results. Morningstar research into the performance of sustainable funds versus traditional funds over a 10-year period found that '*58.8% of sustainable funds outperformed their traditional peers*'. Meanwhile, the NYU Stern Center for Sustainable Business research aggregated findings from 1,000 research papers authored between 2015 and 2020 and found a positive relationship between ESG and financial performance in 58% of the corporate studies.

Not all asset managers are ESG sceptics or greenwashing.

Still, it is a reality that there are asset managers who are not truly committed to unlocking the benefits of incorporating ESG in their investment processes, and greenwashing does exist. However, it is not accurate to generalise that these are common occurrences across the entire industry.

Many asset managers do take ESG seriously. At Prescient Investment Management (PIM), we have long championed integrating ESG factors into our investment processes because for ESG to be effective, it must be rooted in rigorous, evidence-based methodologies. Thus, our ESG strategy is not a superficial add-on but a deeply integrated component of our investment process. Our systematic approach, supported by extensive data analysis, ensures that ESG considerations are genuinely embedded in our decision-making.

ESG as a sustainability framework is working

While there may be challenges in standardising and implementing ESG criteria, dismissing the entire framework ignores the significant strides made in this area. Research consistently shows that ESG integration leads to better risk management and long-term financial performance, as long investment processes ensure non-financial risks are identified and managed effectively within an ESG framework.

We believe ESG is not a mere vehicle for 'saving the world,' which has contributed to its waning popularity, but a fundamental pillar of a comprehensive investment strategy. The positive strides we've seen include the growing adoption of ESG criteria across multiple asset classes, developing innovative ESG-linked financial products, and the increasing collaboration between investors and companies to drive meaningful change.

These advancements underscore the enduring value of ESG in the investment landscape and highlight its potential to enhance both financial performance and societal impact.

Politics aside, ESG is primarily a modern risk management tool

While US political stances informed by climate change and ESG naysayers may influence the global discourse around ESG, ESG is not a politically motivated concept but a critical aspect of modern risk management. The evolution of ESG practices has led to more sophisticated risk assessment models, enhanced corporate transparency, and closer alignment of investment portfolios with long-term sustainability goals.

Regulation 28 of the Pension Funds Act also mandates that fiduciary investors consider quantitative and qualitative risks, including ESG factors, in their decision-making processes. This regulatory requirement underscores the importance of ESG as a fiduciary duty and a crucial non-financial risk assessment.

Thus, the focus should be on the objective benefits of ESG integration, such as enhanced risk management, improved corporate governance, and sustainable long-term returns. At PIM, we remain committed to ESG integration, independent of external influences, because we believe it is essential for achieving superior, risk-adjusted returns for our clients. It provides a deeper understanding of potential risks and opportunities and ensures that clients' portfolios are resilient and positioned for sustainable growth.

Through our systematic and holistic approach, combining quantitative analysis derived from vast amounts of data with qualitative insights, we are committed to remaining a forerunner in the industry. ESG factors will always inform our investment decisions, ensuring that our clients' capital can withstand growing climate change risks, ever-present societal challenges and corporate governance transgressions.

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