In the Midst of COVID-19, Don't Forget About Earth Day

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by Team
of Russell Investments

It's easy—and perhaps even appropriate—for the current global pandemic to push other key issues from our minds. But on Earth Day, we feel it's vital to talk about one such issue: the intersection of investing and our planet.

As a global company, we perhaps feel a keener connection than some to issues impacting the earth. From our corporate offices in Seattle, we look west to the waters of the Puget Sound and the Olympic Mountains, east to the Cascade mountain range, and, if it's a clear day, see majestic Mount Rainier on our southern horizon. It's a stunningly beautiful place to call home and we want that beauty to last. And, our associates in offices in London, Australia, New York, and throughout Europe and Asia, love the beauty of their local environments just as much. We personally feel the impact of Australian wildfires, because we have colleagues and clients impacted by them. We worry about rising seas in The Netherlands for the same reason. And we're concerned about melting glaciers near to Seattle, where we work and live, so we try hard to minimize our own negative impact and maximize our positive effect.

We're an investment company, and our mission is *improving people's financial security*, so our primary focus is always on delivering solutions that help our clients meet their desired investment outcomes. But we also believe that focus is in no way at odds with protecting our planet. We consider true responsible investing as a long-term approach that accounts for a wide range of complex environmental, social and governance (ESG) factors. We believe that responsible investing *and* performance can be complementary. Our responsible investment solutions aim to capture the right exposure without jeopardizing returns.

The most material response we feel we can bring—one that is aligned with our purpose—is to empower our clients who desire to embrace responsible investing. This is no simple task. Meaningful work is always hard. So we challenge ourselves and our industry to take it seriously, to lean into the complexity, and to work to deliver the meaningful outcomes our clients desire.

A focus on materiality

A key focus at our firm is to ensure that the desired ESG outcomes of our clients are met in a meaningful way. As our associate Emily Steinbarth recently noted, it's easy to check the ESG investing box without achieving the material ESG outcomes an investor may desire. Emily explains how big technology stocks dominate ESG funds. But tech companies are not usually associated with the big ESG issues like climate change, renewable energy, or diversity. So, are investors being fooled?

To answer that, we need to dig deeper. *Which* tech names do they hold? And *why* did they hold them? Were tech companies selected just because they happen to be low carbon emitters? Is that how we think a tech company should be judged? Or did they score well on some ESG rating methodology with a few hundred inputs?

Rather than adopt a one-size-fits-all approach, it pays to look at the small number of sustainability issues that have the biggest impact for that company. When it comes to measuring ESG impact, we think that materiality matters. Are the ESG efforts of a company material? For example, if a tech company and an airline both claim to have reduced fuel consumption by 25%, that effort is clearly more material to an airline than to tech. Some ratings may miss this, so we've developed a scoring approach that focuses on the material impact that ESG efforts may have on a company. Armed with this scoring, investors are better equipped to make meaningful decisions. Read Emily's latest update on materiality scoring to get the complete picture.

Performance *and* responsibility

Does an ESG-related mandate require a performance hit? No.

In most cases, there are two reasons investors care about ESG issues. An often-cited reason is *values-based*: The investor wants to include or exclude securities because of a specific values-based world view. The other reason is *value-based*.

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Investors, seeking to generate excess returns, are looking at ESG issues for performance and risk-mitigation issues. For example, growth investors may see green energy as a growth opportunity or a restructured governance process as a way to realize a price correction. These two factors—values and investment value—are different. Our colleague Leola Ross explains how they can be addressed at the same time and may, in fact, be complementary.

Is this two-pronged approach harder than investing for just one goal or the other? Like we said, meaningful work is always hard. At Russell Investments, we've been researching investment managers for five decades. We currently monitor more than 13,000 manager products—an undeniably large universe. And out of all those managers, our research tends to find that approximately half have above-market ESG metrics and half do not. In particular, manager products with both above and below-market ESG metrics still have earned a *hire* ranking from us—no easy task. In other words, approximately half of our recommended managers are expected to deliver value AND exhibit holdings with above-average ESG metrics. SO THEN, can we deliver an ESG mandate while delivering strong performance? We believe the answer is yes. Read Leola's full report on our analysis.

Looking beyond equities

While ESG was initially a hot topic for equity investors, fixed income market investors are taking notice and practitioners are quickly catching up. Our colleague Yoshie Phillips recently reported on the rapid expansion in ESG integration practice among fixed income asset managers in recent years.

Fixed income investing is primarily about diversifying from and moderating the risks associated with equity investing, which is true even for the riskier securities such as high-yield bonds and emerging markets bonds. It is not surprising, then, that ESG considerations are mainly considered a risk-mitigation exercise in fixed income investing. ESG factors tend to have a long-term outcome that corresponds well for fixed income investing where the investment horizon also tends to be long-term.

In our 2019 Annual ESG Manager Survey, we asked market practitioners to state how often they engage with underlying companies related to ESG issues. We saw 89% of market practitioners with both equity and bond offerings and 71% of market practitioners with bond-only offerings claim they often or always discuss ESG topics when they interface with companies they are invested in. Read Yoshie's full report on fixed income and ESG.

The bottom line

On any day, in any market condition, investing is hard. Throw in ESG considerations and our current levels of market volatility and the complexity becomes daunting. For investors who choose to prioritize such efforts, we ask that they keep this complexity in mind and work to find solutions and partners capable of delivering meaningful impact.

The intent of responsible investing is noble and worth taking seriously. The health of our planet depends on such efforts. On Earth Day and every day, it has our full support.

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