Investing for impact: The evidence

WHY WOULD I INVEST FOR IMPACT?

Investing that does well and does good.

“That sounds great, but surely you can’t have both?”. It’s a refrain we hear a lot at Tribe. We believe fundamentally the answer to this question is that you can have both.

We’ve answered this question using behavioural finance in our paper “Investing for Humans”. Now we want to answer this another way, taking you through some of our investment theory.

WHAT IS TRIBE’S PHILOSOPHY THEN?

Our investment philosophy is simple: We invest in well managed companies solving global challenges. First, sustainable or responsible companies are less likely to be hit by adverse regulation, reputational controversy or customer apathy. We don’t want to invest in badly-run businesses.

Second, companies that are trying to solve for the biggest problems we face are, in our opinion, future-focused growth businesses; they therefore present the biggest global opportunities. At some point we are all going to need cleaner energy and we are all going to need more effective healthcare.

Sure, we might miss out on some good dividends from cigarette products, but this is an industry that is systematically killing its clients (7m a year, according to the WHO[2]). Where are their revenues going to come from after their product has killed all their customers?

“At some point, we are all going to need cleaner energy and better healthcare.”

BUT DOESN’T THIS MEAN YOU’RE RESTRICTING YOUR INVESTMENT UNIVERSE?

The argument we often hear is that by only investing sustainably you are closing down potential sources of return. This is true.

In reality it’s impossible to invest without some sort of constraint. Simply put, the time and resources required to keep track of everything that it’s possible to invest in are too great, and most investors naturally apply some constraints.

Narrowing the universe allows an investor like Tribe to focus on an area in which they have a particular strength or advantage. So the debate isn’t whether your constraint allows you better investment options compared to being completely unconstrained (logic says it can’t).

Instead, it’s whether your constraint is the best use of your time and resources, or even more simply: is it better than everyone else’s?

Essentially, Tribe has made the choice to seek out well managed companies, that are solving some of the world’s biggest challenges (energy, education, health, financial inclusion etc). The investment logic seems clear to us, and we believe that is additive to both our risk management and our financial return.

Tribe | A NEW WEALTH ORDER

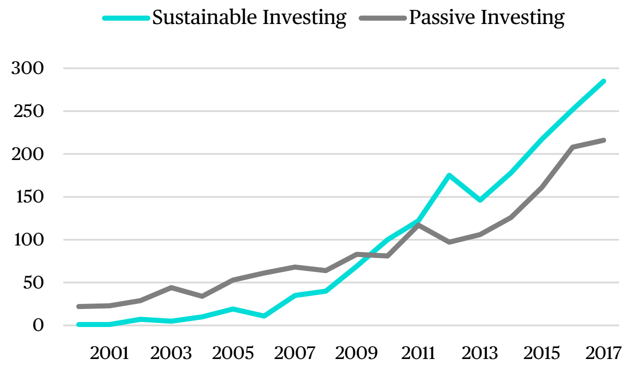
SO THAT'S THE PHILOSOPHY, BUT WHAT ABOUT REALITY?

There are many studies on whether sustainable investing adds or detracts value. In fact, it's one of the most contentious areas of study. You can see this by comparing with another popular debate: passive investing. In the last decade 1,290 academic studies were written on passive investing, compared to the 1,640 written on sustainable investing[3]. Of course, their results aren't unanimous, but we think they're conclusive.

For example, a 2015 Morgan Stanley study[4] found "across 10,000 funds, sustainable equity funds had equal or higher median returns, with equal or lower volatility, than traditional funds." Hamburg University[5] reviewed 2,200 different studies and found that 90% of the studies showed positive or neutral effects of sustainable investing on returns. In a somewhat restrained manner, they concluded that "the business case for Environmental, Social and Governance (ESG) investing is empirically very well founded".

"Across 10,000 funds, sustainable equity funds had equal or higher median returns, with equal or lower volatility, than traditional funds."

ACADEMIC PAPERS PUBLISHED ON "SUSTAINABLE INVESTING" AND "PASSIVE INVESTING"



Source: Tribe Impact Capital, Google Scholar

CAN YOU GO INTO MORE DETAIL ON THE EVIDENCE?

We don't want to show you all of them, but picking two recent papers:

Eccles, Ioannou and Serafeim[6] found that over 18 years high sustainability companies outperform low sustainability firms in both share price performance and accounting performance. Not only that, they also found that using analyst's forecasts of annual earnings, the market tends to underestimate the profitability of high sustainability companies compared to low sustainability companies. So the former are often undervalued.

"High Sustainability firms tend to generate significantly higher stock returns, suggesting that in fact, the integration of such issues into a company's business model and strategy may be a source of competitive advantage for a company in the long-run.

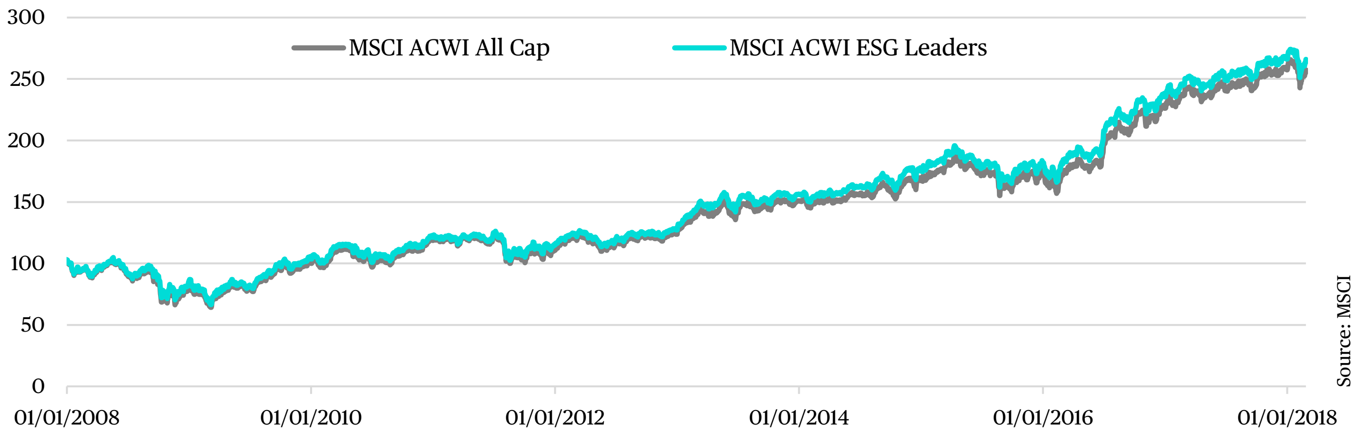
A more engaged workforce, a more secure license to operate, a more loyal and satisfied customer base, better relationships with stakeholders, greater transparency, a more collaborative community, and a better ability to innovate may all be contributing factors to this potentially persistent superior performance in the long-term."

A paper by MSCI[7], one of the largest financial data providers in the world, demonstrated that ESG strategies outperformed the global benchmark for 8 years up to the publication in 2015. They found this was the case for both a high ESG-rated strategy (ESG Tilt) and an improving ESG strategy (ESG Momentum). In fact, the Momentum strategy delivered over 2.2% annually compared to the global MSCI benchmark over the period.

OK, THAT'S ENOUGH STUDIES: CAN YOU SHOW ME WHAT'S HAPPENED IN THE MARKETS?

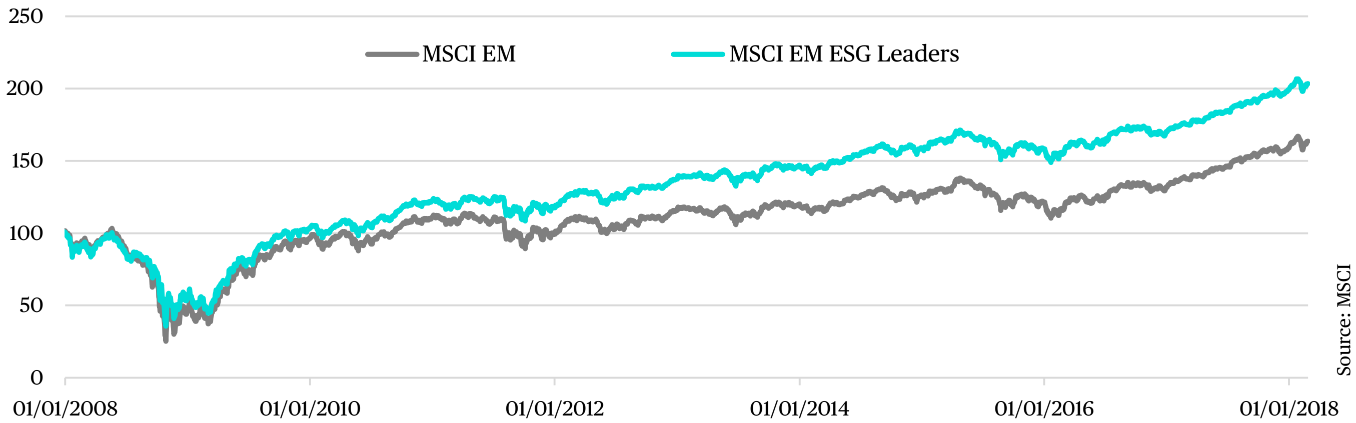
The chart below shows the performance of the broad MSCI ACWI index compared to a generic ESG index. Whilst this index is only one interpretation of sustainable investing, it and others have outperformed historically. Furthermore, this was achieved with a lower standard deviation (or risk) than the broader market.

BROAD MARKET INDEX VERSUS ESG INDEX



The difference is even more stark in Emerging Markets (EM). Compare the MSCI Emerging Markets Leaders index (which includes 417 companies that score highly on ESG) to the normal MSCI EM benchmark below.

EMERGING MARKET INDEX VERSUS ESG INDEX



In the words of the Financial Times, "The outperformance of ESG strategies is beyond doubt."[10]

The beginning of 2018 saw a bout of market volatility. A snapshot review[11] found that during the period 1st - 9th February, sustainable equity funds fared better than their peers. 65% outperformed their non-sustainable rivals, with more than twice as many finishing in their category's top quartile than in the bottom quartile. In fact, the review found that there wasn't a broad market sustainable index fund that didn't beat the main market in this period.

WHAT ABOUT THE ADDED COSTS TO BUSINESSES THAT WANT TO BE 'ETHICAL' OR RESPONSIBLE, WON'T THIS ERODE REVENUES BY INCREASING COSTS?

Yes, potentially in the short run. But in the medium term, we've already seen some of the rationale for businesses behaving sustainably above. It's also the case that companies can charge a premium for goods that are 'ethical'.

It appears that customers are willing to pay more for responsibly produced goods. In fact, Stanford Business school recently did a study[12] on whether consumers would pay more for fair trade coffee. The researchers found sales of the two most popular bulk coffees rose by almost 10% when the coffees carried a fair-trade label as compared with the placebo label.

"Customers are willing to pay more for responsibly produced goods."

SO WHAT DOES THIS ALL MEAN?

Fundamentally, we believe that investing responsibly doesn't mean giving up performance. It means the opposite: it appears to enhance performance through improved risk management and investing in companies of the future. And yes, we have reduced our investable universe, but who doesn't? We are focused on the best bit already, validated by literally thousands of studies as well as real market performance.

So that's the reality in the narrow field of investment theory. There are many other reasons for impact investing outside financial results, and if you consider how much change you can create in the world through investing positively, really the question becomes:

WHY WOULDN'T YOU DO THIS?

1 Tribe Impact Capital 2017
2 World Health Organisation, Tobacco Factsheet May 2017
3 Tribe, Google Scholar 2018
4 Sustainable Reality, Morgan Stanley, 2015
5 ESG and Financial Performance, Friede, Busch & Bassen, 2015
6 The Impact of Corporate Sustainability on Organisational Processes and Performance, 2011
7 Can ESG add Alpha?, 2015
8 Source MSCI 2018. Low Carbon Target index available in November 2010, when it is rebased to MSCI ACWI
9 Source MSCI 2018
10 The ethical investment boom, James Kynge, 2017
11 Sustainable Funds Outperformed During the Early-February Market Swoon, Morningstar, 2018
12 Will Consumers Actually Pay for Fair Trade?, Hainmueller, Hiscox & Sequiera, 2015