Australian Standfirst

Scrutinising ESG Rigour When The World Grinds To A Halt

Responsible Investing

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Mike Tyson said it best that everybody has a plan until they get punched in the mouth.

Environmental, Social & Governance, or ESG, fit the bill when it came to on-trend vocabulary but what's been interesting to closely monitor during *March Madness* has been how those validated as ESG before March, have kept to their plans, rigour and responsibilities after mayhem and quantifiable challenges ensued.

Also, especially regarding Environmental elements of ESG, in many instances it has always been somewhat theoretical to truly determine what positive or negative footprint any given company, industry, sector or even country has had at any given moment in time, **until now**, given that it's the first time since the Industrial Revolution of the nineteenth century that the vast majority of the developed world has ground to a halt in near-unison.

As collectively painful as this may be, the silver lining is that we can for the first time in modern history, measure carbon dioxide changes, marginal pollution zones and absolute energy consumption levels in jurisdictions ranging from the metropolises of the United States' East Coast to the Amazonian fringes of Brasil, Perú, Bolivia, Colombia, Venezuela, Guyana, Suriname, French Guyana and Ecuador.

The hallmark of quality businesses is that they deliver high returns on capital during either ends of the business cycle spectrum but to pass ESG muster has meant more and the current unprecedented global halt provides us all an opportunity to ascertain who truly are deserving of ESG recognition and whom needs to rise more to the occasion.

Collective confidence that investor focus on long-term sustainability challenges is not fleeting is important if ESG is to survive as a yardstick and endure as a standard of excellence.

At Australian Standfirst, we begin our global macro, top-down ESG carbon analysis by tracking *Carbon to Value Invested* (CVI), *Carbon to Revenue* (CR), *Weighted Average Carbon Intensity* (WACI) and *Fossil Fuel Reserve Emissions* (FFRE) statistics monthly via our firm's chosen ESG benchmark, the S&P Global LargeMidCap Ex-Australia and New Zealand ESG and Green Bond TR 70/30 Monthly Blend Index – we will keep readers *up-to-date* on how these measures track over this and the coming months.

↓ CLICK VIDEO BELOW TO PLAY

→ PLAY **Watch:** Dame Jane Goodall & Stirling Larkin discuss conservation at Australian Standfirst's Infinity Black Digital Studio, 10 May 2019.

Beginning with these four broad metrics to measure an investment portfolio's carbon footprint, allows the DDPM team to better understand and communicate a portfolio's exposure to climate risks with clients.

Weighted Average Carbon Intensity, or WACI, for instance, allows us to understand and disclose to clients, our portfolios' exposure to climate change-related risks in relative real time.

WACI does have limitations however – it relies on carbon footprint analysis, an important starting point that itself has limitations.

It applies only one lens and is backward-looking; it doesn't encompass company policies and other forward-looking information that may change and it excludes short positions, sovereigns, derivatives, securitised products and bonds issued by trusts.

The example of WACI analysis highlights that the broader challenge for all lies in the extreme diversity of disclosures, leading to hundreds of often industry- or company-specific reporting conventions, with selective and uneven subject matter emphasis that makes knowing what to focus on extremely difficult.

Fortunately, however, to dive deeper and to even take charge of one's own assessments has become easier for the self-directed and proactive Australian investor, with audited data-sets available via the World Trade Organisation, helpful and practical insights into how one best tracks metrics in real time and any number of dependable leading indicators, which serve to pre-empt economic, environmental and potentially political disruptions to come.

Proactively investing through a longer-term ESG lens involves weighing factors that could impact an invested company or sectors future cash flows and sustainable values and in the best of worlds, investors naturally will attempt to seek to reward strong ESG companies, not be wrong-footed by isolated ESG events (such as Elon Musk's 7 August 2018 Corporate Governance *faux pas*) and generate superior risk-adjusted returns.

Finding a framework capable of directing capital toward good ESG performers is part of the challenge but equally, ensuring good is actually being achieved is a further part to fulfill the rigour ESG portfolio management requires.

But of the obstacles to deep integration of ESG into an investing framework, the most sobering relate to the amount and quality of data and again, one of the few silver linings of *March Madness* in 2020 is that **for a short window of time**, we can empirically ascertain the impact a seismic drop in global commerce has on our environment, what we currently understand to be our social fabric and the governance that claims to balance all.

Please read more and we welcome your feedback at Responsible Investing Optimisation, Understanding In Three Easy Steps. ■

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