

<https://blog.en.erste-am.com/esg-too-much-of-a-good-thing/>

ESG: Too much of a good thing?

Walter Hatak



For a long time, the ESG sceptics could not really be heard in all the noise around the megatrend that sustainability has become in recent years across all sectors. There is hardly a corporate strategy in sight that does not bring up sustainability, hardly a lifestyle product that does not come with a planted tree pledge when you are buying it.

Megatrends tend to be put to the test after a while. This either puts an end to the trend or reinforces it by decluttering and focusing it. Hence, the headwind that ESG investments are currently faced with can also be read from a positive angle. But what are the main points of criticism?

1. Hypothesis: ESG is dying from its own success

In separate blog entries, my colleagues will be discussing a recently published, scientific paper in detail. For now, let me only describe its basic premise: due to the megatrend of sustainable investing, all investors are trying to buy those companies that are considered best from a sustainable (ESG) perspective. However, once all investors have bought the ESG pioneer for their portfolio, this company will not be able to record any gains any longer in the future because there are no buyers anymore. Since the stock exchange is a place of trading the future, this should push the return on brown (i.e. non-sustainable) investments above that on green (i.e. sustainable) investments.

In other words, has the outperformance in recent years been the exception, and will ESG investors earn a less significant performance in the future? The aforementioned premises are fortunately easy to rebut, and there is little need to worry:

- THE undisputed model company that every sustainable investor wants to hold in their portfolio does not exist. Depending on the understanding of sustainability as held by the respective investment company, the global orientation, and the focus of the fund, different companies qualify as sustainable investment.
- If certain companies have been identified by a sustainable investor as pioneer in the sector, they do not automatically keep this label for life but remain locked into ongoing competition. Today's best can be tomorrow's worst.
- There will always be ESG sceptics, just as there are sceptics in other, well-researched areas. If the aforementioned paper had a lot of supporters, the investors following its rationale would prefer to buy brown investments (thinking erroneously that would earn them higher rates of return) and thus (ironically) refute the underlying assumption (i.e. all investors wish to buy sustainable investments).

2. Hypothesis: sustainable investors do not make the world a better place

In addition to science sceptics, we have also seen doubts from the sector itself in recent months. The former Head of Sustainability of one of the world's biggest investment companies one day commented that the understanding of sustainability as embraced by his house did not come with any positive contribution for the world. Rather than investors exerting pressure on the specific companies, politicians should do so.

Who exerts pressure on whom?

The exchange between politicians and the economy is very important for the future of a country, as it determines jobs, tax revenues, competitiveness, and investments. The assumption that national governments can exert large amounts of pressure on global companies is just not in line with reality. In fact, if anything, there is pressure going the other way, not the least from various lobbying groups, which represent their sector interest in a bundled form. However, that is not necessarily also in the interest of long-term investors. For example, it may be profitable in the short run not to take any measures against climate change regionally. But in the long run this puts the innovative power and the international competitiveness at risk, if other countries decide on stricter measures that are then implemented successfully by the companies.

Sustainable investing works!

In order for the public statements of the oil sector not to be in diametric opposition to their private opinion, we have – in collaboration with other investors – successfully demanded transparency with respect to memberships and donations at lobbying groups.

This is one example of many where we managed to effect positive change as sustainable investment company. We document this annually in our public engagement and voting report. This way, you can check and hopefully come to the conclusion that sustainable investors do make the world a slightly better place.

ESG has not reached its destination yet, unfortunately

My colleagues and I are looking forward to the day when ESG has become irrelevant. This will be the day when climate change has been beaten and social grievances in companies have been done away with. It will still take a while though.

Legal note:

Prognoses are no reliable indicator for future performance.

Legal disclaimer

This document is an advertisement. Unless indicated otherwise, source: Erste Asset Management GmbH. Our languages of communication are German and English.

The prospectus for UCITS (including any amendments) is published in Amtsblatt zur Wiener Zeitung in accordance with the provisions of the InvFG 2011 in the currently amended version. Information for Investors pursuant to § 21 AIFMG is prepared for the alternative investment funds (AIF) administered by Erste Asset Management GmbH pursuant to the provisions of the AIFMG in connection with the InvFG 2011. The fund prospectus, Information for Investors pursuant to § 21 AIFMG, and the key investor document/KID can be viewed in their latest versions at the web site www.erste-am.com or obtained in their latest versions free of charge from the domicile of the management company and the domicile of the custodian bank. The exact date of the most recent publication of the fund prospectus, the languages in which the key investor document is available, and any additional locations where the documents can be obtained can be viewed on the web site www.erste-am.com.

This document serves as additional information for our investors and is based on the knowledge of the staff responsible for preparing it at the time of preparation. Our analyses and conclusions are general in nature and do not take into account the individual needs of our investors in terms of earnings, taxation, and risk appetite. Past performance is not a reliable indicator of the future performance of a fund.



Walter Hatak

Head of SRI Investments, Erste Asset Management