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Investors See 'Material Risk' in Ignoring ESG

Asset owners expect environmental factors will be more material than traditional financial criteria in the next five years, according to a UBS survey.

By Christine Idzelis June 11, 2019

Krisztian Bocsi/Bloomberg

Large investors believe ignoring environmental, social, and governance criteria when allocating capital would imperil their portfolios, according to a UBS Group survey.

Asset owners expect environmental factors will become more pertinent to their investments than traditional financial criteria over the next five years, with more than 80 percent indicating it would be a "material risk" not to integrate ESG factors, UBS Asset Management said Tuesday. In a study with news and research provider Responsible Investor, the firm probed more than 600 investors with about €19 trillion (about $21.5 trillion) of assets globally.

Seventy-eight percent of asset owners representing pensions, endowments, and sovereign wealth funds are already integrating ESG into their investment processes, with Europe being the most active region, the survey found. While such investing may feel good, PG&E Corp.'s bankruptcy this year underscored concerns that brushing off environmental risks such as the threat of wildfires can lead to investor losses.

"ESG is not ethical investing," Saker Nusseibeh, chief executive officer of London-based Hermes Investment Management, said Tuesday during a roundtable discussion on responsible investing at The Lambs Club in New York. "It is trying to apply a set of matrixes. It turns out, that's just old-fashioned, long-term investing."

[*II* Deep Dive: Investors Ignored This Risk in PG&E]

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Investors should be jumping at the chance to allocate to strategies tied to climate-change strategies, argued GMO founder Jeremy Grantham and a co-author in a recent paper. He said climate change has become a major risk to the economy as hurricanes, droughts, and wildfires cause record damage, and laid out a case for investing in green energy companies.

As investors embrace ESG, artificial intelligence may help shape their strategies. For example, Acadian Asset Management, a Boston-based quantitative investment firm with $97 billion of assets at the end of April, is evaluating the use of machine learning to pick stocks based on ESG factors.

Some asset owners are asking for a portion of their private-market exposure to be dedicated to impact investing, according to Julia Cormier, director of alternative investments at Russell Investments Group. Russell provides outsourced-chief investment officer services to pensions, endowments, and healthcare organizations, among other institutions. A European corporate pension client of Russell, for example, invested in a hospital to increase the number of beds available to local residents, Cormier said Tuesday in a phone interview.

Russell’s OCIO clients are expressing diverse views on how to integrate ESG-related factors into their portfolios. The investment style goes beyond screening out publicly traded companies that sell goods investors oppose, such as firearms or tobacco, Cormier said. “We’re definitely seeing an evolution.”

Just under half of investors (48 percent) who adopt ESG strategies view them as positive for financial performance, according to the UBS survey. Yet more than half have those surveyed admitted that they have not assessed the return impact of integrating ESG factors. That may be because the strategies are relatively new to their portfolios, according to the report.

This story was reported with assistance from Leanna Orr.

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As Competitors Shed Staff, MFS Is Hiring

The active manager is betting on global fixed income, and bringing in staff from rivals to support the effort.

By Julie Segal June 11, 2019

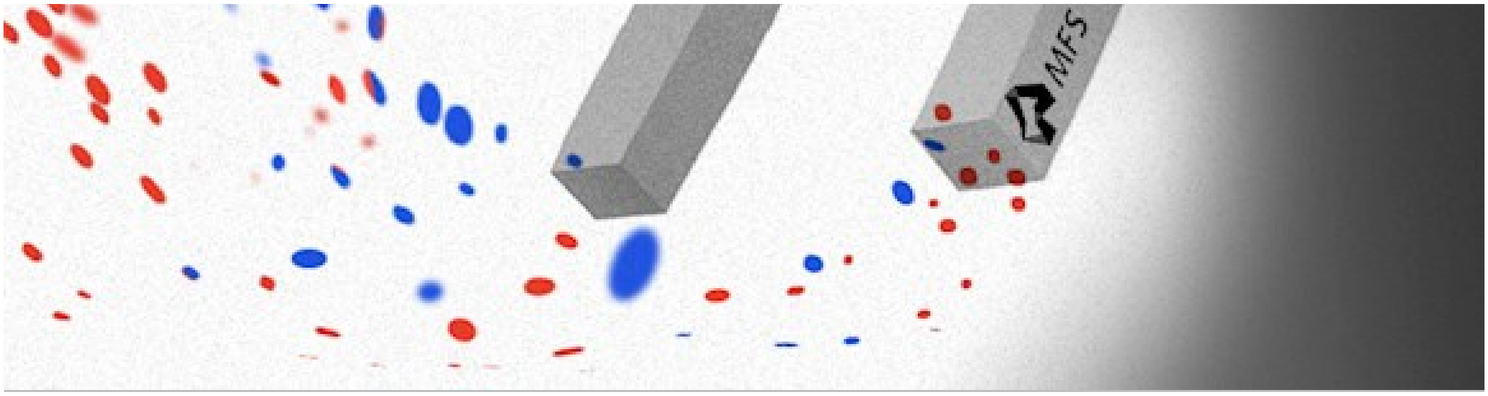

Illustration by II

Boston-based MFS Investment Management is one of the few active management firms in hiring mode, as the trend to passive persists unabated.

MFS is staffing up in particular to support a multi-year build-out of its institutional fixed income platform.

"We're investing in active fixed income at a time when the headlines aren't great," said Bill Adams, chief investment officer of fixed income at MFS, a subsidiary of insurance company Sun Life.

[*II* Deep Dive: Why Machines May Replace Active Bond Managers]

"When we bring new investors [portfolio managers] into MFS they're saying, 'We really appreciate the commitment to active,'" Adams told *Institutional Investor* in an interview. "We're getting really talented people because so many others are disinvesting in this business. But that is short-term perspective. Are there challenges for 2019? Yes, but we don't run this business for one quarter or one year. If we can find the right people now, we think it's the right outcome for shareholders."

Adams explained that low interest rates around the world make an active approach to fixed income crucial, especially during the next downturn. Searching for yield, investors have moved into riskier areas of the bond markets. When credit becomes tighter, defaults will rise and investors will experience volatility and losses.

"Traditional fixed income plays an important role in a fully diversified portfolio and you need to manage it in line with the characteristics of the asset class," said Adams. "When we go through a cyclical event, investors will learn that through fundamental research globally, we can build better solutions and generate alpha over and above passive."

MFS isn't entirely new to fixed income, but it has historically focused on global equity strategies.

With institutional investors increasingly interested in multi-asset products, the firm moved to develop as broad a platform in fixed income as it had in equities. In addition to customized strategies for institutions in the past few years, the firm has launched two new bond products this year. In April, MFS started an emerging markets debt product that combines corporate credit denominated in U.S. dollars and local currencies into one portfolio. In February, the Boston-based company launched a European credit strategy for non-U.S. retail clients.

MFS has been quietly seeding some fixed income strategies to develop their track records. "We wanted to institutionalize the platform, so we could withstand scrutiny. We couldn't just assume fixed income flows would come," Adams said.

Since January 2018, MFS has added 14 investment professionals in fixed income, including an ESG (environmental, social, and governance) analyst. Nine staffers recently joined in Boston and five in MFS' London office. The firm is currently in the process of hiring two fixed income professionals for its Singapore office, which is its bond hub in Asia.

Another trader is to start shortly at the London office, MFS said, which will bring the team there to 14.

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