CAN WE MAKE THE WORLD A BETTER PLACE WHILE IMPROVING INVESTMENT RETURNS?

Jeremy Schwartz — Global Head of Research
08/25/2020

ESG (environmental, social, governance) investing is one of the trends gaining traction in the investment world. We had a great guest on our Behind the Markets podcast last week to discuss how his firm provides ESG ratings and analytics to help "make the world a better place" while also focusing on improving investment outcomes. Ben Webster is the CEO of Owl Analytics, whose ESG composite risk scores are used by WisdomTree in our ESG investment strategies.

Webster is convinced there is a way to make the world a better place while also increasing your risk-adjusted returns by considering environmental, social and governance issues.

In the United States, investors have been interested in socially responsible investing (SRI) for a long time, and Webster described SRI as a process that screens companies in an eligible investment universe through an ethical lens based on the type of business they conduct. Common screens in this SRI world generally eliminate businesses involved in, for example, tobacco, energy companies and cluster munitions. Webster described this as a fringe part of the investor base but acknowledged that it has been increasing. In Europe, on the other hand, there is a much larger share of the investing base that invests this way.

What has changed though, according to Webster, is that an increasing number of academic papers have demonstrated the value added by companies that score highly based on ESG considerations. Several papers document the value added from Owl Analytics' ratings, including a study from Axioma that looked at their data in a sector-neutral fashion to remove the impacts of just under-weighting in sectors and industries that are not ESG-friendly based on the fundamental nature of their business, such as energy companies.

For those interested, here is some of the research to read:

1. "Going 'Green' is the Profitable Future – A Global Perspective" by Ralf Conen, Stefan Hartmann and Markus Rudolf
2. "Sustainable Investing and the Cross Section of Maximum Drawdowns" by Lisa Goldberg and Saad Mouti
3. "ESG's Evolving Performance: First, Do No Harm" by Axioma

Webster made one analogy that compared ESG ratings to the sports world. Everyone can look at traditional stats in picking a fantasy sports lineup. But if there was information on one player taking care of their body, eating healthy, training in ways that do not show up in traditional stats—and another player doing the opposite—that would motivate trading for those "healthier" players. To Webster, ESG considerations are similar: They go beyond what investors focus on in mainstream analysis but ultimately give reads of "healthier" companies.

This was an interesting conversation on the application of ESG investing principles. Please listen to the full conversation with Ben Webster below.

Behind the Markets on Wharton Business Radio · Behind the Markets Podcast: Ben Webster

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DEFINITIONS

ESG : An acronym for environmental, social and governance, ESG standards quantify the degree to which a company is socially responsible. .

Risk-adjusted returns : Returns measured in relation to their own variability. High returns with a high level of risk indicate a lower probability that actual returns were close to average returns. High returns with a low level of risk would be more desirable, as they indicate a higher probability that actual returns were close to average returns.

Sector-Neutral : refers to a sector weight constraint that aims to match that of a respective benchmar.