

## Looking further than environmental, social and governance (ESG) ratings

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Global trends indicate that the flow of capital has been reshaped by the dawn of responsible capitalism. Sustainability considerations, and sustainable finance are major factors to financial decision-making as climate and social changes continue to influence global markets.



**Carole Millet**

Senior Investment Advisor

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A major factor to investor capital is influenced by companies who are seen to behave responsibly with regards to conscious capitalism. With that in mind, companies have not sufficiently prepared for the mounting regulations and shareholder pressure they will face under an intensifying ESG lens. A deep impact in performance is the result of firms who have failed to evolve their businesses.

### Avoid the herd

We are encouraged that pressure is mounting on companies to improve their ESG metrics due to pressure from regulators and investors, mainly institutional investors. However, we believe the hot money flowing into companies with a higher ESG score is stoking a bubble, where investors are following the herd without looking deeper and allowing for a big picture view. For Banque SYZ, ESG ratings are an integral part of the investment process to consider when assessing ESG risk, but we have found that adding more insightful and individualised research can reveal far more valuable information about the future value together with the ESG sustainability of a company. Sustainable long-term investment must combine analytical ESG tools such as ratings together with fundamental bottom-up analysis to determine where cash generation and return on equity can justify valuations.

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Larger capitalisations currently dominate ESG-labelled funds and investors often - without realizing it - invest in the same way, multiplying risk. This could lead to a risky bubble and hinder the global transformation to more sustainable investing. Ignoring small firms in the sustainable chain avoids a rich vein of alpha opportunities, as micro and small caps are the cradle of entrepreneurs. If investors adopt a herd-like mentality and only invest in large cap best-in-class companies displaying the highest ratings, it can lead to valuations becoming detached from reality.

## Going a little further

The consideration of ESG ratings is essential, not only in managing investment funds but also in the advisory functions. Plugging the non-financial data into traditional analysis adds value, however it is important to go a little further in our assessments. "At Banque SYZ, this means understanding what the future challenges are that a company might face and considering how those challenges will affect earnings", says Carole Millet, Lead on the responsible investments.

The exercise becomes more arduous when we consider smaller-sized companies, as most are frequently under-research by analysts. However ignoring smaller firms means missing out on a big pool of opportunities.

Embracing sustainable investment is not a race. It is about making incremental gains through a combination of analysis and engagement. In order to affect positive change; we must assess impact and exercise engagement when evaluating a potential fund or investment.

A key consideration, to also bear in mind, is that it is more difficult to maintain a high ESG ratings score than reshape a company to improve a low score. Will it have more impact having a few companies with high ESG scores or many companies improving low scores?

Many offers today are packaged around environmental issues – something which is increasingly aligned to investor objectives. If we want to be active and successful in fighting climate change, we should think creatively and design new products that will reward investors - the basic principle of investing - and support companies that want to ensure a better future and a healthier planet for the next generation. Ultimately, though it all starts with good governance, and a real motivation to reduce societal and environmental impact. So the "S" and "G" are as pivotal in the analysis in determining a worthy candidate for investment as the "E".

ESG investment decisions are increasingly shaping the future by advancing market transformation. At Banque SYZ we believe these investment market-led changes will act as a force for good on a truly massive scale.



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